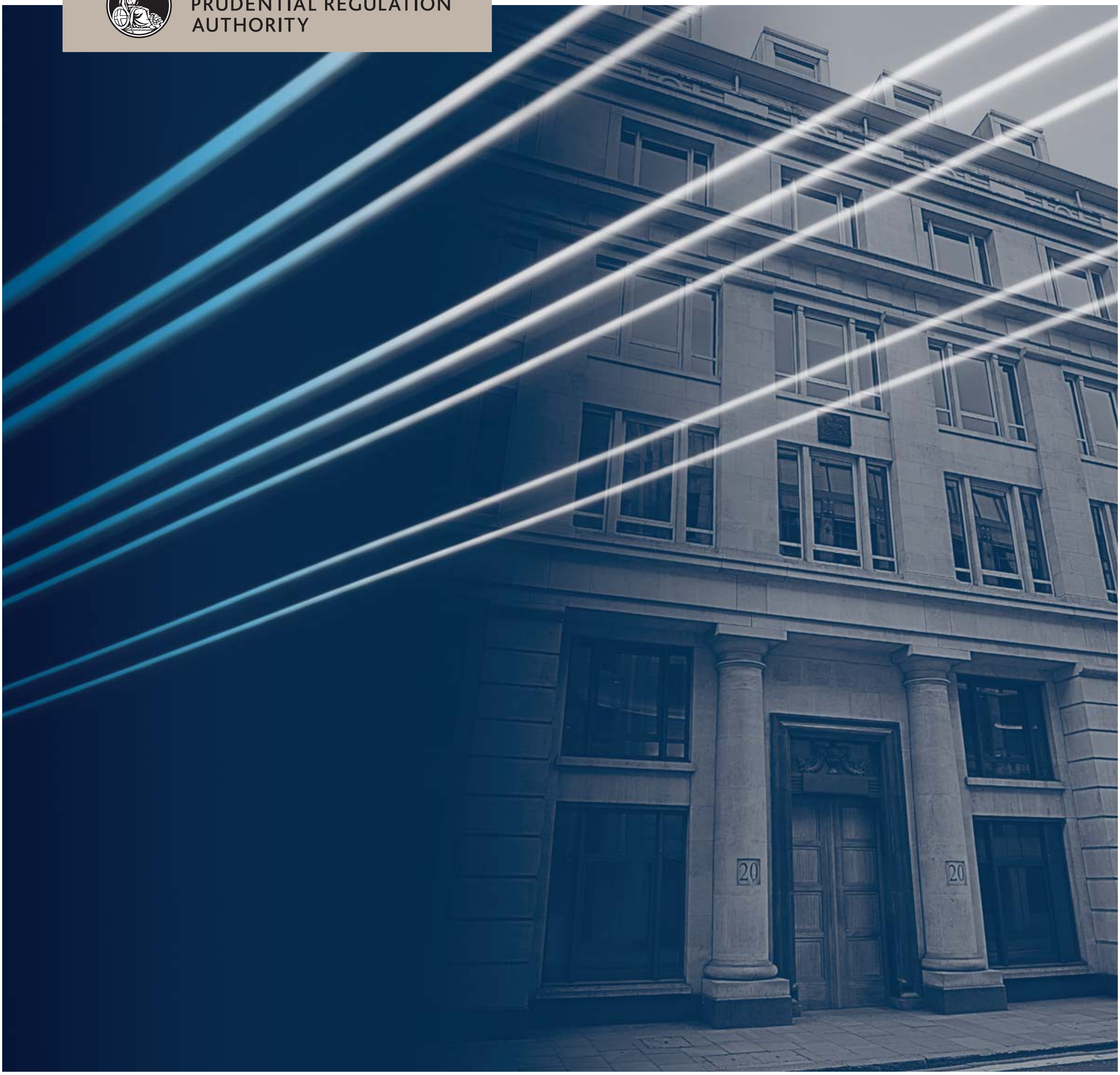
1 January 2018: Please note, the requirement in the Capital Requirements Regulation (CRR) to meet the Basel I floor has now lapsed and the PRA's expectations as set out in this supervisory statement are no longer applicable. If you have any questions please get in touch with your usual supervisory contact.

Supervisory Statement | SS8/13

The Basel I floor

December 2013

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



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1 Introduction

1.1 This statement is aimed at firms to which CRD IV applies.

1.2 This statement sets out the Prudential Regulation Authority's (PRA's) expectations regarding the application of the Basel I floor. This statement complements the requirements set out in the CRR and replaces the requirements in BIPRU TP 2[1] which set out how the capital floor provisions were to be applied.

2 Calculation of capital requirements

2.1 Firms should apply the requirements in CRR Article 500(1) to their portfolio as it changes over time. For example, if a firm is calculating its capital requirements as at 31 December 2014 it will have two calculations. The first is carried out in accordance with CRR Article 92 (disregarding Article 500) and the second takes 80% of the requirements of IPRU[2] as it stood on 31 December 2006. Both calculations are applied to the firm's figures as at 31 December 2014, and the firm's capital requirement is the greater of these two calculations. Firms should take into account the impact of expected loss, credit risk adjustments and other similar adjustments as defined in CRR Article 159 in these calculations.

2.2 This section provides an illustrative example.[3] In this example:

(a) the own funds required by Article 92 (disregarding Article 500) would be £5.4 million, and the sum of credit risk and similar adjustments are £0.25 million less than expected losses; and

(b) under IPRU, the firm's capital resources requirement would be £8.0 million and this would be met in part by general credit risk adjustments of £0.5 million.

2.3 Expected losses need to be taken into account. In these calculations both capital requirements will be compared against the CRR definition of capital, which includes the expected loss adjustment. Therefore, expected loss needs to be factored in by amending the IPRU capital resources requirement. For these purposes, if expected losses, less value adjustments and provisions are positive, then the absolute value of that amount should be deducted from the IPRU capital resources requirement. If the result is negative then that amount should be added to the IPRU capital resources requirement. In this example the result is positive, and so a capital requirement of £5.65 million (which is 80% multiplied by £8.0 million, less £0.5 million less £0.25 million) should be used for the second calculation.

2.4 As the CRR Article 92 calculation of £5.4 million is still less than the floor-adjusted IPRU capital resources requirement of £5.65 million, the effect of CRR Article 500 is that the firm is subject to the (higher) IPRU-based capital requirement. If the Article 92 calculation had been greater than £5.65 million, the effect of Article 500 is that the firm would have been subject to the Article 92 requirement at that time. (See Article 500(1).)

3 Permission to apply floor based on non-modelled CRR approaches

3.1 The PRA expects that it will only grant permission to apply a floor based on non-modelled CRR approaches[4] in place of the Basel I floor in accordance with CRR Article 500(2) in the following circumstances:

(a) the firm has first used an advanced approach on 1 January 2010 or later; and

(b) the firm does not have access to systems and data that would allow it to calculate capital requirements based on IPRU without incurring materially greater costs than if it were to use non-modelled CRR approaches for the floor instead; and

(c) the firm can demonstrate, based on the latest available information at the time it applies for permission, that its floored capital requirements based on non-modelled CRR approaches are not materially less than those based on IPRU (see: CRR Article 500(2)).

4 Permission to disapply floor

4.1 The PRA does not expect that it will waive the application of the Basel I floor in accordance with CRR Article 500(5).

(1) Prudential sourcebook for Banks, Building Societies and Investment Firms: http://fshandbook.info/FS/html/PRA/BIPRU/TP/2.
(2) 'The Interim Prudential Sourcebook', comprising IPRU(BANK), IPRU(BSOC), IPRU(FSOC), IPRU(INS) and IPRU(INV), which formed part of the FSA Handbook.
(3) This example assumes that a firm does not have permission under CRR Article 500(2) to apply the floor based on non-modelled CRR approaches.
(4) CP10/22 section 3.10.