BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

# PRA statement on the interaction between the PRA buffer and the CRD IV combined buffer

1. This Prudential Regulation Authority (PRA) statement clarifies the PRA's approach to adjustments to firms' PRA buffers as the CRD IV combined buffer – made up of the systemic, conservation and countercyclical buffers – is implemented up to 2019. In particular, it sets out the timing of changes to firms' PRA buffers following the Financial Policy Committee's (FPC) announcement[1] to increase the countercyclical capital buffer rate for the UK to 0.5%.

2. As the capital conservation buffer (CCoB) is phased in, the existing PRA supervisory buffers will be assessed to ensure there is no duplication in capital required to cover the same risks.[2] In addition, the PRA Board's intention is that, where the existing PRA supervisory buffers already reflect risks captured by a 0.5% UK countercyclical capital buffer (CCyB) rate, the effect of the first 0.5% of the UK CCyB rate will be reduced as far as possible when it comes into effect.[3] This one–off adjustment means that many firms will not see their overall capital buffers increase as a result of the UK CCyB rate being increased to 0.5%. Buffer assessments and any adjustments will take place only when CCoB and CCyB buffers come into effect in order to avoid volatility in firms' overall levels of capital. The resulting PRA buffer reductions will occur as soon as practicable after the UK CCyB rate comes into effect, depending on the timings of firms' supervisory review and evaluation process and, where applicable, the JRAD process.

3. These adjustments seek to ensure that:

    a. the transition to the new capital framework avoids double counting in capital buffers to cover the same risks; and

    b. all firms get sufficient time to transition to the requisite end-2019 capital buffers. Firms which currently have no or low PRA buffers can build up capital over time.

## Explanatory notes

4. These explanatory notes provide more detail on the PRA statement. They present end-2019 capital buffers and requirements and describe in more detail the transition path until 2019 with a focus on the interaction of the PRA buffer and elements of the CRD IV combined buffer.

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[1] See FPC statement on the CCyB, 29 March 2016; http://www.bankofengland.co.uk/publications/Pages/news/2016/032.aspx.

[2] See CP5/13 'Strengthening capital standards: implementing CRD IV', p.16: "the PRA will deduct the CCoB from the PRA buffer assessment", August 2013; www.bankofengland.co.uk/pra/Pages/publications/implemcrdivcon.aspx. See also PS17/15 'Assessing capital adequacy under Pillar 2', July 2015; www.bankofengland.co.uk/pra/Pages/publications/ps/2015/ps1715.aspx.

[3] See discussion in the *Supplement to the December 2015 Financial Stability Report on the framework of capital requirements for UK banks;* available at www.bankofengland.co.uk/publications/Pages/fsr/2015/dec.aspx.

*End-2019 going concern capital buffers and requirements*

5. Table 1 summarises the transition arrangements for key elements of the 2019 capital framework. These elements are:
   - Pillar 1: minimum requirements that banks must meet at all times. This requirement is published.
   - Pillar 2A: adjustment to minimum requirements to reflect risks not captured or not adequately captured in Pillar 1 (e.g. trading book and pension deficit risk). Firms may disclose their aggregate Pillar 2A requirement.
   - Capital conservation buffer (CCoB): buffer for all banks that can be used to absorb losses while avoiding breaching minimum requirements. This buffer is published.
   - Systemic buffers: they comprise of the Global Systemically Important Institutions (G-SII) buffer and the systemic risk buffer (SRB):
     - G-SII buffer: buffer set for globally systemic banks to reduce their probability of failure or distress commensurately with the greater cost their failure or distress would have for the global financial system and economy.
     - SRB: buffer set for ring-fenced banks and large building societies to reduce their probability of failure or distress commensurately with the greater cost their failure or distress would have for the UK economy.

     These buffers are set at different levels of consolidation: the G-SII buffer applies at the consolidated group level whereas the SRB applies at the level of the ring-fenced bank sub-group, where a sub-group is in place.[4] It is therefore likely that the SRB will sit within any group consolidated capital buffer. The banking group will need more equity if its G-SII buffer does not cover the amount of equity it needs to 'downstream' to the ring-fenced bank subgroup. This additional common equity Tier 1 (CET1) will be held at the ring-fenced sub-group.[5] These buffers are published when in effect.

   - Countercyclical capital buffer (CCyB): buffer that can be varied over time. The primary objective of the countercyclical capital buffer is to ensure that the banking system is able to withstand stress without restricting essential services, such as the supply of credit, to the real economy. The FPC therefore intends to vary the buffer – both up and down – in line with the risk, at the system level, that banks will incur losses on UK exposures. Each firm's CCyB will depend on its weighted average CCyB rate determined according to the CCyB rates that apply in the jurisdictions in which the bank has relevant exposures. This buffer is published.

[4] The PRA will decide on the level of application of the systemic risk buffer for banks subject to ring-fencing on a case-by-case basis where a sub-group is not in place.
[5] As set out in CP37/15 'The implementation of ring-fencing: prudential requirements, intragroup arrangements and use of financial market infrastructures', October 2015; www.bankofengland.co.uk/pra/Pages/publications/cp/2015/cp3715.aspx. The PRA stated it does not expect the parent of the ring-fenced sub group to use double leverage to fund its equity investment in the ring-fenced sub group.

- Pillar 2B / PRA buffer: buffer set using supervisory judgement informed by the impact of stress scenarios on a firm's capital requirements and resources, and taking account where appropriate of other factors including leverage, systemic importance and weaknesses in firms' risk management and governance[6].

6. Some elements of the capital buffers framework are in place and others are due to be phased in by 2019. The composition and calibration of the majority of these elements have been decided, and the remainder are currently undergoing public consultation, which will be concluded by mid-2016.

[6] For more information see the PRA's Statement of Policy on the PRA's methodologies for setting Pillar 2 capital (July 2015) http://www.bankofengland.co.uk/pra/Documents/publications/sop/2015/p2methodologies.pdf and the PRA's Policy Statement on Assessing capital adequacy under Pillar 2 (July 2015) http://www.bankofengland.co.uk/pra/Documents/publications/ps/2015/ps1715.pdf

**Table 1: Phasing in of going concern risk-weighted loss absorbency requirements until 2019**

| Requirement | Effective from | Current status | Amount of Capital | Type of Capital |
|---|---|---|---|---|
| Pillar 1 | Now | In place | 8% | CET1: 4.5% of RWAs<br>Tier 1: 6% of RWAs<br>Total capital: 8% of RWAs |
| Pillar 2A | Now | In place | Firm specific | At least 56% in CET1; no more than 44% in AT1; and at most 25% in Tier 2 capital |
| Systemic buffers: if set by G-SII | G-SII buffer will phase in between 2016-2019 in equal increments | Transition phase | Buffers will range from 0% - 2.5% for UK banks based on G-SII criteria (≈ 1.5% on average) | CET1 |
| Systemic buffers: if set by SRB | SRB will apply from 2019 | Not yet applicable | Buffers will range from 0% -3% for UK banks based on SRB criteria (≈ 0.5% on average) | CET1 |
| Countercyclical capital buffer | No later than 12 months after the date when the increased buffer setting is announced[1] | In place | Time varying | CET1 |
| Capital conservation buffer | Phased in between 2016-2019 in steps of 0.625% | Transition phase | Buffer will transition from 0.625% in 2016 to a 2.5% from 2019 onwards. | CET1 |
| Pillar 2B / PRA buffer | Now | Transition phase[2] | Firm specific | Fully CET1 by 2019 |

[1] Article 136(5) CRD states that: "If the date is less than 12 months after the increased buffer setting is announced, that shorter deadline for application shall be justified on the basis of exceptional circumstances."
[2] See Supervisory Statement SS31/15: "Firms are expected to meet their PRA buffer in increasing proportions of CET1 from January 2016 to January 2019: at least 25% by January 2016; 50% by January 2017; 75% by January 2018; and 100% by January 2019."

7. The following principles underpin the transitional path of capital requirements:

   a. Pillar 1 + 2A will continue as the minimum requirements.

   b. Systemic buffers will add to capital buffers as they are phased in and introduced.

   c. The phasing in of the CCoB will be accompanied by commensurate reductions in existing PRA buffers where these are sufficient to accommodate this – otherwise the capital conservation (CCoB) will be additive.

   d. Firm-specific countercyclical buffers derived from the first increase of the UK CCyB rate to 0.5% will be accompanied by commensurate reductions in

PRA buffers where these are sufficient to accommodate this – otherwise the CCyB will be additive.

*Interaction of the CRD IV combined capital buffer with the PRA buffer*

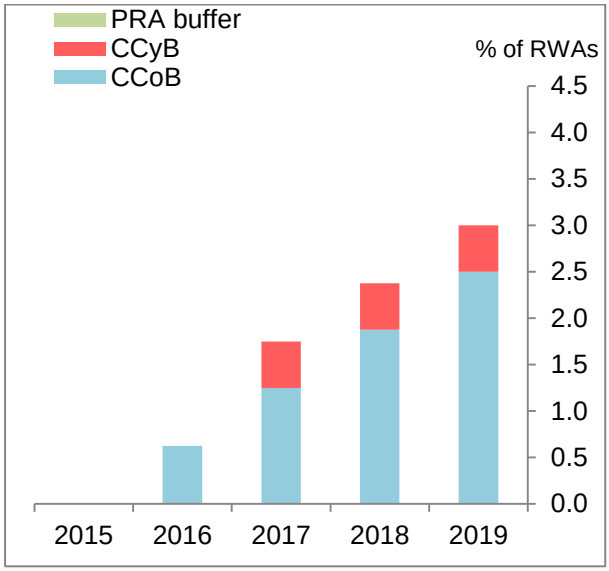
8. During the transition period the PRA Board will seek to ensure risks are not double counted and capital held against certain risks currently captured in the PRA buffer is migrated to the CCoB and CCyB. The fact that firms have varying initial levels of PRA buffers means that their overall capital requirements may be affected differently by the phasing in of these buffers. This is shown in **Figures 1 a-e** which represent a subset of the elements in Table 1 (underlying numbers are included in the accompanying tables, respectively). They illustrate how different hypothetical firms' PRA buffers may evolve until 2019 as the PRA buffer interacts with the phasing in of the capital conservation buffer and the setting of the countercyclical capital buffer rate in the UK. For simplicity, the figures assume that a UK CCyB rate of 0.5% will come into force in 2017 and remain at that level during the transition period. The figures assume a pass through rate of 100%, i.e. that all relevant exposures are in the United Kingdom. Further, they assume that firms are not systemic and that no additional capital buffer has been set for risk management and governance.

9. The examples allow firms to understand how their future buffers may change based on today's announcement by the FPC on the CCyB rate. The evolution of a firm's capital requirements stemming from the CCoB, CCyB and PRA buffer until 2019 depends on the initial level of the PRA buffer it is subject to. Firms with an initial PRA buffer of 3% or more already have to meet the end-state 2019 loss absorbency requirements (assuming no further increases in the CCyB rate). In contrast, firms with initial PRA buffers below 3% see their capital requirements build up to the 2019 level, as highlighted by Figures 1 a-c below.

10. Under CRD IV, the capital conservation buffer, the countercyclical capital buffer, the G-SII and the systemic risk buffer (where applicable) make up the combined buffer. Firms are subject to restrictions on distributions while they fail to meet the combined buffer requirements or if firms plan a payment that would take them into their combined buffer requirements. These restrictions are calculated by reference to the firm's Maximum Distributable Amount (MDA)[7]. The MDA trigger is above P2A and below the PRA Buffer. MDA restrictions are not automatically triggered if a firm fails to meet its PRA buffer.

[7] See SS6/14: 'Implementing CRD IV: capital buffers', April 2014; www.bankofengland.co.uk/pra/Pages/publications/capitalbuffersss614.aspx.

**Figure 1a: Interaction of PRA buffer and CRD IV combined buffer during transition period for firms with no initial PRA buffer[8]**



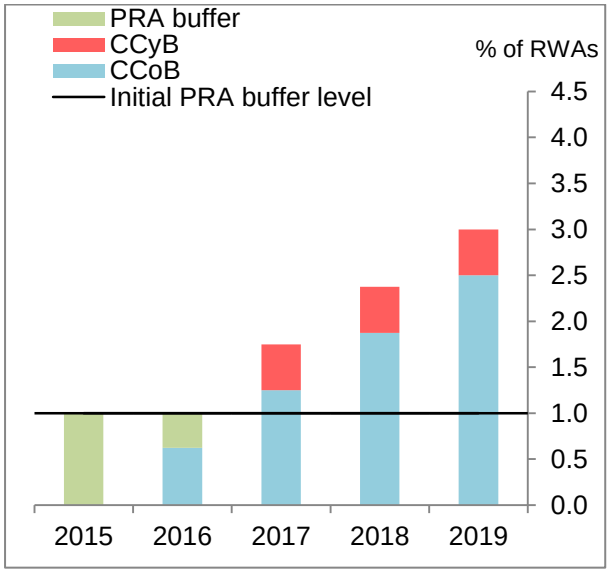

***Firm with no 2015 PRA buffer***

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Initial PRA Buffer | 0 | 0 | 0 | 0 | 0 |
| | | | | | |
| CCoB | 0 | 0.625 | 1.25 | 1.875 | 2.5 |
| CCyB | 0 | 0 | 0.5 | 0.5 | 0.5 |
| PRA buffer | 0 | 0 | 0 | 0 | 0 |
| **TOTAL** | **0** | **0.625** | **1.75** | **2.375** | **3** |
| *Buffers > CRD IV minima* | *0* | *0* | *0* | *0* | *0* |

This figure shows that a firm's capital buffers with no initial PRA buffer will increase steadily until 2019. The CCoB is being phased-in in equal increments of 0.625% each year until its final level of 2.5% in 2019. The CCyB rate takes effect 12 months after it is announced. There is no overlapping PRA buffer.

[8] The figures assume that a UK CCyB rate of 0.5% will come into force in 2017 and remain at that level during the transition period. The figures assume a pass through rate of 100%, ie that all relevant exposures are in the UK. Further, they assume that firms are not systemic and that no additional capital buffer has been set for risk management and governance.

**Figure 1b: Interaction of PRA buffer and CRD IV combined buffer during transition period for initial PRA buffer of 1%[9]**



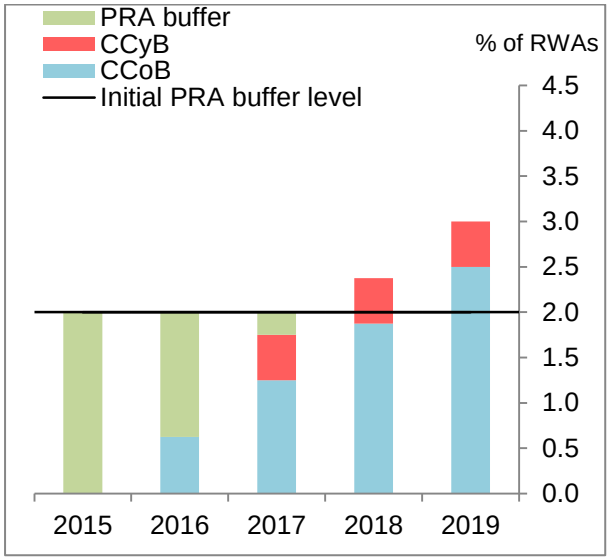

***Firm with a 2015 PRA buffer of 1%***

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Initial PRA Buffer | 1 | 1 | 1 | 1 | 1 |
| | | | | | |
| CCoB | 0 | 0.625 | 1.25 | 1.875 | 2.5 |
| CCyB | 0 | 0 | 0.5 | 0.5 | 0.5 |
| PRA buffer | 1 | 0.375 | 0 | 0 | 0 |
| **TOTAL** | **1** | **1** | **1.75** | **2.375** | **3** |
| *Buffers > CRD IV minima* | *1* | *0.375* | *0* | *0* | *0* |

A firm whose initial PRA buffer is set at 1% will see its regulatory capital buffer increase, starting in 2017. The CCoB is being phased-in in equal increments of 0.625% each year until its final level of 2.5% in 2019. The CCyB rate takes effect 12 months after it is announced. The PRA buffer is reduced in 2016 and 2017 (assuming no change in firm-specific risks assessed by supervisors) as the overlap with the CCoB is removed and is zero from 2017 onwards.

[9] The figures assume that a UK CCyB rate of 0.5% will come into force in 2017 and remain at that level during the transition period. The figures assume a pass through rate of 100%, ie that all relevant exposures are in the UK. Further, they assume that firms are not systemic and that no additional capital buffer has been set for risk management and governance.

**Figure 1c: Interaction of PRA buffer and CRD IV combined buffer during transition period for initial PRA buffer of 2%[10]**



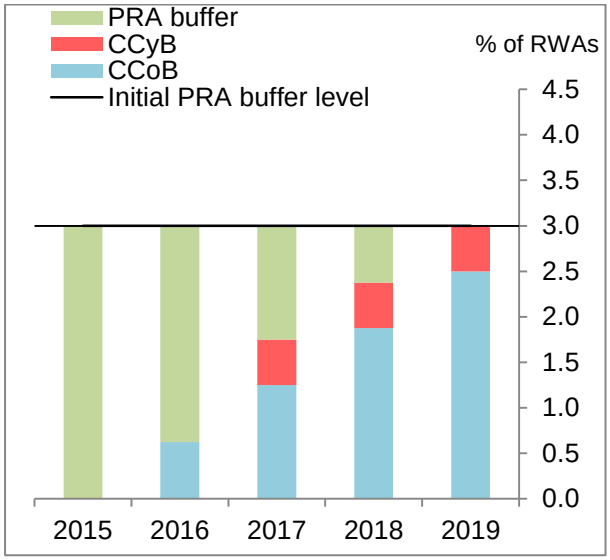

***Firm with a 2015 PRA buffer of 2%***

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Initial PRA Buffer | 2 | 2 | 2 | 2 | 2 |
| | | | | | |
| CCoB | 0 | 0.625 | 1.25 | 1.875 | 2.5 |
| CCyB | 0 | 0 | 0.5 | 0.5 | 0.5 |
| PRA buffer | 2 | 1.375 | 0.25 | 0 | 0 |
| **TOTAL** | **2** | **2** | **2** | **2.375** | **3** |
| *Buffers > CRD IV minima* | *2* | *1.375* | *0.25* | *0* | *0* |

Similarly, a firm whose initial PRA buffer is set at 2% will see its regulatory capital buffer increase, starting in 2018. The CCoB is being phased-in in equal increments of 0.625% each year until its final level of 2.5% in 2019. The CCyB rate takes effect 12 months after it is announced. The PRA buffer is reduced in 2016, 2017 and 2018 as the overlaps with the CCoB and the first 0.5% UK CCyB are removed. It is zero from 2018 onwards (assuming no change in firm-specific risks assessed by supervisors).

[10] The figures assume that a UK CCyB rate of 0.5% will come into force in 2017 and remain at that level during the transition period. The figures assume a pass through rate of 100%, ie that all relevant exposures are in the UK. Further, they assume that firms are not systemic and that no additional capital buffer has been set for risk management and governance.

**Figure 1d: Interaction of PRA buffer and CRD IV combined buffer during transition period for initial PRA buffer of 3%[11]**



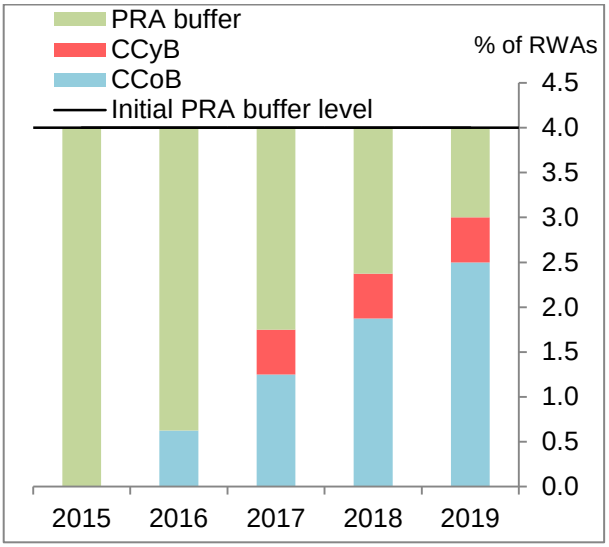

***Firm with a 2015 PRA buffer of 3%***

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Initial PRA Buffer | 3 | 3 | 3 | 3 | 3 |
| | | | | | |
| CCoB | 0 | 0.625 | 1.25 | 1.875 | 2.5 |
| CCyB | 0 | 0 | 0.5 | 0.5 | 0.5 |
| PRA buffer | 3 | 2.375 | 1.25 | 0.625 | 0 |
| **TOTAL** | **3** | **3** | **3** | **3** | **3** |
| *Buffers > CRD IV minima* | *3* | *2.375* | *1.25* | *0.625* | *0* |

A firm with an initial PRA buffer of 3% does not see any absolute increase in capital buffers due to the PRA buffer, CCoB and CCyB during the phasing in of the CRD IV combined buffer. The CCoB is being phased-in in equal increments of 0.625% each year until its final level of 2.5% in 2019. The CCyB takes effect 12 months after it is announced. The PRA buffer is reduced in 2016, 2017, 2018 and 2019 as the overlaps with the CCoB and the first 0.5% UK CCyB are removed. It is zero starting in 2019 (assuming no change in firm-specific risks assessed by supervisors).

[11] The figures assume that a UK CCyB rate of 0.5% will come into force in 2017 and remain at that level during the transition period. The figures assume a pass through rate of 100%, ie that all relevant exposures are in the UK. Further, they assume that firms are not systemic and that no additional capital buffer has been set for risk management and governance.

**Figure 1e: Interaction of PRA buffer and CRD IV combined buffer during transition period for initial PRA buffer of 4%[12]**




***Firm with a 2015 PRA buffer of 4%***

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Initial PRA Buffer | 4 | 4 | 4 | 4 | 4 |
| | | | | | |
| CCoB | 0 | 0.625 | 1.25 | 1.875 | 2.5 |
| CCyB | 0 | 0 | 0.5 | 0.5 | 0.5 |
| PRA buffer | 4 | 3.375 | 2.25 | 1.625 | 1 |
| **TOTAL** | **4** | **4** | **4** | **4** | **4** |
| *Buffers > CRD IV minima* | *4* | *3.375* | *2.25* | *1.625* | *1* |

Similarly, a firm with a 4% initial level of the PRA buffer will not see its absolute capital buffers increase. The CCoB is being phased-in in equal increments of 0.625% each year until its final level of 2.5% in 2019. The CCyB takes effect 12 months after it is announced. The PRA buffer is reduced in 2016, 2017, 2018 and 2019 as the overlaps with the CCoB and the first 0.5% UK CCyB are removed. The figure shows that a firm with an initial PRA buffer larger than 3% will have a positive PRA buffer after the CRD IV combined buffer has been fully phased in (in the case here, the 2019 PRA buffer is 1% - assuming no change in firm-specific risks assessed by supervisors).

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[12] The figures assume that a UK CCyB rate of 0.5% will come into force in 2017 and remain at that level during the transition period. The figures assume a pass through rate of 100%, ie that all relevant exposures are in the UK. Further, they assume that firms are not systemic and that no additional capital buffer has been set for risk management and governance.