Bank of England PRA

Strong and Simple: The simplified capital regime for SDDTs

Consultation paper (CP) 7/24

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Caveat

These slides should not be relied on as a source of law or policy. Where the slides refer to policy proposals and near-final policy published on 12 September 2024, they contain only a high-level summary of detailed proposals that are set out in full in **CP7/24** and other consultation papers, and of detailed near-final policy that is set out in **PS9/24**. The slides should not be used as an alternative source of information to the CPs and PS.

Anyone wishing to respond to **CP7/24** should do so in writing by the means set out in the CP. Comments and questions raised in the Q&A session will not be considered as CP responses.

The presentation slides and recording of the presentation are available at: Strong and Simple webinar event

Welcome and purpose

- Welcome
- Purpose of today's session:
  - To provide a **teach-in of the proposals for the simplified capital regime for SDDTs** ('Phase 2' of the regime, following 'Phase 1' on liquidity and disclosure simplifications)
  - Explain **why this is a good package of proposals for SDDTs**
  - Set out the next steps:
    - Eligible firms should **engage with the material and actively consider whether to become SDDTs and/or enter the Interim Capital Regime (ICR)**
    - Outline our **further planned engagement** with trade associations (BSA,UK Finance)
    - **Firms should respond to the CP** (via individual response or via their trade association)

Key messages

- The S&S CP proposals **significantly simplify the capital regime for SDDTs without weakening their overall resilience** and, together with the liquidity and disclosure simplifications, will **support a dynamic, diverse and sustainable banking sector**.
- The S&S CP proposes simplifications to all elements of the capital stack:
  - **Pillar 1** risk weighted assets would be calculated using **Basel 3.1 rules**, which provide a better measure of risk, and which will be simplified in some areas for SDDTs;
  - **Pillar 2 would be radically simplified**, and there would be tailored documents for SDDTs covering the Pillar 2 Statement of Policy and the ICAAP/SREP SS;
  - There would be **a single, more constant and therefore predictable capital buffer**, rather than three buffers which vary significantly over time; and **regulatory capital would be simpler** to calculate; and
  - There would be **simplifications to ICAAP, ILAAP and some reporting requirements**.
- The proposals would **advance the PRA's objectives.**

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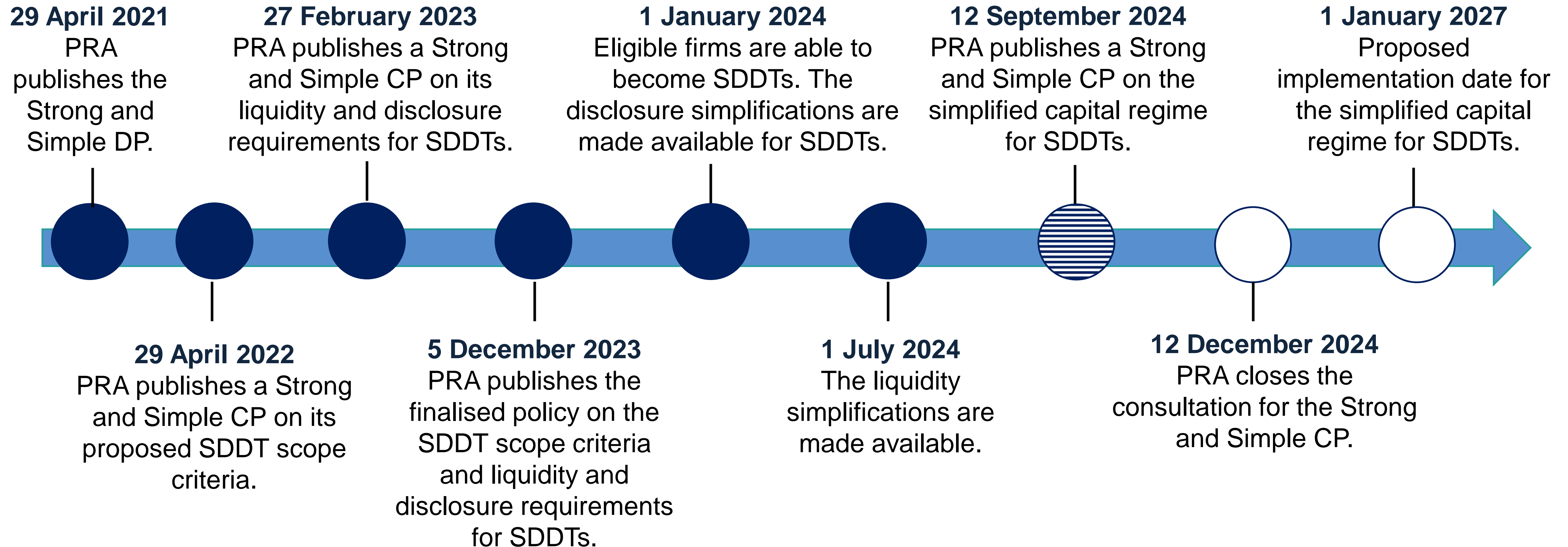
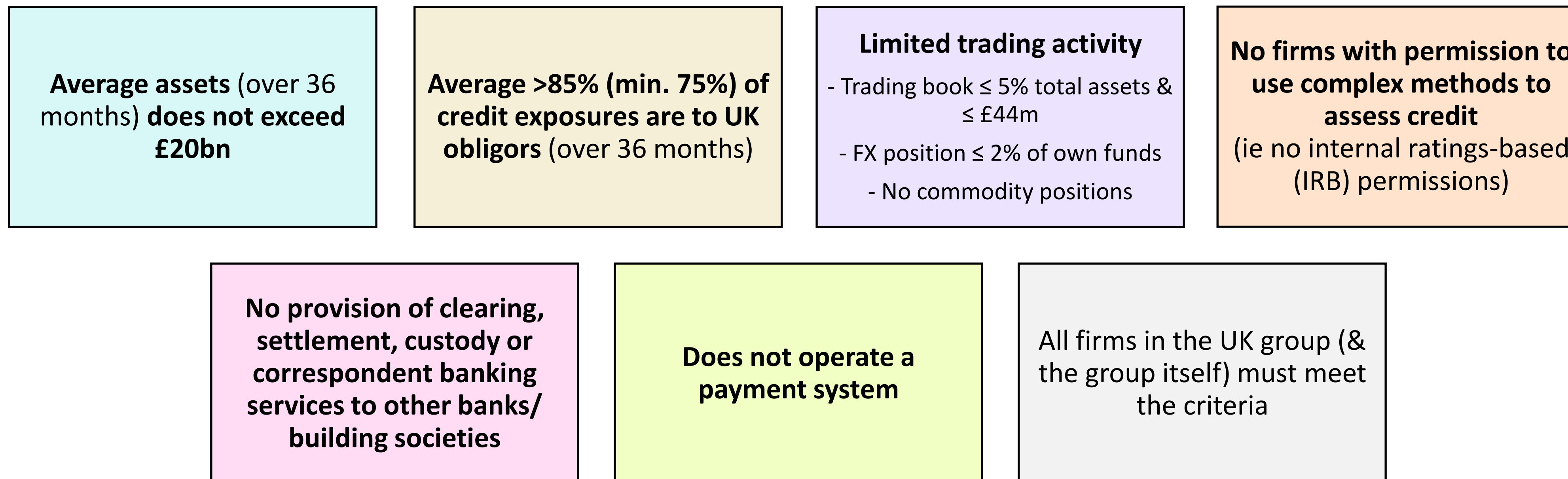
Timeline for implementing the SDDT regime in the UK



Recap: SDDT criteria



Note:

- Criteria are set out in the 'SDDT Regime – General Application' Part of the PRA Rulebook.
- Incoming branches are not included.
- To be eligible, firms must be UK headquartered. We have said small groups with non-UK parents (<£20bn global assets) where the UK group meets the SDDT criteria are likely to be able to get a modification to enter the regime (see SoP "Operating the SDDT Regime").

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Overview of the package of publications:

- **PS9/24** – Implementation of the Basel 3.1 standards near-final part 2
- **CP7/24** – The Strong and Simple Framework: the simplified capital regime for Small Domestic Deposit Takers (SDDTs)
- **CP8/24** – Definition of capital: restatement of CRR requirements in PRA Rulebook
- **CP9/24** – Streamlining the P2A capital framework and the capital communications process
- **CP10/24** – Updates to the UK policy framework for capital buffers

Near-final policy

Proposals for consultation

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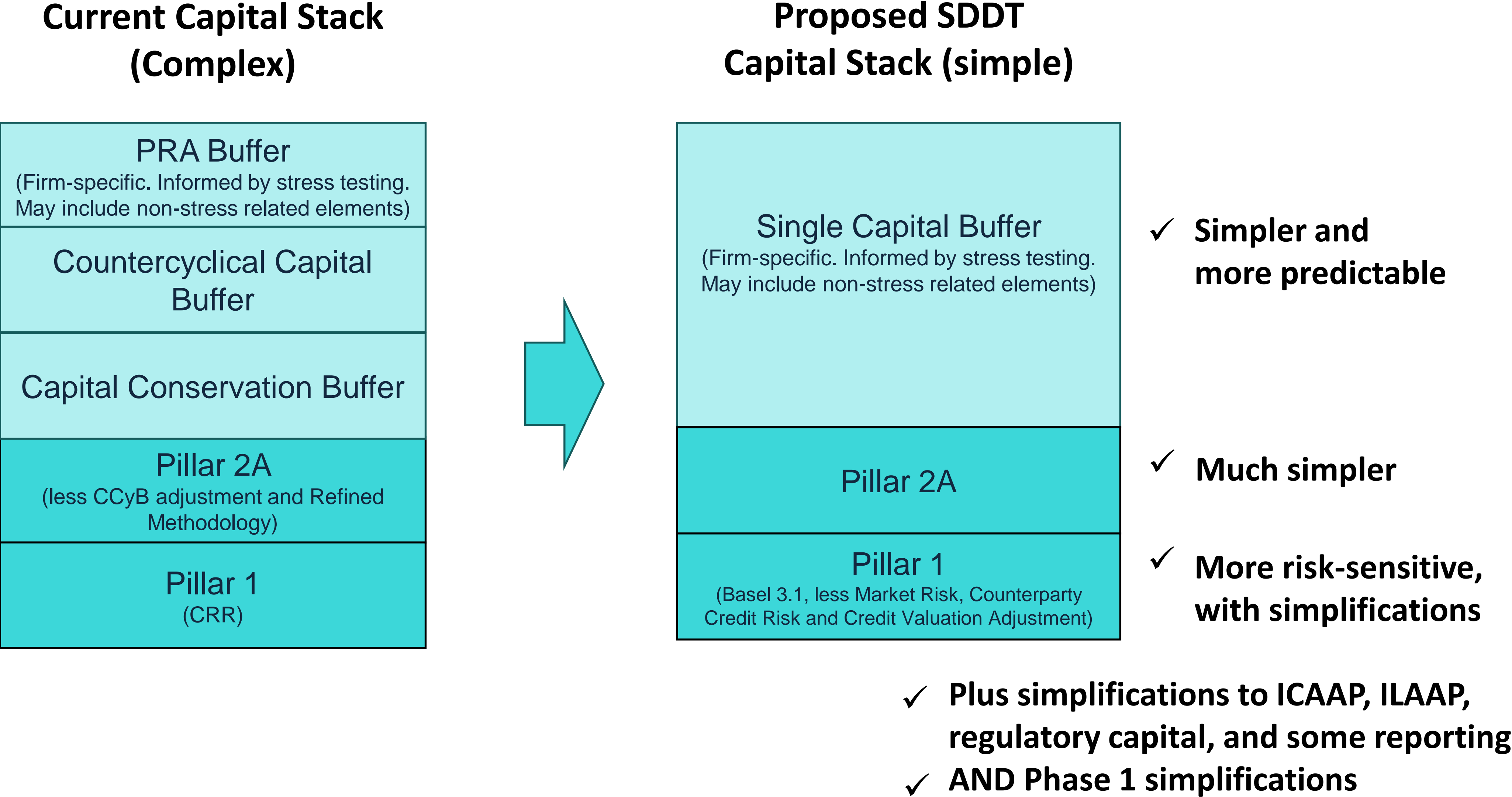
Summary of proposed simplifications to the capital stack for SDDTs



[See Chapter 1 of CP7/24]

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Pillar 1: Overview of proposed changes for SDDTs

(see Chapter 2 of CP7/24)

The PRA proposes to:

- Apply the **Basel 3.1 standards for calculating Pillar 1 RWAs for credit risk and operational risk**, which provide **a better measure of risk** than the current framework.
  - SDDTs would be **descoped from 'due diligence requirements'** related to credit risk
- **Descope SDDTs from Pillar 1 capital requirements for counterparty credit risk (CCR)** for derivatives (with some exceptions) and **credit valuation adjustment (CVA) risk**;
- Require SDDTs to apply the **credit risk approach** to measure Pillar 1 capital requirements for positions in the **trading book**, and **remove capital requirements for SDDTs' market risk business activities related to FX and commodity risk**;
- To achieve the above, **revoke the Interim Capital Regime (ICR) at the point the SDDT capital regime is implemented**.

Pillar 1: Standardised approach to credit risk (SA-CR)

(see Chapter 2 of CP7/24 and Chapter 2 of PS9/24)

- The PRA proposes that SDDTs would calculate credit risk RWAs using the **standardised approach to credit risk (SA-CR) set out in the second near-final Basel 3.1 PS** (PS9/24)
- As a reminder, key elements of the implementation of Basel 3.1 for the SA-CR include:
  - **Enhanced risk-sensitivity**, including **lower risk weights for low-risk mortgage lending** and the introduction of **specific treatments for 'specialised lending'**
  - **Option of a more risk-sensitive treatment** for exposures to **unrated corporates**, including unrated funds, **or a simpler 'risk-neutral' approach**
  - **Removal of CRR SME and infrastructure support factors in Pillar 1** (see next slides for changes vs the CP) with a new lower risk weight treatment for unrated corporate SMEs
  - **Off-balance sheet conversion factors (CFs) aligned to UK market conditions** (see next slides for changes vs the CP)

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Pillar 1: SA-CR key changes vs Basel 3.1 CP (1 of 2)

(see Chapter 2 of PS9/24)

- The near-final policy in PS9/24 includes these **key changes vs the CP for real estate**:
  - **A more risk-sensitive and operationally simpler approach to valuation of residential real estate** incl. a new 'backstop revaluation' event every 5 yrs (3 yrs for high value loans)
  - **Changes to simplify how firms assess if real estate exposures are materially dependent on cashflows generated by the property (MDCFP)**;
  - **Changes to risk weights for regulatory real estate exposures secured by CRE**, with a differentiated approach for SMEs and exposures that are non-MDCFP:
    - Non-MDCFP SME exposures will be risk-weighted under the loan splitting approach with no risk weight floor
    - Non-MDCFP exposures to other counterparties will receive the counterparty risk weight with a reduced 60% risk weight floor
  - **Changes to the definition of regulatory real estate**, with **self-build loans** now classified as regulatory real estate if certain conditions are met.

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Pillar 1: SA-CR key changes vs Basel 3.1 CP (2 of 2)

(see Chapter 2 of PS9/24)

- The near-final policy in PS9/24 includes **further key changes vs the consultation**:
  - **An accompanying adjustment in Pillar 2A to ensure the removal of the SME and infrastructure support factors** (SME SF and ISF) in Pillar 1 does not result in an increase in overall capital requirements for SME and infrastructure lending.
  - **A simpler SME definition** for firms to operationalise which may allow more exposures to benefit from lower SME risk weights.
  - **Changes to the following off balance sheet items conversion factors (CFs)**:
    - 20% CF for transaction-related contingent items (reduced from 50% in CP)
    - 40% CF for 'other commitments' (reduced from 50% in CP) except for UK residential real estate commitments which will still receive a 50% CF

Pillar 1: Credit risk mitigation (CRM)
(see Chapter 2 of CP7/24 and Chapter 4 of PS9/24)

- The PRA's implementation of the Basel 3.1 SA-CR and the available credit risk mitigation (CRM) methods set out in PS9/24 introduce more granular requirements that better reflect the riskiness of firms' exposures.
- Table 2 of CP7/24 shows the CRM methods available to SDDTs:

CRM method	Description
On-balance sheet netting	A method for recognising on-balance sheet netting under all approaches to credit risk, which the PRA is restricting to recognition through exposure value only.
Financial collateral simple method (FCSM)	A method for recognising financial collateral, by reducing risk weights, to reflect the effect of funded credit protection.
Financial collateral comprehensive method (FCCM)	A method for recognising financial collateral, by reducing exposure values, to reflect the effect of funded credit protection.
Other funded credit protection (OFCP) method	A bespoke method for recognising other funded credit protection (pledged cash and cash-assimilated instruments, pledged life assurance policies, and instruments issued by third-party institutions that will be repurchased on request).
Risk weight substitution method	A method that involves substituting the risk weight of the exposure with that of the protection provider to reflect the effect of unfunded credit protection.

- The near-final Basel rules (in Appendix 2 of PS9/24 pages 217-220) contain a helpful flowchart on CRM.

Pillar 1: SA-CR for SDDTs recap

- **SDDT's risk weighted assets for credit risk would be calculated using the Basel 3.1 standardised approach to credit risk**, which provide a **better measure of risk than the current framework.**
- In developing the SDDT proposals, we took into account feedback from small, domestically focused firms to the Basel 3.1 consultation.
- The **due diligence requirements in the approach would not apply to SDDTs** (see paras 2.14 to 2.16 in CP7/24)
- As for other firms, the **Pillar 2A SME and infrastructure lending adjustments would apply to SDDTs** if they choose to provide the necessary data (see footnote 23 in CP7/24 and paras 1.16, 2.140 and 2.178 in PS9/24)

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Pillar 1: Operational Risk

(see paras 2.17-2.18 of CP7/24 and Chapter 5 of PS17/23)

- The **Operational Risk standardised approach to calculating Pillar 1 capital requirements, set out in Chapter 5 of PS17/23 would apply to SDDTs**.
- The calculation is simple and based on financial statement information, where Pillar 1 operational risk capital is equal to:

Business indicator component: A measure of firm size and economic activity, covering: • the interest, leases, and dividend component (ILDC); • the services component (SC); and • the financial component (FC).	X	Internal loss multiplier equal to 1

Pillar 1: Market risk

(see paras 2.19-2.33 of CP7/24)

- SDDTs would calculate Pillar 1 capital requirements for their trading book business using the standardised approach to credit risk.
  - The SDDT criteria include the thresholds in the derogation for small trading book business in the PRA rules.
- SDDTs would not need to calculate market risk capital requirements for business activities subject to foreign exchange risk or commodity risk.

Pillar 1: Counterparty Credit Risk (CCR) and CVA
(paras 2.34-2.43 of CP7/24)

- **SDDTs would not need to calculate Pillar 1 capital requirements for CCR for derivatives (with certain exceptions)**, including for credit derivatives, where a CCR method would otherwise need to be used to determine the exposure value. Exceptions, where an SDDT would need to calculate capital requirements, are:
  - default fund contributions and trade exposures to a central counterparty (CCP) where an SDDT is a clearing member of the CCP;
  - a securitisation position resulting from a derivative instrument listed in Annex II of the CRR.
- SDDTs would need to use Credit Risk Mitigation rules (not CCR provisions) to determine exposure values of securities financing and long settlement transactions.
- SDDTs would not be permitted to use the Internal Model Method (IMM) to calculate exposures values.
- **SDDTs would not need to calculate Pillar 1 capital requirements for CVA risk.**

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Pillar 1: Large Exposures and Leverage Ratio
(paras 2.44-2.47 of CP7/24)

- Under the proposals on the previous slide, SDDTs would not need to use a counterparty credit risk method to determine exposure values for Pillar 1 purposes (with some exceptions).
- The PRA proposes a simplified method to incorporate derivative exposures into the leverage and large exposures calculations, calculated as:

  Exposure value = α x max (current market value of derivative, 0)

  Where current market value would be calculated based on individual contracts, and gross of any collateral held or posted.

  This would replace the current calculation of:

  Exposure = α x (replacement cost plus potential future exposure)

  which is applied to netting sets.

Pillar 1: further details

Area	Proposal	Further details
Credit risk	SDDTs would apply the Basel 3.1 standardised approach to credit risk and credit risk mitigation.	Para 2.8 in CP7/24 and Chapters 2 and 4 in PS9/24
	SDDT would not be subject to the due diligence requirements in the Basel 3.1 standardised approach to credit risk.	Paras 2.14-2.16 in CP7/24
	SME and infrastructure lending adjustments in Pillar 2A would apply to SDDTs if they choose to provide the necessary data	Footnote 23 in CP7/24 and paras 1.16, 2.140 and 2.178 in PS9/24
Operational risk	SDDTs would apply the Basel 3.1 standardised approach to operational risk.	Para 2.17 in CP7/24 and Chapter 5 in PS17/23
Market risk	SDDTs calculate Pillar 1 capital requirements for their trading book business using the Basel 3.1 standardised approach to credit risk (akin to the 'Small Trading Book' derogation in CRR 2).	Paras 2.19-2.24, 2.30 in CP7/24
	SDDTs do not have to calculate Pillar 1 capital requirements for business activities subject to foreign exchange risk or commodity risk. These activities are limited for SDDTs by the SDDT criteria.	Para 2.19 in CP7/24 and the SDDT criteria
	SDDTs could continue to use a foreign exchange permission for the purposes of assessing themselves against the SDDT criteria.	Para 2.33 and appendix 11 in CP7/24
Credit valuation adjustment (CVA) risk	SDDTs do not need to calculate Pillar 1 capital requirements for CVA risk.	Paras 2.34-2.39 in CP7/24

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Pillar 1: further details

Area	Proposal	Further details
Counterparty credit risk (CCR)	SDDTs do not need to calculate Pillar 1 capital requirements for CCR for banking-book and trading-book derivatives (with some exceptions), including credit derivatives, where a CCR method would need to be used to determine the exposure value.	Paras 2.34-2.40 in CP7/24
	The exceptions are: default fund contributions and trade exposures to a CCP if an SDDT is a CCP clearing member; securitisation positions resulting from a derivative instrument listed in Annex II of the CRR.	Para 2.41 in CP7/24
	SDDTs must continue to apply capital requirements for securities financing transactions and long settlement transactions, but determine exposure value using the CRM rules. SDDTs cannot use the Internal Models Method (IMM).	Paras 2.42-2.43 in CP7/24
	So that SDDTs don't have to continue to use CCR methods: the derivative exposure measure used in the leverage ratio and in large exposures would become α*max(current market value of derivative contract, 0) for SDDTs; and there would be consequential changes to the credit-risk treatment of exposures in the form of units or shares in collective investment undertakings (CIUs).	Paras 2.44-2.48 in CP7/24
Interim Capital Regime (ICR)	The Interim Capital Regime (ICR) would cease to apply upon implementation of the SDDT capital regime; ie the ICR would run from 1 January 2026 to 1 January 2027. On 1 January 2027, ICR firms would move onto the SDDT capital regime if they are SDDTs or Basel 3.1 in full if they are not.	Paras 2.49-2.55 in CP7/24
Other aspects of Pillar 1	SDDTs could continue to be able to submit an IRB application while remaining an SDDT. The Pillar 1 minimum requirements (as a % of risk weighted assets) remain unchanged.	Paras 2.56-2.57 in CP7/24

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Pillar 2A: Overview of proposed changes
(see Chapter 3 of CP7/24)

- The PRA proposes to:
  - Set out its **Pillar 2 methodologies for SDDTs in a separate Statement of Policy** specific to SDDTs (draft SDDT Pillar 2 SoP) and its **expectations in relation to SDDTs' ICAAPs in a separate Supervisory Statement** specific to SDDTs (draft SDDT ICAAP SS);
  - **Substantially simplify the Pillar 2A approaches for credit risk, credit concentration risk and operational risk for SDDTs**;
  - **Retain the existing Pillar 2A approaches for IRRBB (with some clarifications), pension obligation risk, and counterparty credit risk** for SDDTs;
  - **Not set out Pillar 2A methodologies for market risk and group risk for SDDTs**; and
  - **Eliminate the complex Pillar 2A adjustment for SDDTs in relation to the CCyB.** This is in addition to the proposal to retire the refined methodology for all firms set out in CP9/24.

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Pillar 2A: Overview of proposed changes

SDDTs will still need to ensure they **assess, and hold adequate capital for, their risks**.

<table>
<tr><th>Pillar 2A element</th><th>Proposed change</th></tr>
<tr><td>Credit</td><td>Simplified</td></tr>
<tr><td>Credit concentration risk</td><td>Simplified</td></tr>
<tr><td>Operational risk</td><td>Simplified</td></tr>
<tr><td>IRRBB</td><td>Retained with some clarifications</td></tr>
<tr><td>Pension obligation risk</td><td>Retained with minor reference update</td></tr>
<tr><td>Counterparty credit risk</td><td>Retained with expanded guidance</td></tr>
<tr><td>Market risk</td><td rowspan="5">No specific approaches set as generally not relevant to SDDTs</td></tr>
<tr><td>Group risk</td></tr>
<tr><td>RFB Group risk</td></tr>
<tr><td>Risk of excessive leverage</td></tr>
<tr><td>Risks relating to foreign currency lending to unhedged retail/SMEs</td></tr>
<tr><td>Adjustment: Refined Methodology Adjustment (see CP9/24)</td><td rowspan="2">Removed</td></tr>
<tr><td>Adjustment: CCyB Adjustment</td></tr>
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Simplified Pillar 2A: Credit risk
(see paras 3.14-3.26 of CP7/24)

- The PRA proposes to:
  - **Remove the credit benchmarking methodology** set out in the existing Pillar 2 Statement of Policy **and the requirement for SDDTs to submit FSA076/077 returns**;
  - Expect that **SDDTs which are (1) new/growing banks or (2) predominantly engaged in unsecured retail lending or (3) engaged in higher risk lending (e.g. sub-prime lending) or (4) where the SDDT considers it would be appropriate to conduct this assessment, would need to provide a detailed assessment** of capital needed in relation to credit risk and propose credit risk add-ons (if any).
    - These firms should design their own **scenarios to assess how high-severity tail events over a 12-month horizon may result in credit losses for higher risk lending which is not captured under Pillar 1;**
  - **Provide supervisory expectations in a supervisory statement** which would guide relevant SDDTs in conducting the requisite analysis (see Appendix 6 of CP7/24)

Simplified Pillar 2A: Credit concentration risk

(see paras 3.27-3.36 of CP7/24)

The PRA proposes:

- To **replace the existing HHI methodology for SDDTs with a simpler calculation** consisting of a base add-on calculated as:
  - **3.5% of wholesale RWAs** (defined as all credit RWAs excluding residential mortgages, unsecured retail, short-term liquid exposures to financial institutions and exposures in default) plus
  - **1% of retail RWAs** (all credit RWAs, excluding wholesale RWAs, short-term liquid exposures to financial institutions, exposures in default and residential mortgages)
- **SDDTs would no longer need to submit FSA078 or FSA079**. Existing reporting would be used to calculate the base add-on.
- To **supplement this approach by periodically evaluating single-name and sector concentration risks using existing data** from the existing large exposures and stress testing frameworks respectively.

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Simplified Pillar 2A: Operational risk
(see paras 3.37-3.49 of CP7/24)

- The PRA proposes to **streamline the methodology for setting operational risk Pillar 2A capital for SDDTs with a simpler bucketing approach**.
- Pillar 2A capital for operational risk would be calculated as:

Bucket 1	Bucket 2	Bucket 3
0.3% of total assets less Pillar 1 Op Risk capital	**0.65%** of total assets less Pillar 1 Op Risk capital	**1.25%** of total assets less Pillar 1 Op Risk capital

- An SDDT would be assigned to a bucket based on information provided in its ICAAP and through supervisory knowledge of the firm.
- The PRA would also use supervisory judgement (as currently) to assess the Pillar 2A add-on and may vary the approach on a case-by-case basis.
- The PRA also proposes **additional guidance on its expectations for SDDTs with regards to operational risk in the ICAAP**, including on scenario analysis, information on management of operational risk, loss events and expected losses.

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Pillar 2A: Other types of risk
(see paras 3.50-3.56 of CP7/24)

- The PRA proposes to:
  - Keep Pillar 2A **IRRBB**, but improve clarity and transparency;
  - Keep **pension obligation risk** (with only a minor referencing update);
  - To provide **guidance on assessing Counterparty Credit risk;** and
  - **Not set out specific approaches for SDDTs for market risk, group risk, RFB group risk, risk of excessive leverage and risks relating to foreign currency lending to unhedged retail and SME borrowers**;
- **The PRA would continue to expect SDDTs to adequately capitalise against the risks they are exposed to.**

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Pillar 2A: Pillar 2 adjustments to the capital stack
(see paras 3.57-3.59 of CP7/24)

- The PRA proposes to **eliminate two complex Pillar 2A adjustments for SDDTs**:
  - **the refined methodology for Pillar 2A for all firms** (see Chapter 2 of CP9/24)
  - **the Pillar 2A adjustment introduced relating to the FPC's decision to increase the level of the UK CCyB rate in a standard risk environment from 1% to 2%.**

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Capital buffer framework: Overview

(see Chapter 4 of CP7/24)

- The PRA proposes to:
  - Introduce **a firm-specific Single Capital Buffer (SCB) replacing the 3 existing buffers**. The new SCB will be implemented as **part of the Pillar 2B** capital framework and would be **set at no less than 3.5% of RWAs.**
  - **Replace the cyclical stress testing framework with a non-cyclical stress test to inform the SCBs.**
  - **Remove the payout restrictions attached with eating into the buffer & instead set out guidance on likely supervisory responses.**
  - **Set out a methodology for calculating the SCB for new & growing banks**.

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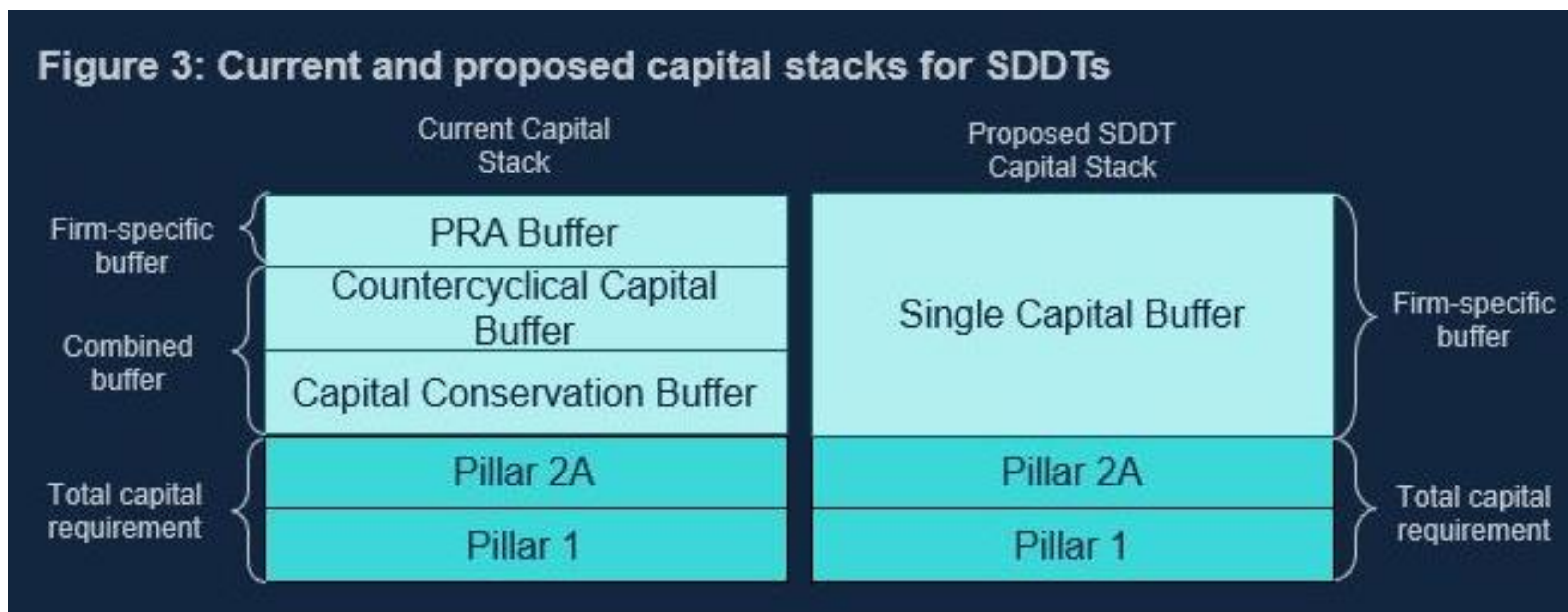
Capital buffer framework: The new single capital buffer (SCB)

(see Chapter 4 of CP7/24)



- SDDTs would be descoped from the CCoB, CCyB and PRA buffer, and would instead be subject to a firm-specific SCB, which would be set no lower than 3.5% of RWAs.
- The SCB would be an amount of capital an SDDT would be expected to maintain in addition to its Total Capital Requirement (TCR) and would need to be met by CET1.

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Capital buffer framework: The SCB

(see paras 4.10-4.27 of CP7/24)

- The SCB would be designed as a **non-cyclical buffer**, to remove the costs arising from the time-varying elements of the current buffer framework.
- Similar to the PRA buffer, the SCB **would consist of**: **a stress impact, a risk management and governance assessment, and supervisory judgement**. It would be assessed in line with the firm's SREP cycle.
- The PRA proposes **the SCB should not be disclosed and should be treated as confidential**, consistent with the approach for the PRA buffer.
- The SCB would be **applied at each level of consolidation which applies to the SDDT** (ie at individual basis, and consolidated basis where this applies to the relevant firm).

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Capital buffer framework: Use of the SCB

(see paras 4.28-4.30 of CP7/24)

- The PRA proposes that **SDDTs would no longer be subject to the Maximum Distributable Amount (MDA) framework**
- Instead, the PRA proposes to set out details in a Statement of Policy of its approach to an SDDT drawing down its SCB, including:
  - **Use of the SCB would not itself be considered a breach of capital requirements or threshold conditions** and the PRA does not expect SDDTs to finance themselves with more capital than the total of their requirements and buffers. However **SDDTS are not expected to use their SCBs in the normal course of business**.
  - SCB drawdown would **not automatically trigger use of PRA supervisory tools**, as the supervisory reaction would be determined on a case-by-case basis.
  - An **SDDT would be given a reasonable period to rebuild its capital buffer** in a gradual way, as part of an agreed capital restoration plan.

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Capital buffer framework: Non-cyclical stress

(see paras 4.31-4.37 of CP7/24)

- Currently, the PRA publishes two stress scenarios each year for firms that are not part of the annual concurrent stress testing (CST) exercise to serve as a template and severity benchmark for them when designing their ICAAP stress tests.
  - These scenarios are countercyclical (severity increases as risks build up and decreases as they abate) as they are derived from the Annual Cyclical Scenario (ACS) used by CST firms, which is countercyclical.
  - To avoid double counting risks already covered by the CCyB, the PRA currently undertakes complex calculations when setting the PRA buffer.
- The **PRA proposes to publish annually two non-cyclical stress test scenarios for SDDTs to serve as a template and severity benchmark for their ICAAP stress tests**.
  - These scenarios would be designed so that as the economy moves through cycles, the **SCB calculated for an SDDT would remain, on average, relatively constant** (provided the SDDT's risk and balance sheet profile remained broadly constant).

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Capital buffer framework: The SCB for new and growing banks

(see paras 4.38-4.41 of CP7/24)

- Currently, the PRA buffer for new and growing banks is calculated differently than for established firms, by considering the forward projection of operating expenses rather than stress testing results.
- The PRA **proposes to set the SCB for new/growing banks which are SDDTs to cover six months of projected operating expenses, but no less than 3.5% of RWAs** in line with the broader proposals for the SCB.

Capital buffer framework: summary

(see para 4.42 of CP7/24)

	PRA-regulated firms which are not SDDTs	SDDTs
Established firms	A **PRA buffer** informed by firm-specific cyclical stress testing results, on top of the combined buffer (which includes the CCoB and CCyB)	An **SCB** informed by firm-specific non-cyclical stress testing results and no lower than 3.5% of RWAs.
New / growing banks	A **PRA buffer** based on six months of projected operating expenses, on top of the combined buffer (CCoB and CCyB)	An **SCB** based on six months of projected operating expenses, and no lower than 3.5% of RWAs.

Capital buffer framework: consequential amendments

(see paras 4.43-4.52 of CP7/24)

- The PRA proposes to make some **further consequential amendments for SDDTs** as a result of descoping them from the combined buffer (CCoB and CCyB):
  - **Recognition of minority interests in regulatory capital** – SDDTs would calculate the minority interests that may be recognised in regulatory capital without considering buffers in the subsidiary (ie only based on Total Capital Requirement)
  - **Capital reduction permissions** – clarifying that SDDTs would not need to provide information on the impact of planned capital reductions on the combined buffer
  - **Limitations on redemption of capital instruments** – clarifying that the combined buffer would not be considered by SDDTs when considering limitations on redemption
  - **Disclosure of capital buffers** – removing SDDTs from the requirement to disclose the combined buffer (which would in any event no longer apply to them)

ICAAP and ILAAP proposals: Overview

(see Chapter 5 of CP7/24)

- The PRA proposes simplifications to SDDTs' ICAAPs based on the **following principles**:
  - ICAAPs should **remain an important tool for setting out firm specific risks**.
  - **SDDTs only need to consider risks relevant to their business and size**, and the ICAAP should be tailored to the simpler business model of SDDT-eligible firms.
  - **PRA guidance on the ICAAP should be clear**, and should enable an SDDT to produce, understand, and own its ICAAP document.
- The PRA proposes:
  - That certain elements of the ICAAP document need only be updated at least every 2 years (although Pillar 2A and Pillar 2B assessments should continue at least annually);
  - That certain elements of the ICAAP can be streamlined;
  - An optional ICAAP document structure;
  - That ILAAPs be updated at a minimum of every 2 years.

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ICAAP proposals: ICAAP document frequency

(see paras 5.10-5.14 of CP7/24)

- The PRA is proposing to reduce the frequency with which SDDTs (other than new/growing banks) are expected to update and document certain elements of the ICAAP to a minimum of every two years

Risk assessment element	At least annually	At least every 2 years
Pillar 2A	✓	
Pillar 2B (incl stress testing)	✓	
Reverse stress testing (RST)		✓
Full ICAAP document		✓

- Caveat: it remains the responsibility of an SDDT to ensure its ICAAP document is relevant and current at all times.
- New/growing banks would still need to update their ICAAPs at least annually

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ICAAP proposals: Tailoring the ICAAP

(see paras 5.15-5.22 of CP7/24)

- The PRA considers it appropriate to propose to introduce **more proportionate expectations in relation to some components of the ICAAP** for SDDTs:
  - **SDDTs should be able to reference sections of the ILAAP when considering liquidity risk in their ICAAP rather than duplicating that material**
    - The ICAAP content should be expanded if liquidity risks could have capital adequacy implications.
  - **Reverse stress testing (RST)** – the PRA proposes to allow an SDDT to perform more qualitative RSTs, describing RST scenarios and its approach but not necessarily including quantitative analysis.
  - **Optional ICAAP document structure** – the optional ICAAP structure which SDDTs may follow is set out in Annex 1 of the draft SDDT ICAAP SS (see Appendix 6 of CP7/24)

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ILAAP frequency

(see paras 5.23-5.25 of CP7/24)

- The PRA proposes to **reduce both the frequency with which SDDTs (other than new / growing banks) are required to review their ILAAP and expected to update their ILAAP document from at least annually, to at least every two years**.
- It would remain the **responsibility of an SDDT to ensure its ILAAP document is relevant and current**.
- The PRA proposes to maintain its expectation that **new/growing banks update and document their ILAAPs at least annually**.

Simplified capital deductions (1 of 2)

(see Chapter 6 of CP7/24)

Summary of current requirements (see Table 6A in CP7/24)

Subject to threshold deduction	Deduction category	Deduction threshold		Tier of capital from which deducted
Items subject to threshold deduction	Temporary DTAs	10% individual	15% aggregate	CET1
	SI in CET1	10% individual		CET1
	NSI in CET1	10% individual		CET1
	NSI in AT1			AT1
	NSI in T2			T2
SI not subject to threshold deduction	SI in AT1	Full deduction		AT1
	SI in T2			T2
Specific items	Qualifying holdings	15% individual or 60% aggregate		Option to deduct from CET1 or risk weight at 1250%
	Certain securitisation positions	n/a		
	Free deliveries			

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Simplified capital deductions (2 of 2)

(see Chapter 6 of CP7/24)

Proposal (see Table 6B in CP7/24)

<table>
<tr><th>Subject to threshold deduction</th><th>Deduction threshold</th><th>Tier of capital from which deducted</th><th>Risk weight for non-deducted amount</th></tr>
<tr><td>Items subject to threshold deduction</td><td rowspan="3">25% aggregate</td><td rowspan="3">CET1</td><td rowspan="2">250%</td></tr>
<tr><td>SI not subject to threshold deduction</td></tr>
<tr><td>Specific items</td><td>1250%</td></tr>
</table>

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Reporting: Approach

(see Chapter 7 of CP7/24)

- In designing the reporting proposals, the PRA has sought to:
  - **Make the reporting changes necessary** to support the proposed simplifications to the capital framework
  - **Maintain reporting that is necessary to enable the PRA to understand SDDTs positions against the SDDT criteria** in some areas; and
  - Introduce **simplifications to the reporting framework for SDDTs through descoping them from a number of reporting templates and tailoring** a number of templates and reporting instructions for them.
- The proposals are made against the reporting framework that would apply **assuming the Basel 3.1 reporting changes are implemented**.
- The PRA has designed the proposals on the basis that **SDDTs would have their own tailored templates and reporting instructions for certain reporting modules**

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Reporting: Overview
(see Chapter 7 of CP7/24)

- In summary, the PRA proposes the following reporting changes:
  - To **descope SDDTs from 38 templates** (a number of which will already not be relevant to many SDDTs, depending on their size and activities)
  - To **replace most Counterparty Credit Risk related reporting** with a new simplified template;
  - To **amend 24 templates and instructions, tailoring many of these specifically to SDDTs.**
- As part of making these changes, the PRA proposes to **create a separate chapter in the Reporting (CRR) Part of the PRA Rulebook which specifies the format and frequency of reporting on own funds and own funds requirements for SDDTs**.

Risk area	Relevant B3.1 changes (see PS9/24)	Descope	New	Amend
Capital adequacy and group solvency	Updated C02.00, PRA102 and PRA103 to OF 02.00, PRA113 and PRA114 respectively	-	-	C 01.00, OF 02.00, C 04.00, C 06.01/02, PRA113, PRA114
Credit risk, counterparty credit risk and securitisation	Updated C 07.00 and C 09.01 to OF 07.00 and OF 09.01 respectively	C34.01 to 34.05, C34.08 to 34.11	C34.XXS	OF 07.00, OF09.01*, C 09.04, C 13.01, C 14.00, C 14.01*, C 33.00, C 34.06
Operational risk	Replace C 16.00, 17.01 and 17.02 with OF 16.00	-	-	-
Market risk	Deleted C 24.00 and FSA005, renamed C 18.00 – 23.00 as OF 18.00 – 23.00, introduced OF 24.01 -24.03 and OF 90.00 – 91.10	OF 18.00 to OF 21.00, OF 24.01 to OF 24.03, OF 91.01 to OF 91.10	-	OF 22.00, OF 90.00
CVA	Replaced C 25.00 with OF 25.01 - 25.03	OF 25.01 – 25.03	-	-
Large exposures	-	-	-	C 28.00*, C 29.00*
Leverage	-	-	-	LV 47.00, LV 41.00*, LV 44.00*
Pillar 2	-	FSA072 – FSA080	-	FSA071, PRA111

* Instruction-only change

Proposed implementation date
(see Chapter 1 of CP7/24)

- The PRA proposes that the **implementation date** for the changes resulting from this CP (**other than certain changes to the Statement of Policy** – Operating the Small Domestic Deposit Taker (SDDT) regime (the SDDT SoP)) – see below – would be **1 January 2027**
  - This would give SDDTs and the PRA sufficient time to exchange feedback on the proposals, to finalise the policy, and for the final rules to be implemented smoothly.
- **Changes to the SDDT SoP** (apart from those related to FX permissions set out in Chapter 2) **would take effect upon the publication of the PS finalising those changes**, as they provide further detail on how the SDDT regime would operate, including changes relevant to implementation.

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Operating the SDDT regime: recap

(see Chapter 8 of CP7/24 and Chapter 9 of PS9/24)

- The **SDDT criteria are set out in the PRA Rulebook**, and a number of firms have already become SDDTs, and apply the liquidity and disclosure simplifications.
- The PRA's policy on **how the SDDT regime operates is set out in the SDDT SoP**, including that eligible firms are offered a modification by consent (MbC) to become an SDDT (and its approach to firms that do not meet the SDDT criteria).
- The PRA has also **set out its near-final policy on the Interim Capital Regime (ICR)** in PS17/23 (see Chapter 8) and updated this in PS9/24 (see Chapter 9):
  - The ICR is a temporary regime that will allow SDDT-eligible firms to choose (via an MbC – separate to the MbC to become an SDDT) to remain subject to existing CRR capital requirements until implementation of the simplified capital regime for SDDTs
  - The PRA's policy on how the ICR will operate is set out in a separate draft **ICR SoP**.
  - There will be a time-window of at least six weeks for eligible firms to consent, or inform the PRA of their intention to consent, to the ICR MbC if they want to be subject to the ICR on the proposed implementation date of the Basel 3.1 standards.

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Accessing the SDDT regime (1 of 3)

(see Chapter 8 of CP7/24, paras 8.16-8.22)

The PRA proposes the following updates to how firms access the SDDT regime:

- **At the implementation date of the simplified capital regime, the finalised measures for the simplified capital regime would automatically apply to all SDDTs** (ie an SDDT would not need to take up an additional MbC to access the simplified capital regime). From January 2027, all SDDTs would need to operate under the simplified capital regime as part of being in the SDDT regime.
- The **SDDT SoP would be updated to give further details on the process to become an SDDT**, including that:
  - Firms **should engage with their supervisors early** prior to taking up the SDDT MbC and would need to coordinate with the PRA on the process.
  - Where an SDDT-eligible firm has not coordinated closely with the PRA on its process and timeline to become an SDDT, the PRA would need more time to plan for relevant changes prior to issuing any modification to the firm to become an SDDT.

Accessing the SDDT regime (2 of 3)

(see Chapter 8 of CP7/24, paras 8.23-8.27)

The PRA proposes that **ahead of the implementation date of the SDDT capital regime, the PRA would conduct an off-cycle review of firm-specific Pillar 2 capital requirements for ICR firms, and non-ICR firms that have consented to the SDDT MbC**:

- This review (similar to the review that will be conducted for Basel 3.1 firms) would aim to **adjust a firm's Pillar 2 requirements and buffers** in accordance with the capital framework the firm has chosen to move to (ie Basel 3.1 standards or the SDDT regime).
- The PRA would **apply applicable SME lending adjustments and infrastructure lending adjustment in line with the near-final policy in PS9/24**. The PRA would also **remove the refined methodology in Pillar 2A for ICR firms**, as set out in CP9/24.
- For firms that will be on the **SDDT regime** on 1 January 2027, the review would also **calculate the firm's SCB and remove the CCyB adjustment** (based on a firm's most recent ICAAP and SREP).
- The PRA does not plan to reset firms' Pillar 2 capital through a full CSREP before implementation. This is because **the reset to a firm's Pillar 2 capital requirements using the proposed simplified Pillar 2A methodologies and non-cyclical stress test would occur over time, in line with the firm's CSREP cycle**.
- The PRA would **communicate to firms adjusted Pillar 2 requirements and expectations (ie the outcome of this off-cycle review) ahead of the implementation date** of the proposals in this CP.
- The PRA proposes to conduct **a data collection exercise to inform these adjustments**, with further details to be set out in due course.

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Accessing the SDDT regime (3 of 3)

(see Chapter 8 of CP7/24, paras 8.28-8.32)

- In PS15/23, the PRA stated that **SDDT-eligible firms will be able to consent to the SDDT MbC at any time**. While this will remain the case, firms looking to operate under the simplified capital regime for SDDTs on the implementation date of that regime would need to opt in to the SDDT regime (by consenting to the SDDT MbC) in advance of the implementation date.
- **The PRA plans to set out a deadline for SDDT-eligible firms which have not already consented to become SDDTs to consent, or inform the PRA of their intention to consent, to the SDDT MbC if they want to be subject to the SDDT regime on the proposed implementation date of the SDDT capital regime**.
- If a firm has not informed the PRA of its intention by the deadline, the PRA would assume that firm wishes to be subject to the full Basel 3.1 standards from the implementation date of the SDDT capital regime.

Operating the SDDT regime: ending the ICR

(see Chapter 8 of CP7/24, paras 8.8-8.15)

- The **ICR is intended to be in place during the interim period between the implementation date of full Basel 3.1 standards (1 Jan 2026) and the proposed implementation date of the simplified capital regime for SDDTs (1 Jan 2027)**
- The PRA therefore proposes that **the ICR will cease to apply upon the implementation date of the simplified capital regime for SDDTs**. At that date:
  - Firms that operate under the ICR (ICR firms) and have taken up the SDDT MbC would move onto the simplified capital regime for SDDTs; and
  - ICR firms that have not taken up the SDDT MbC would immediately move onto the full Basel 3.1 standards.
- The PRA is proposing to **implement ICR transitional rules to migrate permissions** relating to provisions in the ICR rules where appropriate to equivalent permissions in relation to an ICR firm's chosen framework.

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Leaving the SDDT regime (1 of 2)

(see Chapter 8 of CP7/24, paras 8.33-8.35)

- The PRA proposes to provide more guidance in the SDDT SoP that:
  - **An SDDT that wishes to leave the regime should engage with its supervisors** to discuss its plans and explain its reasons for seeking to leave at the earliest opportunity before requesting the PRA to revoke its modification;
  - Such an SDDT will generally be able to prepare for leaving the regime so that by the time it requests revocation of the modification it will be able to comply almost immediately with the full Basel 3.1 regime;
  - **Early engagement with the PRA will allow the time needed for the firm and PRA to prepare for necessary changes**, which will need to be completed before the PRA would be able to accede to a request to revoke the modification direction.
  - When considering when to revoke a firm's modification direction, **the PRA would consider the time a firm needs to comply with the full Basel 3.1 regime**, the **time needed by the PRA** to action changes, and **information needed from the SDDT**.

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Leaving the SDDT regime (2 of 2)

(see Chapter 8 of CP7/24, paras 8.36-8.39)

- In line with the PRA's proposed general approach to firms seeking to leave the regime, the PRA proposes that **an SDDT that sees the final Phase 2 measures and wants to leave the regime before they are implemented would be encouraged to engage early with its supervisors** to discuss its plans before requesting that the PRA revoke its modification direction.
  - There would be **no specific 'transitional arrangements' for such firms**. Instead the PRA's policy in respect of firms wishing to leave the SDDT regime would apply.

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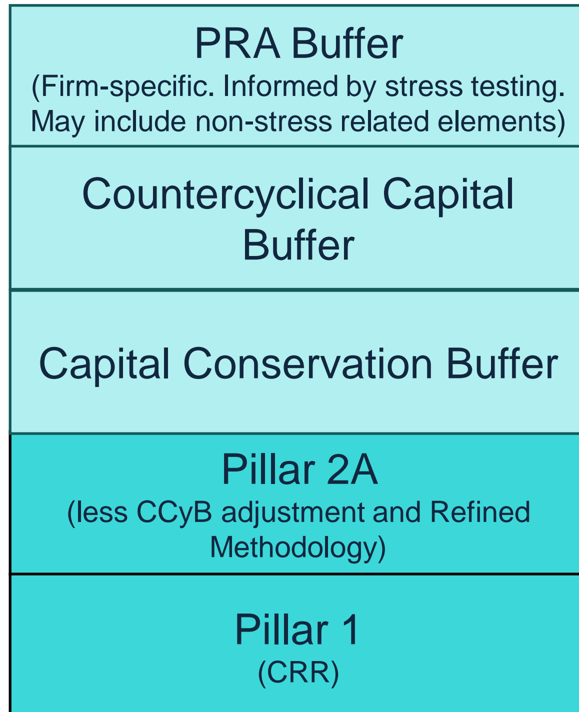
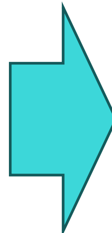
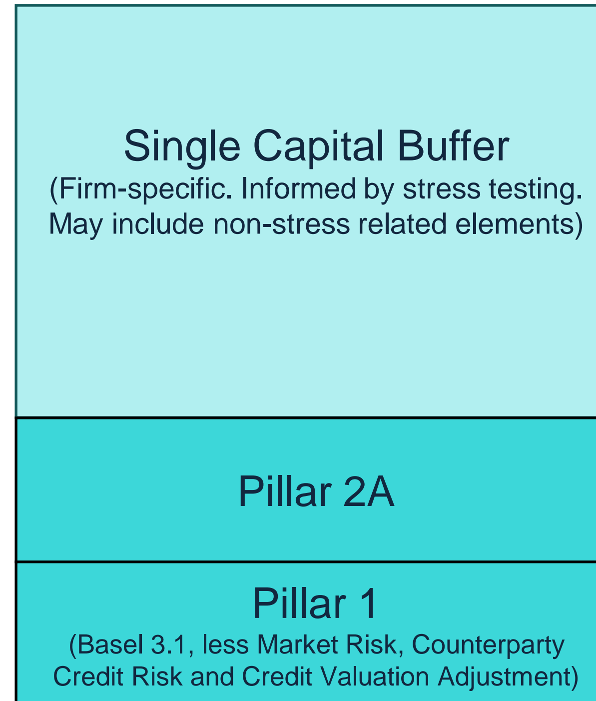
Recap: Summary of proposed simplifications to the capital stack

Current Capital Stack (Complex)





Proposed SDDT Capital Stack (simple)



- ✓ **Simpler and more predictable**
- ✓ **Much simpler**
- ✓ **More risk-sensitive, with simplifications**
- ✓ **Plus simplifications to ICAAP, ILAAP, regulatory capital, and some reporting**
- ✓ **AND Phase 1 simplifications**

[See Chapter 1 of CP7/24]

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Cost benefit analysis
(see Chapter 9 of CP7/24)

The proposals would **maintain resilience of SDDTs** but will also **introduce a number of benefits** for them, including:

- **Better measurement of risk from applying the Basel 3.1 Pillar 1 standardised approaches for credit risk and operational risk**
- **Simpler, more transparent and more certain capital requirements** from simpler Pillar 2A methodologies and the introduction of the Single Capital Buffer
- A **simpler capital stack** from simpler Pillar 2A requirements, simpler calculations for deductions from regulatory capital, and the simplification of Pillar 1 requirements
- **Simpler reporting requirements and supervisory processes**, including from tailored reporting requirements and proposed changes to the ICAAP and ILAAP

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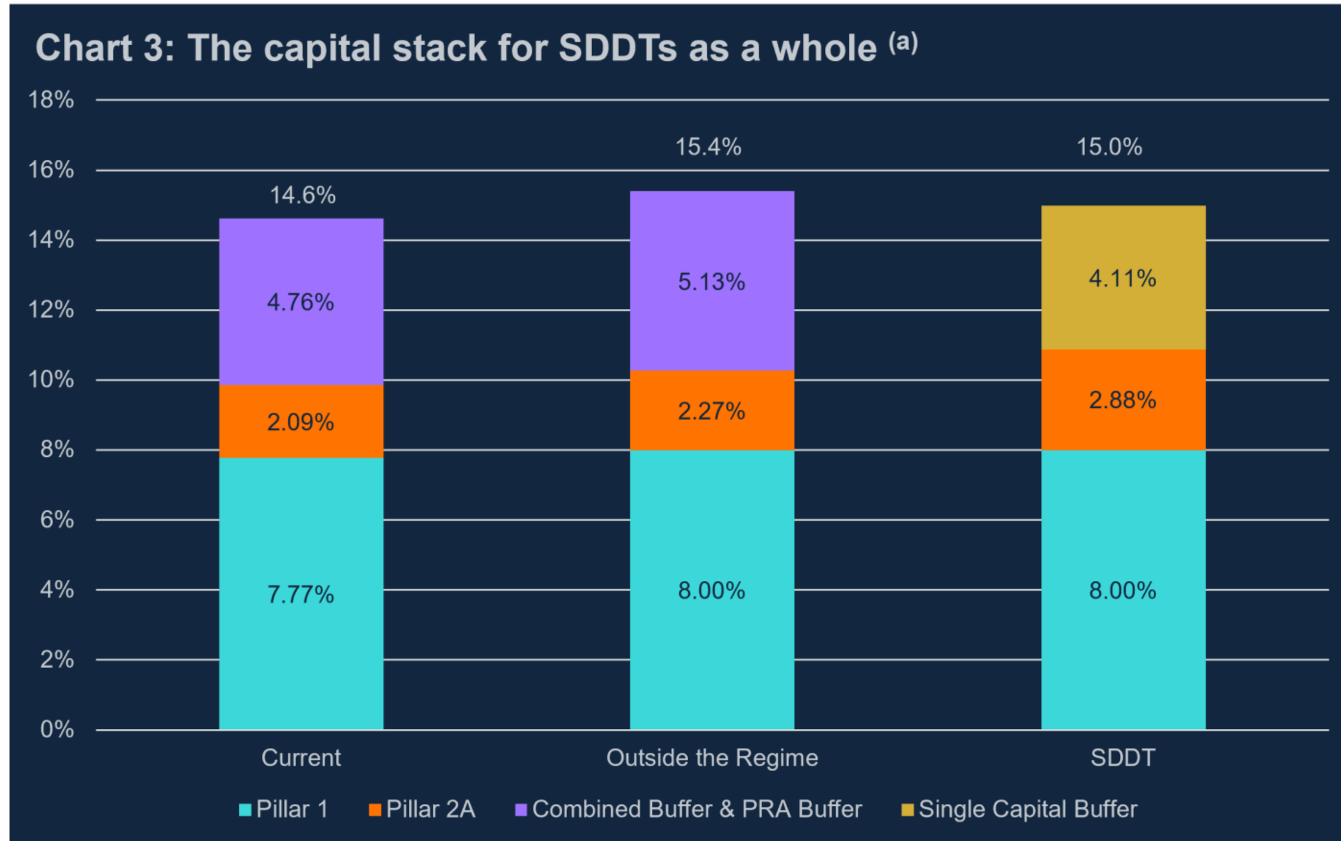
Cost benefit analysis

(see Chapter 9 of CP7/24)



- Our analysis suggests that, on a weighted average basis across the cohort, the top of the capital stack under the S&S proposals would be a **little above the current stack** (the difference is just below 40 basis points of Basel 3.1 RWAs), and **just slightly below the stack outside of the SDDT regime** (the difference is around -40 basis points of Basel 3.1 RWAs).

Source: PRA regulatory returns, PRA analysis and calculations.
(a) The bars show the weighted average capital stack for SDDT-eligible firms under current rules, outside of the SDDT regime, and under the proposals in this CP, respectively. Firms are weighted by their RWAs under the Basel 3.1 standards (ie to calculate the average value of a component of the stack, the weight placed on firm i's value for the component is firm i's estimated RWA under the Basel 3.1 standards divided by the sum of SDDTs' estimated RWAs under the Basel 3.1 standards).

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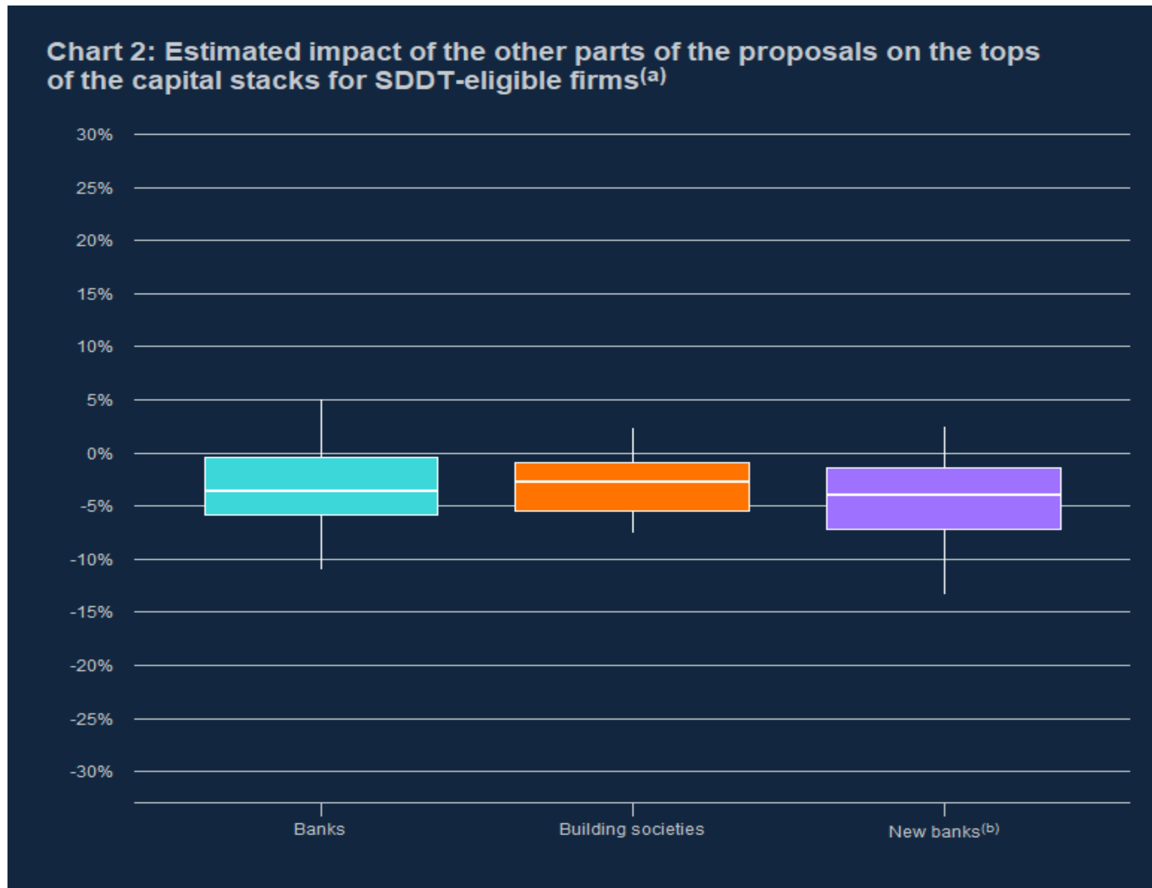
Cost benefit analysis

(see Chapter 9 of CP7/24)



- This chart sets out our analysis of how the capital requirements and regulatory buffers of different types of SDDT-eligible firms would be impacted if they were inside the SDDT regime vs following the full Basel 3.1 regime.
- As you can see, for all types of firms on average there would be a slight reduction in the total capital stack inside the SDDT regime vs outside.

Source: PRA regulatory returns, PRA analysis and calculations.
(a) The boxplots show for banks, building societies, and new banks the distributions of estimated percentage differences between the top of the stack under the proposals in this CP (expressed in pounds) and the top of the stack outside of the SDDT regime (expressed in pounds). For each box, the whisker on top is drawn up to the highest estimate within 1.5*interquartile range of the 75th percentile and the whisker below is drawn down to the lowest estimate within 1.5*interquartile range of the 25th percentile.
(b) New banks are those firms among the estimated population of SDDT-eligible firms that are in scope of SS3/21.

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Key messages – recap

- The S&S proposals **significantly simplify the capital regime for SDDTs without weakening their overall resilience** and, together with the Phase 1 simplifications, will **support a dynamic, diverse and sustainable banking sector**.
- The S&S CP proposes simplifications to all elements of the capital stack:
    - **Pillar 1** risk weighted assets would be calculated using **Basel 3.1 rules**, which provide a better measure of risk, and which will be simplified in some areas for SDDTs;
    - **Pillar 2 would be radically simplified**, and there would be tailored documents for SDDTs covering the Pillar 2 Statement of Policy and the ICAAP/SREP SS;
    - There would be **a single, more constant and therefore predictable capital buffer**, rather than three buffers which vary significantly over time; and **regulatory capital would be simpler** to calculate;
    - There would also be **simplifications to ICAAP, ILAAP and certain reporting**.
- The proposals would **advance the PRA's objectives.**

Next steps

- Eligible firms should **engage with the material and actively consider whether to become SDDTs and/or enter the ICR.**
- We will be holding further engagement with trade associations (BSA, UK Finance).
- **Firms should respond to the CP** (via individual response or via their trade association) **by the closing date of 12 December**.
- We have made near-final policy on the ICR, and **we plan to publish final ICR rules that will allow the PRA to offer the ICR modification by consent by the end of this year, and along with the Basel 3.1 Final Policy Statement in Q1 2025.**
- We **aim to publish the final policy for the simplified capital regime for SDDTs in Q3 2025**, though that timing depends in part on how much feedback we get to our proposals.