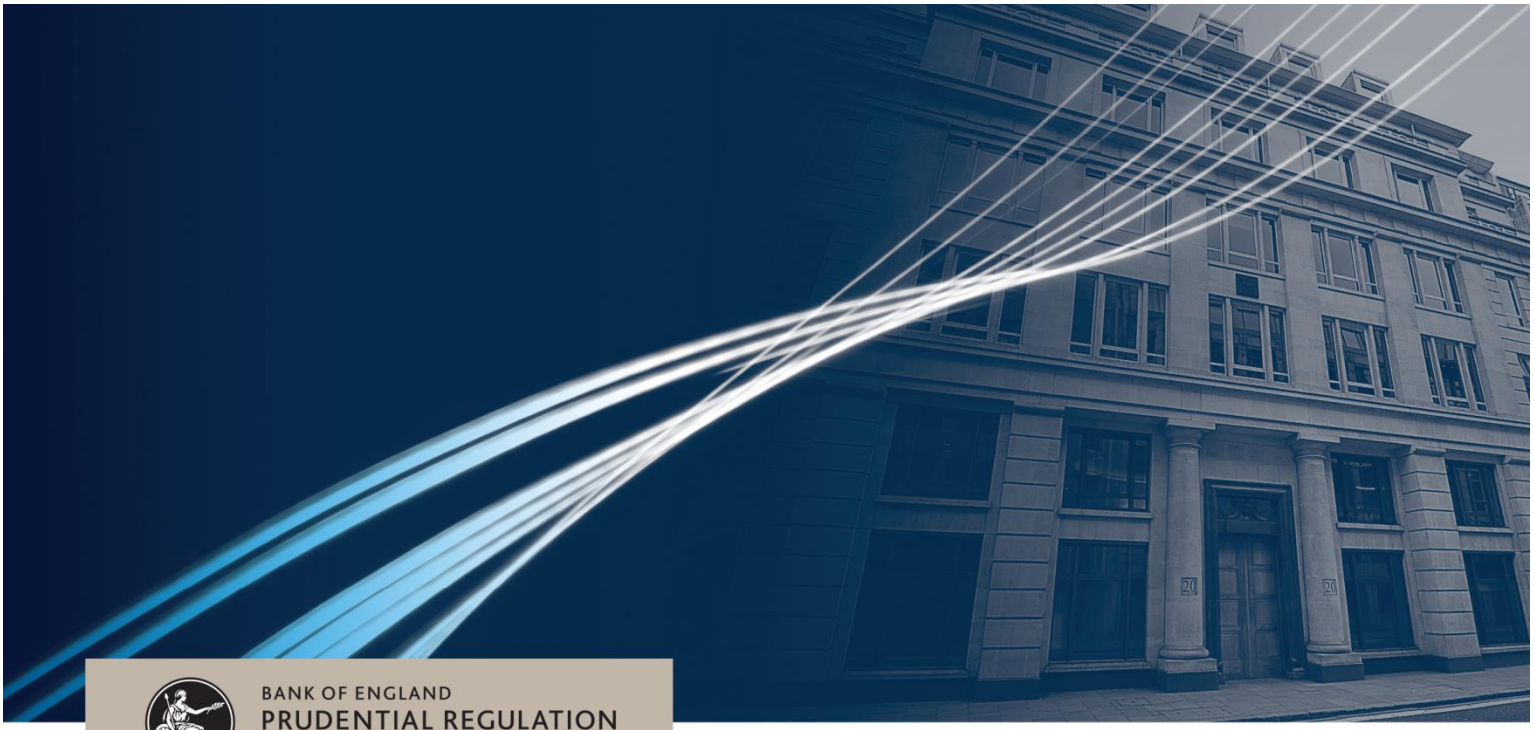

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Consultation Paper | CP20/19

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

September 2019

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Responses are requested by Monday 9 December 2019.

Please address any comments or enquiries to:
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1 Overview

1.1 In this consultation paper (CP), the Prudential Regulation Authority (PRA) sets out its proposals for amendments to the Pre-Issuance Notification (PIN) regime applicable to PRA-authorised Capital Requirements Regulation (575/2013) (CRR) firms.[1] Appendix 1 contains the proposed amendments to the PIN regime as set out in the Definition of Capital Part of the PRA Rulebook.

1.2 The PRA's PIN rules are intended 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 such instruments. The proposals in this CP reflect the adoption of amendments to Part Two of CRR[2] via CRR II[3] and make improvements identified through the PRA's experience of assessing the quality of capital instruments. The PRA considers that the proposed improvements would make the PIN regime more risk-sensitive and proportionate, and would allow firms greater flexibility in issuing capital instruments.

1.3 CRR II amends various aspects of the CRR, including Article 26(3) which now allows a firm to classify subsequent issuances of an approved Common Equity Tier 1 (CET1) instrument as CET1, subject to meeting certain conditions including notification to the PRA (see paragraphs 3.12 – 3.15 of this CP). As a result of these amendments, there is an overlap between the PRA's rules in Chapter 7 of the Definition of Capital Part and Article 26(3) of the CRR as amended. On Monday 10 June 2019, the PRA made available a modification by consent[4] as an interim solution to address this overlap ahead of formally consulting on rule changes. The PRA now proposes to amend the Rulebook to address this overlap.

1.4 The PRA also sets out a number of proposals to make the PIN regime for CRR firms more risk-sensitive and proportionate, and to allow firms greater flexibility in issuing capital instruments. For example, the PRA proposes to amend the Rulebook to strengthen the governance of CET1 issuance, align the requirements for subsequent issuances of Additional Tier 1 (AT1) instruments to those for subsequent issuances of CET1 instruments, and remove the requirement to make a pre-issuance notification of Tier 2 (T2) instruments. The proposed restructure of Chapter 7 of the Definition of Capital Part is intended to ease understanding of the rules.

1.5 The PRA's Supervisory Statement (SS) 7/13 'CRD IV and capital'[5] sets out the PRA's expectations of CRR firms in relation to their quality of capital resources. The PRA proposes to update SS7/13 to emphasise the PRA's preference for simpler CET1 capital structures and set out its proposed expectations of firms' senior management in relation to the quality of capital resources. The PRA also proposes to clarify two terms introduced by CRR II, to ensure common understanding of notification requirements in relation to subsequent issuances of CET1 and AT1 capital instruments. Appendix 2 contains the proposed revisions to SS7/13 which is proposed to be renamed 'Definition of Capital'.

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1 CRR firms include banks, building societies and PRA UK designated investment firms. For avoidance of doubt, these requirements apply at both the individual and UK consolidated level.

2 Capital Requirements Regulation: Regulation (EU) No 575/2013; http://eur-lex.europa.eu/legalcontent/EN/TXT/?uri=CELEX:32013R0575

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

4 Modification by consent of definition of capital rules 7.1 and 7.5; https://www.bankofengland.co.uk/prudential-regulation/authorisations/waivers-and-modifications-of-rules

5 December 2013: https://www.bankofengland.co.uk/prudential-regulation/publication/2013/crdiv-and-capital-ss.

Implementation

1.6 The proposed implementation date for the proposals in this CP is Wednesday 1 April 2020.

Responses and next steps

1.7 This consultation closes on Monday 9 December 2019. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP20_19@bankofengland.co.uk.

1.8 The proposals set out in this CP have been designed in the context of the current UK and EU regulatory framework. The PRA has assessed that the proposals will not be affected in the event that the UK leaves the EU with no implementation period in place. In case of an implementation period, the PRA may need to amend the definition of CRR for the purposes of Chapter 7 of the Definition of Capital Part to explicitly include relevant amendments via CRR II.

2 Background

2.1 The CRR contains directly applicable provisions defining the tiers of required capital and the level of application of these requirements, against which the PRA supervises firms. In order to effectively supervise the quality of firms' capital, and thereby advance their safety and soundness in line with the PRA's objectives, the PRA has put in place rules and expectations to complement the CRR provisions on the definition of capital.

2.2 As set out in Chapter 7 of the Definition of Capital Part of the PRA Rulebook, CRR firms must notify the PRA before issuing any capital instrument that they intend to include in capital resources or own funds. A firm must notify the PRA regardless of whether the instrument would be issued by itself, or by another member of its consolidated or sub-consolidated group. The requirements contained in Chapter 7 are collectively known as the PIN regime. The PIN regime is intended to ensure that the PRA receives consistent information on the quality and quantity of own funds or capital resources issued and has advance notice of any proposed change in a particular firm's capital position. The PIN regime also intends to ensure firms have conducted an appropriate assessment to satisfy themselves that capital items that they intend to count towards own funds meet relevant rules and PRA expectations regarding capital quality.

2.3 The PRA proposes to update the PIN regime to reflect the adoption of amendments to Part Two of CRR through CRR II and to make improvements identified through the PRA's experience of assessing capital instruments. These proposals are explained below. Appendix 1 contains the proposed amendments to the rules. SS7/13 sets out the PRA's expectations on the quality of regulatory capital resources that firms are required to hold under CRD[6] and CRR. SS7/13 complements CRR and the PIN regime. The proposed revisions to SS7/13 (see paragraphs 3.6 - 3.11 and 3.19 - 3.24 of this CP) are set out in Appendix 2.

6 Capital Requirements Directive: Directive 2013/36/EU; https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0036&from=EN

3 Proposals

Improving quality and governance of CET1 issuance

3.1 The PRA proposes a number of measures to enhance the quality and governance of CET1 issuance.

Documentation requirements for new CET1 issuances

3.2 The PRA proposes 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. Currently, the PRA requires firms to provide an independent legal opinion in support of proposed AT1 and T2 instruments, but requires only a self-assessment form known as the 'CET1 compliance template' in respect of proposed CET1 instruments. The PRA proposes that the independent legal opinion would be required alongside the CET1 compliance template. For the avoidance of doubt, this requirement would not apply to subsequent issuances of an approved instrument.

3.3 This proposal is intended to ensure that the firm is supported by the independent opinion of a qualified legal professional that the new CET1 instrument complies with the letter and objective of the CRR, including relevant technical standards and guidance, as well as the PRA's rules and supervisory expectations. This should raise the quality of firms' capital resources and help to inform the PRA's assessment of such instruments.

3.4 The PRA appreciates that there would be some additional costs to regulated firms as a result of this proposed new requirement; however, the PRA considers these costs to be outweighed by the benefits set out above. This proposal also more closely aligns the requirements of the CET1 pre-issuance regime with those of the AT1 regime, which already require the submission of an independent legal opinion. The PRA considers that this is appropriate given that CET1 instruments are intended to contribute the highest quality of capital, and therefore should be subject to a standard of scrutiny which is at least as high as that for other tiers of capital.

3.5 Given that the PRA is proposing to require firms to submit an independent legal opinion for new CET1 issuances, the PRA proposes to simplify the CET1 compliance template to include only certain key questions pertaining to the notification, as opposed to detailed assessment against each criterion. These questions would help the PRA to better understand key features of the proposed CET1 instrument and its place in the wider capital structure. The proposed amended CET1 compliance template is set out in Appendix 4.

Clarify the PRA's expectations on complex capital structures

3.6 The PRA proposes that SS7/13 be amended to clarify the PRA's expectations on complex capital features and structures. Complex features and structures complicate prudential assessment and may also undermine instruments' loss-absorbing properties and CRR compliance. Complexity can arise, for instance, when CET1 shareholders do not all have the same rights and entitlements, including in relation to preferential realisation provisions or other features that guarantee a distribution to CET1 shareholders. The PRA has observed increased usage of complex features in recent CET1 issuances. The PRA proposes to set out an expectation that firms refrain from employing such features other than in a relatively rare case where it may be necessary and, where those features are used, that firms fully understand the potential risk to loss absorbency and/or recapitalisation. The proposed amendments are to:

(a) note the PRA's preference for simple, vanilla share structures consisting of only one class of share that is fully subordinated to all other capital and debt, that has full voting rights and equal rights across all shares with respect to dividends and rights in liquidation;

(b) set out non-exhaustive examples of features the PRA views as complex;

(c) make clear that when the PRA is notified of a complex instrument, it is likely to require more time to make an assessment; and

(d) note the PRA's expectation that complex features are highlighted by firms at the point of notification, and that a clear rationale for their inclusion should be provided.

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

3.7 Currently, the PRA expects a 'member of the senior management' of the firm to confirm that capital instruments meet the relevant eligibility criteria. The PRA has not previously defined which 'member of the senior management' it views as suitable.

3.8 The PRA proposes to clarify that for the purposes of SS7/13 the 'member of the senior management' means an individual approved to hold a Senior Management Function under the Senior Managers and Certification Regime (SM&CR) and who has been allocated 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).

3.9 The PRA also proposes that:

(a) the relevant individual should approve and sign all PIN submissions;

(b) the relevant individual should inform the firm's board when the firm proposes to utilise a complex capital structure or feature (see paragraph 3.6 above), and evidencing: i) why the instrument cannot be issued without the proposed complexity; and ii) that the complexity does not impact on CRR eligibility;

(c) the proposed capital structure should be subject to appropriate board-level review and discussion, including consideration of ways to minimise the complexity; and

(d) in cases where the firm adopts a complex share structure notwithstanding the PRA's preference for simplicity, the firm's board should discuss whether the continued inclusion of the complexity within the share structure is necessary at least annually as part of its Internal Capital Adequacy Assessment Process (ICAAP) review, and should try to simplify the structure where possible.[7]

3.10 The PRA further proposes to set an expectation that the firm engages with its usual supervisory contact at an early stage when planning to submit a PIN regarding a complex capital instrument.

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7 See PRA SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)', November 2018: https://www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss.

3.11 These proposals intend to ensure that there is clear, individual accountability for a firm's capital arrangements, consistent with the scope of the Prescribed Responsibilities set out above. They also intend to encourage greater engagement from the firm's senior management in submissions to the PRA and improve the quality of those submissions, enhancing the efficiency of the process.

Notification requirements for subsequent issuances of CET1 and AT1

Subsequent issuances of CET1 under CRR Article 26(3)

3.12 CRR II amends Article 26(3) of the CRR to provide for a firm to classify an instrument as CET1 where that instrument has previously been approved under the Article. This is possible where two conditions are met:

(a) the provisions governing the subsequent issuance are substantially the same as the provisions governing the issuance for which the firm has already received permission; and

(b) the subsequent issuance is notified to the PRA sufficiently in advance of its classification as CET1.

3.13 Currently, the PRA's rules permit a firm to classify any subsequent issuance of an approved instrument as CET1 provided that:

- In the prior 12 months the PRA has approved a CET1 instrument whose terms are identical, other than in respect of the:
    - issue date;
    - amount of the issuance; or
    - currency of the issuance[8].
- The PRA is notified no later than the day of issuance.[9]

3.14 Where the CET1 instrument was approved more than 12 months prior to the subsequent issuance, current rules require that the PRA is notified at least one month prior to intended issuance.

3.15 Because the CRR has direct effect, the overlapping PRA rules described in paragraph 3.13 of this CP are no longer relevant or applicable. The PRA has offered firms a 'modification by consent' to address this overlap in the interim.[10] The PRA now proposes to amend its rules to require firms to submit:

- a PIN form;
- draft terms and conditions together with any side agreements; and
- written confirmation that the capital instrument meets the:

8 Definition of Capital 7.5 (2). The other characteristics which are permitted to vary – the maturity date and the rate of interest payable by the issuer - are not relevant to CET1 instruments.
9 Definition of Capital 7.5.
10 See footnote 4 above.

- condition in point (a) of the second subparagraph of Article 26(3) of the CRR as amended; and

- conditions for qualification as a CET1 instrument.

Alignment of requirements for subsequent issuances of CET1 and AT1 instruments

3.16 The changes made by CRR II to CET1 subsequent issuances, outlined in paragraph 3.12 above, mean that the current notification regime for AT1 subsequent issuances would be more restrictive than that for CET1. This would be disproportionate given that CET1 is the highest quality capital and as such the potential ineligibility of an instrument is likely to present the most prudential risk. Taken together with our proposed changes to the Tier 2 regime (below at paragraphs 3.20 – 3.24 of this CP), maintaining the current regime for AT1 repeat issuances would also add complexity to the PIN regime in that there would be different requirements for each tier of capital.

3.17 The PRA proposes that the requirements for subsequent issuances of CET1 and AT1 instruments should be aligned, as set out in Table 1 below and reflected in the proposed amendments to the PRA rules in Appendix 1. 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). This proposal is 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.

3.18 The PRA has observed that some debt programmes permit substantial variation in the terms of AT1 instruments (including different trigger points for conversion/write-down). For that reason, the PRA proposes to remove the existing reference to note issuance programmes (NIPs).[11] This change is for clarification only as the current rules make no distinction in practice between a standalone issuance and issuance via a NIP.

Interpretation of CRR II terms

3.19 The PRA proposes to clarify in SS7/13 its interpretation of two terms introduced to Article 26(3) (ie 'substantially the same' and 'sufficiently in advance'). This is to ensure common understanding of notification requirements in relation to subsequent issuances of previously approved CET1 and AT1 instruments. The proposed clarification is set out in Table 1 below and in Chapter 9 of Appendix 2.

11 Definition of Capital 7.1.

Table 1: Interpretation of CRR II terms

Term	CET1	AT1
'Sufficiently in advance'	By the day of issuance at latest	By the day of issuance at latest
'Substantially the same'	Includes instruments issued on identical terms. Excludes issuances with: • any changes to those provisions governing voting rights, maturity, subordination, or distributions; or any features that might be considered a barrier to recapitalisation; • material changes to any other provisions governing the instrument; • new or amended side agreements which were not considered in the PRA's initial assessment.	Includes instruments which are identical other than with respect to the (i) issue date; (ii) amount of issuance; (iii) currency; and (iv) interest rate.

Post-notification regime for Tier 2 instruments

3.20 The PRA proposes to remove the requirement for firms to notify the PRA in advance of issuing T2 instruments. The PRA considers that it is appropriate to concentrate its limited resources on proposed CET1 and AT1 instruments, as this is where there has been more innovation and where the PRA considers that the prudential risk associated with eligibility criteria is higher. Tier 2 instruments do not contribute to going concern loss absorbency.

3.21 However, the PRA proposes to review T2 instruments through an ex-post sampling approach. To ensure that the PRA has necessary information for such ex-post assessments, the PRA proposes to retain a post-notification requirement for T2 instruments as follows:

- Firms would continue to submit a PIN form, final terms and conditions, and final independent legal opinion on or immediately after the date of a new issuance. For avoidance of doubt, there would no longer be any requirement to submit draft versions of the terms and conditions, or a draft independent legal opinion in advance of the new issuance.

- Similar to the proposed changes in respect of CET1 and AT1 instruments set out at paragraphs 3.16 – 3.18 of this CP, the PRA also proposes that a new independent legal opinion should not be required for subsequent issuances of T2 instruments where the terms are identical except for: i) issue date; ii) maturity date; iii) amount; iv) currency; and v) rate of interest.

3.22 The proposals regarding T2 instruments are reflected in proposed amendments to the PRA rules and SS7/13, as set out in Appendices 1 and 2. These proposals would result in a reduction in the documentation required from firms and in greater flexibility (in that one month advance notice would no longer be required). At the same time, they would ensure that the PRA possesses sufficient information to conduct ex-post reviews in accordance with a sampling process.

3.23 The proposals are intended to ensure the PRA is taking a proportionate approach to assessing the quality of firms' capital instruments and to reduce the burden both on firms and on the PRA.

Notification of amendment to the terms of an existing capital instrument

3.24 Current PIN rules do not specify the information that a firm should submit when it notifies the PRA of its intention to amend the terms of an existing instrument. The PRA proposes to clarify that firms must submit all relevant documentation alongside their notification, as set out in Table 2 below and reflected in the proposed amendments to the PRA rules in Appendix 1. This would ensure that the PRA has the information needed to ascertain the instrument's continued eligibility and make the process more efficient.

Table 2: Required documentation and notice period for pre- and post-issuance notifications

	Common Equity Tier 1	Additional Tier 1	Tier 2
Pre-notification of new capital instrument, or amendment of terms of existing capital instrument			No pre-notification for Tier 2
Notice period *	at least one calendar month before intended date of issuance, more time for complex structures (see SS7/13)	at least one calendar month before intended date of issuance, more time for complex structures (see SS7/13)	
Documents	• PIN form	• PIN form	
	• draft terms and conditions together with any side agreement	• draft terms and conditions together with any side agreement	
	• draft independent legal opinion	• draft independent legal opinion	
	• CET1 compliance template	• draft accounting opinion by auditors (as to the treatment under the applicable accounting framework)	
Pre-notification of subsequent issuance of previously issued form of capital instrument			
Notice period	sufficiently in advance (see SS7/13)	sufficiently in advance (see SS7/13)	
Documents	• PIN form	• PIN form	
	• terms and conditions together with any side agreement	• terms and conditions together with any side agreement	
	• written confirmation of substantially the same terms (see SS7/13)	• written confirmation of substantially the same terms (see SS7/13)	
	• written confirmation of CET1 eligibility	• written confirmation of AT1 eligibility	
Submission of final documents on new issuance, amendment, or variation			**Post-notification of new and subsequent issuance, amendment, or variation**
Notice period	on or immediately after issuance, amendment, or variation	on or immediately after issuance, amendment, or variation	on or immediately after issuance, amendment, or variation
Documents	• terms and conditions together with any side agreement	• terms and conditions together with any side agreement	• terms and conditions together with any side agreement
	• independent legal opinion	• independent legal opinion	• independent legal opinion (unless subsequent issuance on terms which are substantially the same; see SS7/13)
		• accounting opinion by auditors (as to the treatment under the applicable accounting framework)	• PIN form

* unless there are exceptional circumstances which make it impracticable to give such a period of notice, in which event the firm must give as much notice as is reasonably practicable in those circumstances

Amend the CRR PIN form to require certain key information on the proposed instrument

3.25 The PRA proposes a number of amendments to the CRR PIN form. This is in order to capture the information detailed below. The proposed amended PIN form is set out in Appendix 3.

3.26 The PRA proposes that the PIN form should be amended to request:

(a) information on the type and quantity of instrument, together with the nominal value per instrument and total amount raised;

(b) a copy of any side agreements and group structure chart;

(c) if a subsequent issuance:

(i) details of the issuance previously seen by the PRA;

(ii) confirmation as to whether the provisions governing the instrument are 'substantially the same' as those governing those issuance(s) previously seen by the PRA; and

(iii) a summary of any changes made to the provisions governing the instrument.

3.27 This information is essential for the PRA's assessment process. The information referred to in paragraph 3.26 (a) (ii) would be required if the proposal at paragraphs 3.16 – 3.18 above is implemented. The proposed amendments intend to promote greater consistency in the quality of responses from firms.

3.28 Firms are required, and will continue to be required under the current proposals, to notify the PRA following issuance of a capital instrument and to submit the final terms and conditions of the instrument.

Miscellaneous proposals

3.29 The PRA additionally proposes to:

- Correct minor errors and improve the readability of SS7/13.
- Correct minor errors and improve the readability of the PIN form and CET1 compliance template.
- Amend the Definition of Capital Part of the PRA Rulebook to:
    - introduce in Chapter 1 a definition of the term 'side agreement';
    - delete redundant text from Chapters 2 and 11 where the PRA had set out the way in which it chose to exercise its discretion in previous years under the relevant CRR articles. The redundant text will still be accessible using the 'View Rulebook as at' functionality of the online Rulebook;[12]
    - delete Chapter 8, which will now be incorporated into Chapters 7A, 7B, and 7C for the sake of clarity. The redundant text will still be accessible using the 'View Rulebook as at' functionality;
    - delete Chapter 9 which the PRA considers redundant given that the requirements of CRR articles 77 and 78 are directly applicable, and the CRR permission requirement is

12 http://www.prarulebook.co.uk.

already covered in the Permissions Part of the PRA Rulebook. The redundant text will still be accessible using the 'View Rulebook as at' functionality; and

- reflect the proposed change from a pre-issuance notification regime to a pre- or post-issuance notification regime (further to the proposal at paragraphs 3.20 – 3.23 above).

4 The PRA's statutory obligations

4.1 In carrying out its policy making functions, the PRA is required to comply with several legal obligations.

4.2 Before making any rules, the Financial Services and Markets Act 2000 (FSMA)[13] requires the PRA to publish a draft of the proposed rules accompanied by:

- a cost benefit analysis;
- an explanation of the PRA's reasons for believing that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective,[14] insurance objective[15] (if applicable), and secondary competition objective;[16]
- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles;[17] and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.[18]

4.3 The Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury.[19]

4.4 The PRA is also required by the Equality Act 2010[20] to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.

Cost benefit analysis

4.5 The PRA considers that the net effect of the proposals is a reduction in regulatory burden on firms without a reduction in the prudential benefits of the PIN process. The proposals that the PRA no longer be given the opportunity to comment on T2 instruments prior to issuance, to no longer require a legal and/or accounting opinion for subsequent issuances of AT1 and Tier 2 on identical terms, and to align the requirements for repeat issuances of CET1 and AT1 instruments in particular would result in a reduction in the volume of documentation the firm would need to share with the PRA and would grant firms additional flexibility in the timing of issuances. Conversely, the proposal to require firms to obtain an independent legal opinion before issuing a new CET1 instrument would

13 Section 138J of FSMA.
14 Section 2B of FSMA.
15 Section 2C of FSMA.
16 Section 2H(1) of FSMA.
17 Sections 2H(2) and 3B of FSMA.
18 Section 138K of FSMA.
19 Section 30B of the Bank of England Act 1998.
20 Section 149.

involve some increase in costs for affected firms. The PRA considers that the benefits of simple, fully loss-absorbing capital structures outweighs the cost of obtaining such a legal opinion.

4.6 Revisions to SS7/13 would clarify the PRA's expectations on governance, particularly of CET1 issuance with complex feature(s), and timing aspects of PIN submissions. This additional clarity should result in a more efficient process.

4.7 The intention of the PRA is to ensure that the PIN regime is risk-sensitive and proportionate, such that PRA resources are focused on the assessment of capital instruments which have the potential to cause the greatest amount of prudential risk.

Compatibility with the PRA's objectives

4.8 The proposals in this CP aim to enhance and maintain the quality of firms' capital resources with an appropriately targeted focus on CET1 which is the highest quality element of the capital structure. The proposals also set out the PRA's expectations of relevant senior management in ensuring the quality of capital resources particularly if a firm wishes to use one or more complex features in its CET1 capital. Firms' compliance with these proposals, once finalised, will contribute to their safety and soundness.

4.9 The PRA has assessed whether the proposals in this CP facilitate effective competition. As noted in paragraph 4.5 above, the proposal to require firms to obtain an independent legal opinion before issuing a new CET1 instrument would involve some increase in costs for affected firms. There could be a negative impact on competition as larger firms will be better able to absorb these costs. However, the PRA does not expect the scale of any cost increase, even to smaller firms, to be sufficiently large to have a material impact on competition.

Regulatory principles

4.10 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. Three of the principles are of particular relevance.

4.11 The principle that a burden or restriction which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of that burden: the PRA has followed this principle when developing the proposals outlined in this CP. For example, the PRA's proposal to require firms to obtain an independent legal opinion before issuing a new form of CET1 instrument will increase the burden on firms. The PRA considers that the benefit, in terms of independently assessing the quality of firms' highest quality capital instruments, outweighs the cost of obtaining such opinions. In addition, the PRA's proposals to remove Tier 2 from pre-issuance notification requirements and to align the notification requirements for subsequent issuances of AT1 instrument to that of CET1 instrument should reduce burden and allow firms greater flexibility to manage their capital resources.

4.12 The principle of senior management's responsibility in relation to compliance: the PRA has followed this principle in proposing to clarify the involvement of individuals performing Senior Management Functions in relation to ensuring the quality of firms' capital resources.

4.13 The principle that the PRA will use its resources in the most efficient and economic way: the PRA has followed this principle in proposing to remove the requirement to notify it of Tier 2 instruments pre-issuance. The PRA is also proposing to clarify the documents needed when firms notify the PRA about any amendments to the terms of existing capital instruments.

Impact on mutuals

4.14 The PRA considers that the impact of the proposed rule changes on mutuals will be no different from the impact on other types of firm.

HM Treasury recommendation letter

4.15 HM Treasury has made recommendations to the PRC about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.[21]

4.16 The aspects of the Government's economic policy most relevant to the proposals in this CP are:

(i) Competition.

(ii) Growth.

(iii) Competitiveness.

4.17 Aspect (i) and has been considered in the 'compatibility with the PRA's objectives' and 'regulatory principles' sections above. Where consideration has been given to the aspects that extend beyond the PRA's objectives and the regulatory principles, these are set out below.

4.18 Growth: The PRA proposals in this CP enhance safety and soundness of firms, which in turn should support sustainable and balanced growth.

4.19 Competitiveness: The proposals would increase transparency of the PRA's rules and expectations, which in turn should help maintain the UK as an attractive market for UK firms and subsidiaries of international financial institutions.

Equality and diversity

4.20 The PRA considers that the proposals do not give rise to equality and diversity implications.

21 Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at https://www.bankofengland.co.uk/about/people/prudential-regulation-committee.

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Appendix 1: Draft amendments to PRA Rulebook – Definition of Capital (CRR firms)

In this Appendix, new text is underlined and deleted text is struck through.

Part

DEFINITION OF CAPITAL

1 **APPLICATION AND DEFINITIONS**

…

1.2 In this Part the following definitions shall apply:

…

Side agreement means any document containing an agreement or other arrangement, including a proposed agreement or other arrangement, related to the capital instrument (whether or not explicitly referred to in the instrument) which could affect the assessment of compliance of the instrument with Part Two of CRR.

…….

2 HOLDINGS OF OWN FUNDS INSTRUMENTS ISSUED BY FINANCIAL SECTOR ENTITIES INCLUDED IN THE SCOPE OF CONSOLIDATED SUPERVISION

2.1 For the purposes of calculating *own funds* on an individual basis and a *sub-consolidated basis*, *firms* subject to supervision on a *consolidated basis* must deduct ~~at least the relevant percentage of~~ holdings of *own funds instruments* issued by *financial sector entities* included in the scope of consolidated supervision in accordance with Part Two of the *CRR*, except where the exception in 2.3 or 2.7 applies.

~~2.2 For the purposes of 2.1 the relevant percentage is as follows:~~

~~(1) 50% for the period from 1 January 2014 to 31 December 2014;~~

~~(2) 60% for the period from 1 January 2015 to 31 December 2015;~~

~~(3) 70% for the period from 1 January 2016 to 31 December 2016;~~

~~(4) 80% for the period from 1 January 2017 to 31 December 2017;~~

~~(5) 90% for the period from 1 January 2018 to 31 December 2018; and~~

~~(6) 100% for the period after 31 December 2018.~~

…

4 CONNECTED FUNDING OF A CAPITAL NATURE

…

4.5 A firm must report to the PRA all connected funding of a capital nature at least ~~30 days~~ one month in advance of entry into the relevant funding transaction and identify each relevant transaction with sufficient detail to allow the PRA to evaluate it.

…

4.11 For the purposes of 4.9(2), a person is an associate of a firm if it is:

…

(2) an appointed representative (in the sense of section 39 of FSMA) or tied agent (as described in Article 4(1)(~~25~~ 29) of MiFID) of the firm or a member of the firm's group; or

…

5 ~~CONNECTED TRANSACTIONS~~ SIDE AGREEMENTS

5.1 [Deleted]

5.2 A firm must ~~report~~ send to the PRA ~~all connected transactions described in 5.1~~ any side agreement not previously sent to the PRA and must do so at least one month ~~30 days~~ in advance of entry into the ~~relevant transaction~~ agreement ~~and identify each relevant transaction~~ together with ~~sufficient~~ sufficiently ~~detail~~ detailed information to allow the PRA to evaluate it.

6 ….

7 [DELETED]

7A PRE-ISSUANCE NOTIFICATION (PIN) REGIME FOR COMMON EQUITY TIER 1 INSTRUMENT

7A.1 Where a *firm,* or another member of its group that is not a firm but is included in the supervision on a consolidated basis of the *firm,* intends to-

(1) issue a capital instrument that it considers will qualify under Part Two of *CRR* as a Common Equity Tier 1 instrument; or

(2) amend or otherwise vary the terms of such an instrument included in its *own funds* or the *own funds* of its *consolidation group*;

the *firm* shall, at least one month before the intended date of issuance or intended date of amendment or variation, as applicable, notify the *PRA* of that intention, except that where there are exceptional circumstances which make it impracticable to give such a period of notice, the firm must give as much notice as is reasonably practicable in those circumstances.

7A.2 When notifying PRA under 7A.1 the *firm* must:

(1) complete and submit the form referred to in 7D.3(1) (Pre/Post-Issuance Notification (PIN) Form);

(2) provide a copy of the draft terms and conditions of the capital instrument together with any *side agreement*;

(3) provide a properly reasoned draft independent legal opinion from an appropriately qualified individual confirming that the capital instrument qualifies as a Common Equity Tier 1 instrument under Part Two of CRR; and

(4) complete and submit the form referred to in 7D.3(2) (CET1 Compliance Template).

7A. 3 Where a *firm* intends to make use of the derogation in the second subparagraph of Article 26(3) of the *CRR* 7A.1 shall not apply. The *firm* must instead send to the PRA at the same time as it sends the notification under point (b) of the second paragraph of Article 26(3)-

(1) written confirmation that the capital instrument-

(a) meets the condition in point (a) of the second subparagraph of Article 26(3) of *CRR*; and

(b) qualifies as a *Common Equity Tier 1 instrument* under Part Two of *CRR;*

(2) a completed form referred to in 7D.3 (1) (Pre/Post-Issuance Notification (PIN) Form;

(3) a copy of the terms and conditions of the instrument together with any *side agreement.*

7B PRE-ISSUANCE NOTIFICATION (PIN) REGIME FOR ADDITIONAL TIER 1 INSTRUMENT

7B.1 Where a *firm,* or another member of its group that is not a *firm* but is included in the supervision on a consolidated basis of the firm, intends to-

(1) issue a capital instrument that it considers will qualify under Part Two of CRR as an *Additional Tier 1 instrument*; or

(2) amend or otherwise vary the terms of such an instrument included in its *own funds* or the *own funds* of its *consolidation group;*

the firm shall, at least one month before the intended date of issuance or intended date of amendment or variation, as applicable, notify the PRA of that intention, except that where there are exceptional circumstances which make it impracticable to give such a period of notice, the firm must give as much notice as is reasonably practicable in those circumstances.

7B.2 When notifying *PRA* under 7B.1 the *firm* must:

(1) complete and submit the form referred to in 7D.3(1) (Pre/Post-Issuance Notification (PIN) Form);

(2) provide a copy of the draft terms and conditions of the capital instrument together with any *side agreement*;

(3) provide a properly reasoned draft independent legal opinion from an appropriately qualified individual confirming that the capital instrument qualifies as an *Additional Tier 1 instrument* under Part Two of *CRR*;

(4) provide a properly reasoned draft opinion by its auditors as to the capital instrument's treatment under the *applicable accounting framework*;

7B.3 Where a *firm* has previously complied with 7B.1 and 7B.2 in respect of the issuance of an *Additional Tier 1 instrument* and that *firm* or another member of its group that is not a firm but is included in the supervision on a consolidated basis of the *firm,* intends to issue a capital instrument on substantially the same terms as the previously notified issuance 7B.1 and 7B.2 shall not apply. In this case the *firm* shall instead:

(1) give the notice of the issuance to the *PRA* sufficiently in advance of the capital instrument's classification as an *Additional Tier 1 instrument*;
(2) send to the PRA written confirmation that the capital instrument will-

(a) be issued on substantially the same terms as the previously notified issuance; and
(b) qualify as an *Additional Tier 1 instrument* under Part Two of *CRR*;

(3) complete and submit the form referred to in 7D.3(1) (Pre/Post-Issuance Notification (PIN) Form);

(4) send to the *PRA* a copy of the terms and conditions of the instrument together with any *side agreement*.

7C POST ISSUANCE NOTIFICATION (PIN) REGIME FOR TIER 2 INSTRUMENT

7C.1 Where a *firm,* or another member of its *group* that is not a *firm* but is included in the supervision on a consolidated basis of the *firm*-

(1) has issued a capital instrument that it considers will qualify under CRR as a Tier 2 instrument; or

(2) has amended or otherwise varied the terms of a Tier 2 instrument included in its *own funds* or the *own funds* of its consolidation group;

the firm shall on or immediately after the date of issuance or the date of amendment or other variation, as applicable, notify the PRA of that issuance, amendment or variation.

7C.2 When giving notice under 7C.1 the *firm* must:

(1) complete and submit the form referred to in 7D.3(1) (Pre/Post Issuance Notification (PIN) Form;

(2) provide a copy of the terms and conditions of the capital instrument together with any *side agreement*; and

(3) provide a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the capital instrument qualifies as a Tier 2 instrument under Part Two of *CRR* .

7C.3 The requirement in 7C.2(3) for the provision of a legal opinion shall not apply where the issuance of the instrument is on substantially the same terms as a previously issued instrument notified under rule 7C.2.

7D FURTHER NOTIFICATIONS ETC.

7D.1 The *firm* shall immediately notify the *PRA* in writing of any change to the intended date of issue, type of investors, type of own funds instrument or any other feature of the capital instrument to that previously notified to the PRA under 7A to 7C.

7D.2 The *firm* shall on or immediately after the date of issuance or the date of amendment or other variation, as applicable, provide the *PRA* with a copy of the final terms and conditions, a copy of the final legal opinion referred to in 7A.2(3) and 7B.2(3) and if applicable the final accounting opinion referred to in 7.B2(4).

7D.3 (1) The Pre/Post Issuance Notification (PIN) Form can be found here:

[insert link]

(2) The CET1 Compliance Template can be found here:

[insert link]

8. [Deleted]

9. [Deleted]

11 TRANSITIONAL PROVISIONS FOR OWN FUNDS

~~11.1 The *Common Equity Tier 1 capital ratio* which *firms* must under Article 465(1)(a) of the *CRR* meet or exceed for the period from 1 January 2014 until 31 December 2014 shall be 4.0%.~~

~~**[Note: Art 465(1)(a) of the *CRR*]**~~

~~11.2 The *Tier 1 capital ratio* which *firms* must under Article 465(1)(b) of the *CRR* meet or exceed for the period from 1 January 2014 until 31 December 2014 shall be 5.5%.~~

~~**[Note: Art 465(1)(b) of the *CRR*]**~~

~~11.3 The applicable percentage for the purposes of Article 467(1) of the *CRR* shall be:~~

~~(1) 100% during the period from 1 January 2014 to 31 December 2014;~~

~~(2) 100% during the period from 1 January 2015 to 31 December 2015;~~

~~(3) 100% during the period from 1 January 2016 to 31 December 2016; and~~

~~(4) 100% for the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 467 of the *CRR*]**~~

~~11.4 The applicable percentage for the purposes of Article 468(1) of the *CRR* shall be:~~

~~(1) 0% during the period from 1 January 2015 to 31 December 2015;~~

~~(2) 0% during the period from 1 January 2016 to 31 December 2016; and~~

~~(3) 0% for the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 468(1)-(3) of the *CRR*]**~~

~~11.5 The applicable percentage for the purposes of Article 468(4) of the *CRR* shall be:~~

~~(1) 100% for the period from 1 January 2014 to 31 December 2014;~~

~~(2) 100% for the period from 1 January 2015 to 31 December 2015;~~

~~(3) 100% for the period from 1 January 2016 to 31 December 2016; and~~

~~(4) 100% for the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 468(4), 478(1) of the *CRR*]**~~

~~11.6 The applicable percentage for the purposes of Article 469(1)(a) of the *CRR* as it applies to the items referred to in points (a)-(b) and (d)-(h) of Article 36(1) shall be:~~

~~(1) 100% during the period from 1 January 2014 to 31 December 2014;~~

~~(2) 100% during the period from 1 January 2015 to 31 December 2015;~~

~~(3) 100% during the period from 1 January 2016 to 31 December 2016; and~~

~~(4) 100% for the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 469(1)(a), 478(1) of the *CRR*]**~~

…

~~11.8 The applicable percentage for the purposes of Article 469(1)(c) of the *CRR* as it applies to the items referred to in point (c) of Article 36(1) that did not exist prior to 1 January 2014 and the items referred to in point (i) of Article 36(1) shall be:~~

~~(1) 100% during the period from 1 January 2014 to 31 December 2014;~~

~~(2) 100% during the period from 1 January 2015 to 31 December 2015;~~

~~(3) 100% during the period from 1 January 2016 to 31 December 2016; and~~

~~(4) 100% for the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 469(1)(c), 478(1) of the *CRR*]**~~

~~11.9 The applicable percentage for the purposes of Article 474(a) of the *CRR* shall be:~~

~~(1) 20% during the period from 1 January 2014 to 31 December 2014;~~

~~(2) 40% during the period from 1 January 2015 to 31 December 2015;~~

~~(3) 60% during the period from 1 January 2016 to 31 December 2016; and~~

~~(4) 80% for the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 474(a), 478(1) of the *CRR*]**~~

~~11.10 The applicable percentage for the purposes of Article 476(a) of the *CRR* shall be:~~

~~(1) 20% during the period from 1 January 2014 to 31 December 2014;~~

~~(2) 40% during the period from 1 January 2015 to 31 December 2015;~~

~~(3) 60% during the period from 1 January 2016 to 31 December 2016; and~~

~~(4) 80% for the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 476(a), 478(1) of the *CRR*]**~~

~~11.11 The applicable percentage for the purposes of Article 479(2) of the *CRR* shall be:~~

~~(1) 0% for the period from 1 January 2014 to 31 December 2014;~~

~~(2) 0% for the period from 1 January 2015 to 31 December 2015;~~

~~(3) 0% for the period from 1 January 2016 to 31 December 2016; and~~

~~(4) 0% for the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 479 of the *CRR*]**~~

~~11.12 The applicable factor for the purposes of Article 480(1) of the *CRR* as it applies to point (b) of Article 84(1) shall be:~~

~~(1) 1 in the period from 1 January 2014 to 31 December 2014;~~

~~(2) 1 in the period from 1 January 2015 to 31 December 2015;~~

~~(3) 1 in the period from 1 January 2016 to 31 December 2016; and~~

~~(4) 1 in the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 480 of the *CRR*]**~~

~~11.13 The applicable factor for the purposes of Article 480(1) of the *CRR* as it applies to point (b) of Article 85(1) and point (b) of Article 87(1) shall be:~~

~~(1) 0.2 in the period from 1 January 2014 to 31 December 2014;~~

~~(2) 0.4 in the period from 1 January 2015 to 31 December 2015;~~

~~(3) 0.6 in the period from 1 January 2016 to 31 December 2016; and~~

~~(4) 0.8 in the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 480 of the *CRR*]**~~

~~11.14 The applicable percentage for the purposes of Article 481(1) of the *CRR* shall be:~~

~~(1) 0% for the period from 1 January 2014 to 31 December 2014;~~

~~(2) 0% for the period from 1 January 2015 to 31 December 2015;~~

~~(3) 0% for the period from 1 January 2016 to 31 December 2016; and~~

~~(4) 0% for the period from 1 January 2017 to 31 December 2017.~~

~~**[Note: Art 481 of the *CRR*]**~~

…

Appendix 2: Draft amendments to Supervisory Statement 7/13 'Definition of capital (CRR firms)'

In this Appendix, new text is underlined and deleted text is struck through. The title of the Supervisory Statement has been changed from 'CRD IV and capital'.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Supervisory Statement | SS7/13

Definition of capital (CRR firms) ~~CRD IV and capital~~

1 Introduction

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

1.2 It sets out the Prudential Regulation Authority's (PRA's) expectations on the quality of regulatory capital resources that firms are required to hold, under CRD and the CRR. This statement complements the requirements set out in Part 2 of the CRR, in the Capital rules of the PRA Rulebook and the high-level expectations on capital as outlined in 'The PRA's approach to banking supervision'.[1]

2 Quality and composition of capital

2.1 As set out in 'The PRA's approach to banking supervision', the PRA expects the most significant part of a firm's capital to be ordinary shares and reserves. These are the highest-quality form of capital, as they allow firms to absorb losses unambiguously on a going concern basis.

2.2 When assessing firms, the PRA will be mindful of the fact that quality of capital is not purely about whether a firm meets each sub-tier of the capital rules. For example, even if two firms have identical Common Equity Tier 1 (CET1) positions, the PRA may view the quality of their capital differently due to the nature of the items underlying their CET1 position.

2.3 As set out in 'The PRA's approach to banking supervision', the PRA also expects firms to comply with the clearly stated internationally agreed criteria around the definition of capital, in spirit as well as to the letter, when structuring capital instruments. ~~This includes an expectation that firms ensure their marketing of proposed capital instruments does not undermine their compliance with the spirit of these criteria.~~ CRR II (Article 79a) requires that institutions have regard to the substantial features of instruments and consider all arrangements related to the instruments to determine that the combined economic effects of such arrangements are compliant with the objective of the relevant provisions.

2.4 With that purpose in mind, the PRA's preference is for firms to adopt simple, plain vanilla CET1 share structures consisting of only one class of share that is fully subordinated to all other capital and debt, that has full voting rights and equal rights across all shares with respect to dividends and rights in liquidation. The PRA expects firms to refrain from ~~innovation to structure new~~ features that ~~capital instruments if these~~ may be ineffective (or less effective) in absorbing losses. For the avoidance of doubt, this expectation also applies to Additional Tier 1 (AT1) and Tier 2 capital instruments. For example, the PRA would expect firms to refrain from complex CET1 share structures, including transactions involving several legs or side agreements, where the same prudential ~~aim~~ objective can be achieved more simply. Complex features and structures complicate the prudential assessment and may also undermine instruments' loss-absorbing properties and CRR compliance. Complexity can arise, for instance, when CET1 shareholders have different rights and entitlements, including preferential realisation provisions or other features that guarantee a distribution to CET1 shareholders.

2.5 The PRA expects the relevant Senior Management Function (SMF) to take responsibility for ensuring the quality of the capital structure overall, including signing off notifications to the PRA

1 https://www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-approach-documents-2018.

under Definition of Capital 7. In a relatively rare case where it may be necessary for a firm to include complex feature(s) in its CET1 instruments, the PRA expects the relevant SMF to inform the firm's board in advance of issuance, evidencing why the instrument cannot be issued without the proposed complex feature(s) and that, notwithstanding the proposed complexity, they consider the instrument compliant with the objective of the CRR. For the purpose of this paragraph and paragraph 2.6, the relevant SMF means the individual with:

(a) responsibility for managing the allocation and maintenance of the firm's capital, funding and liquidity (Allocation of Responsibilities 4.1(7) – PR O); or

(b) responsibility for managing the firm's financial resources (Allocation of Responsibilities 5.2(5) – PR CC) (small firms only).

2.6 The PRA expects the SMF's proposal, in turn, to be subject to appropriate board-level review and discussion and the board should consider and suggest ways to minimise any proposed complexity. In cases where the board does adopt the SMF's proposal and complex features are included in CET1 instruments, notwithstanding the PRA's preference for simplicity (paragraph 2.4), the PRA expects the board to discuss whether the continued inclusion of the complex features within the share structure is necessary, at least annually as part of its Internal Capital Adequacy Assessment Process (ICAAP).[2] The PRA also expects firms to try to simplify the structure where possible.

3 Additional Tier 1 Triggers

3.1 CRR requires AT1 instruments to contain a trigger of at least 5.125% CET1, but allows firms to select a higher trigger. It also recognises that the terms of an AT1 instrument may provide for a write-down that is either temporary or permanent, and that the amount converted or written down may be limited to that necessary to restore the firm's CET1 ratio to 5.125% or may be greater.

3.2 Depending on the circumstances, an instrument with a trigger of 5.125% CET1 may not convert in time to prevent the failure of a firm. A temporary write-down may make it more difficult for the firm to re-establish its capital position following a stress. Also, conversion or write-down that only restores the firm's CET1 ratio to 5.125% may leave the firm close to a second trigger event. Firms will wish to consider these factors when deciding how to exercise the choices available to them under CRR. The PRA expects to discuss with firms their analysis on features of draft capital instruments that they submit for our review.

4 Preference

4.1 Where possible, the PRA expects firms to meet their CET1 requirements entirely with voting common shares and associated reserves. The PRA strongly discourages firms from including non-voting shares in CET1, particularly if such shares have higher dividends than common shares. The main reason for the PRA's concern is that it is imperative that the composition of a firm's CET1 is as straightforward and transparent as possible. There should also be no doubt that a firm's CET1 only

2 See: PRA Supervisory Statement SS31/15, 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)', November 2018: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2018/ss3115update-november-2018.pdf?la=en&hash=C4AB250282852FA5D2A5894FBDB81F8E66EC12DB

includes the highest quality capital. The inclusion of instruments other than voting common shares in CET1 could lead to concerns that such instruments may not have the same capital quality.

5 Subordination, remedies, events of default and set-off

5.1 Under CRR, all regulatory capital must be capable of absorbing losses either on a going or gone concern basis. Therefore, all capital instruments as a minimum must be subordinated to all senior creditors, including depositors. In particular, building societies must ensure that any capital instruments issued by them are subordinated to ~~retail depositors~~ non-deferred shares (as per the rule in Definition of Capital 10.2).

5.2 It is also important that subordination is not made less effective by granting additional rights to holders of subordinated instruments for example in respect of events of default, remedies and rights of set-off. The PRA expects events of default to be restricted to non-payment of any amount falling due under the terms of the instrument or on the winding-up of the firm. This ensures that the subordinated creditor cannot force early repayment while the issuer may still be technically solvent. This is important so as not to hinder the efforts of the authorities in the context of recovery or resolution actions in relation to the issuer.

5.3 In the event that default occurs, the PRA expects remedies to be restricted, to the fullest extent permitted under the laws of the relevant jurisdictions, to petitioning for the winding-up of the firm or proving for the debt in liquidation or administration. Limiting remedies in this way prevents holders of subordinated instruments using other remedies to receive payment, potentially ahead of senior creditors. The expectations set out for restrictions on remedies are not intended to capture remedies for breaches of contract that do not relate to payment obligations, ie remedies that are not available for failure to pay any amount of principal, interest, expenses or in respect of any other payment obligation. Further, any damages or repayment obligation (arising, for example, because remedies could not be limited under applicable law) must be subordinated in accordance with the normal ranking of the instrument in insolvency.

5.4 Also, to the fullest extent permitted under the laws of the relevant jurisdictions, the PRA expects subordinated creditors to waive any rights to set off amounts they owe the issuer against subordinated amounts owed to them by the issuer. Waiving rights of set-off helps to maintain the creditor hierarchy so that subordinated creditors are not treated in the same way as senior creditors.

6 Regulatory capital and subordinated swaps

6.1 CRR requires that the full amount of regulatory capital is subordinated. If a firm chooses to hedge the valuation volatility associated with a capital instrument that it has issued under fair value hedge accounting, then to maintain consistency with the CRR capital regime the PRA expects the hedging instrument also to be subordinated. For example, if the value of a subordinated debt instrument falls from 100 to 90, then the hedge must also be subordinated in order to continue to count 100 of subordinated debt as regulatory capital. If the hedge is not subordinated, then only 90 of subordinated debt would be eligible to count as regulatory capital. This is because the ten contributed by the swap would not be subordinated and therefore would not meet the minimum eligibility criteria specified in CRR.

7 Significant insurance holdings

7.1 As announced in the PRA statement on 29 June 2013 and reiterated in CP5/13, the PRA requires firms to follow the default position in CRR Article 49(1). Firms are therefore required to deduct holdings of own funds instruments issued by an insurer in which the firm has a significant investment.

7.2 For the purposes of valuation, the PRA considers that the embedded value method is not appropriate for determining the value of firms' significant insurance holdings. This is because the embedded value method could have the effect of inflating banks' CET1 as it takes into account the present value of the expected future inflows from existing life assurance business.

8 Connected funding of a capital nature (CFCN)

8.1 Chapter 4 of the PRA's Definition of Capital rules states that firms must treat all CFCN as a holding of capital of the connected party and apply to it the treatment under the CRR applicable to such a holding. The CFCN rule applies on an ongoing basis. Therefore where a loan initially falls outside the definition of CFCN but later falls into it, the appropriate capital treatment should be applied immediately and the PRA should be notified. For example, if the initial lending to a connected party is subsequently downstreamed to another connected party, the relationship between the bank and the ultimate borrower may be such that, looking at the arrangements as whole, the entity to which the bank lends is able to regard the loan as being capable of absorbing losses.

8.2 Banks should take account of contractual, structural, reputational or other factors when determining whether a transaction is a CFCN.

8.3 Lending to a connected party will not normally be considered CFCN where that party is acting as a vehicle to pass funding to an unconnected party and has no other creditors whose claims could be senior to those of the lender.

8.4 Additionally, for connected parties within the same consolidation group, it is likely that a loan is not CFCN if:

(c) it is secured by collateral that is eligible for the purposes of credit risk mitigation under the standardised approach to credit risk; or

(d) it is repayable on demand (and is treated as such for accounting purposes by the borrower and lender) and the bank can demonstrate that there are no potential obstacles to exercising the right to repay, whether contractual or otherwise.

9 Pre/post-issuance notification (PIN) requirements

9.1 Firms are required to notify the PRA at least one month before the intended date of issuance or amendment or variation to the terms of each CET1 or AT1 capital instrument, and immediately after issuing or amending or varying the terms of each Tier 2 capital instrument, that will count towards

regulatory capital resources or own funds, either at solo, sub-consolidated or group consolidated level or any combination of these.[3]

9.2 CRR II allows a firm to count any subsequent issuances of a form of CET1 instrument for which it has already received the PRA's permission (pursuant to CRR Article 26(3) (as amended)) towards its CET1 capital provided the conditions set out in the second subparagraph of the amended Article 26(3) are met. CET1 issuances whose terms and conditions (including any side agreements) are identical to those of an issuance for which a firm has already received permission would satisfy the conditions for being 'substantially the same' as the previous issuance. For subsequent issuances of CET1 instruments on such identical terms, firms may notify the PRA no later than the intended date of the subsequent issuance.

9.3 However, a CET1 issuance will normally not be considered substantially the same as a previous issuance if:

(a) there are any changes to provisions governing voting rights, maturity, subordination, or distributions; or any features that might be considered a potential barrier to recapitalisation;

(b) there are material changes to other provisions governing the instrument; or

(c) the transaction involves new or amended side agreements which were not considered in the PRA's previous assessment.

9.4 In any such cases, firms should notify the PRA at least one month in advance of the intended date of issuance. The PRA is likely to need more time to review a notified instrument with complex feature(s) (as set out in paragraphs 2.3 to 2.5 above). The PRA expects the firm to engage with its usual supervisory contact as early as possible (for example, once the relevant terms and conditions including any side agreements are drafted) with a clear explanation of how the proposed features comply with the letter and objective of the relevant CRR requirements, the PRA's rules and the PRA's supervisory expectations.

9.5 Similarly, a firm may count subsequent issuances of a form of AT1 instrument which was notified and assessed under Definition of Capital 7B.1 towards its AT1 capital provided that the AT1 instrument will be issued on substantially the same terms as the previously notified issuance. The PRA considers an AT1 instrument to be substantially the same if its terms and conditions (including any side agreements) are identical to a previous AT1 instrument except for the issue date, the amount of issuance, the currency of issuance or the rate of interest payable by the issuer. For subsequent issuances of AT1 instruments on such terms, firms may notify the PRA no later than the intended date of the subsequent issuance. In all other cases, the PRA expects firms to notify the PRA at least one month in advance of the intended date of issuance.

9.6 For issuances of Tier 2 instruments, firms need not submit a legal opinion provided that the Tier 2 instrument was issued on substantially the same terms as the previously notified issuance. Similar to AT1 instruments, the PRA considers a Tier 2 instrument to be substantially the same if its terms and conditions (including any side agreements) are identical to a previous Tier 2 instrument except

[3] Rules 7A to 7C of the PRA Rulebook require pre-issuance notification for CET1 and AT1 issuances, and post-notification for Tier 2 issuances.

for the issue date, the amount of issuance, the maturity, the currency of issuance or the rate of interest payable by the issuer.

9.7 The PRA expects the relevant SMF (as defined in paragraph 2.5) to ensure that the notified capital instrument complies with the letter and objective of the relevant CRR requirements, the PRA's rules and its supervisory expectations.

9.8 The PRA requires all new issuances of capital instruments to be accompanied by an independent legal opinion to confirm the instrument's eligibility as a capital instrument. We expect the legal opinions to explain how the instrument complies with the respective CRR eligibility criteria, including the CRR Article 79a requirement that the combined economic effect of the substantial features of instruments and all arrangements related to the instruments are compliant with the objective of the CRR eligibility requirements.

9.9 The PRA may ask firms to provide additional information, for example in case of an incomplete notification or unclear terms and conditions or changes to terms and conditions during the assessment period, which is likely to delay the PRA's assessment beyond the normal one month period. The PRA reserves the right to review any capital instrument at any time – particularly in light of international policy development or lessons learnt from its own assessments.

Appendix 3: Draft amendments to PIN form

In this Appendix, new text is underlined and deleted text is struck through.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Prudential Regulation Authority (PRA) – Pre- / Post-Issuance Notification (PIN) form for CRR firms[1]

Notification to the PRA of ~~planned~~ issuance of a regulatory capital instrument

Please send completed form to CRRFirms.regulatorycapital@bankofengland.co.uk. Submission only to your PRA supervisory contact does not constitute the required notice.

1.	*Name and, where applicable, Firm Reference Number (FRN) of the issuer:*	
2.	*Proposed tier of capital (Common Equity Tier 1, Additional Tier 1 or Tier 2):*	
3.	*Reason(s) for the issuance of the capital instrument:*	
4.	*(For CET1 or AT1 instruments only) Is this a notification of a new issuance, or of a subsequent issuance for which notification has previously been provided to the PRA?*	*If this is a notification of a subsequent issuance, please specify:* *5.1 When the notification of the initial new issuance was provided to the PRA.* *5.1.1. For CET1 instruments, please specify the number of the written permission notice.* *5.1.2. For AT1 instruments, please provide email confirmation of the previous notification to the PRA.* *5.2. Whether the provisions governing the issuance are 'substantially the same'[2] as the provisions governing those issuances for which notification has previously been provided to the PRA? [Yes/No]* *5.3 A summary of any and all changes to the provisions governing the instrument(s).*

1 Rules 7A, 7B and 7C of the Definition of Capital part of the PRA Rulebook require pre-issuance notification for CET1 and AT1 issuances, and post-issuance notification for Tier 2 issuances.
2 See Supervisory Statement 7/13, paragraphs 9.3 and 9.5,

5. *(For CET1 or AT1 instruments only) Is this a notification of amendment to an existing capital instrument?*	*If yes, please provide a summary of the key amendments.*
6. *Pursuant to paragraphs 2.4 to 2.6 of PRA supervisory statement 7/13, would this constitute a complex capital structure or feature? If so has the firm's board been informed of and discussed the need for this structure/feature and considered ways to minimise the complexity?*	
7. *Position of the issuer within the group (Please attach a current group structure chart and, if the group structure will change, the intended group structure post issuance)*	
8. *At what level is the regulatory capital proposed to be included (individual/sub-consolidated/group consolidation; or a combination of these):*	
9. *Will the capital instrument be issued externally or intra-group?* • *If external, please describe the targeted investor group (if known) or a description of likely investors.* • *If intra-group, please specify the entity and describe how the purchase of the capital instrument will be funded.*	*If external, please describe the targeted investor group (if known) or a description of likely investors.* *If intra-group, please specify the entity and describe how the purchase of the capital instrument will be funded.*
10. *(For proposed AT1 issuances only) If the proposed tier of capital is Additional Tier 1, p Please state whether it will be accounted for as an equity instrument or debt instrument under the applicable accounting framework.* *(Please provide (in accordance with 7.3(4) of Definition of Capital) a draft of a properly reasoned opinion by your auditor):*	
11. *Proposed date of issue or amendment (or, for T2 instruments, actual date):*	
12. *Please specify:* *12.1 the type of the instrument (e.g. ordinary shares; core capital deferred shares; CoCos; subordinated debt);* *12.2 the number of instruments to be issued;* *12.3 the nominal value of the instrument; and* *12.4 the (expected) total amount to be raised from the proposed issuance.*	
13. Proposed currency and amount (or approximation) to be issued):	

14. Is the capital instrument compliant with the relevant provisions of the Capital Requirements Regulation (EU) No 575/2013 and Commission Delegated Regulation (EU) 241/2014 as amended (including by Regulation (EU) No 2019/876 of the European Parliament and of the Council of 20 May 2019), and any other relevant binding technical standard and any successor regulation?	

~~Please note that your submission is incomplete unless you have included the following:~~

~~- A completed PIN form for CRR firms;~~
~~- A copy of the draft terms and conditions of the proposed capital instrument;~~
~~- For any item intended for inclusion Additional Tier1 or Tier 2 capital, a draft of a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification as Additional Tier 1 or Tier 2 capital (in accordance with 7.3(3) of Definition of Capital);~~
~~- For any item intended for inclusion within Common Equity Tier 1 capital, a Common Equity Tier 1 compliance template completed by an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification as Common Equity Tier 1 capital (in accordance with 7.4 of Definition of Capital); and~~
~~- For any item intended for inclusion within Additional Tier 1 capital, a draft of a properly reasoned opinion by your auditor (in accordance with 7.3(4) of Definition of Capital).~~
~~- For any item intended for inclusion within Additional Tier 1 capital a written statement confirming compliance with art. 52(1) (a),(b) and (c) CRR and for any item intended for inclusion within Tier 2 capital a written statement confirming compliance with art. 63 (a),(b) and (c) CRR.~~

Please include the following in your submission:

- A completed PIN form for CRR firms;
- A copy of the (draft/final) terms and conditions of the proposed capital instrument, and any side agreements; and
- A current and/or an intended group structure chart.

Where applicable, please also provide[3]:

- *For pre-issuance notification of Common Equity Tier 1 instruments:*
  - A Common Equity Tier 1 compliance template completed by an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification as Common Equity Tier 1 capital (in accordance with 7A.2(4) of Definition of Capital)

3 Please provide information in accordance with the notification requirements for new or subsequent issuances of own funds instruments, as set out in Chapters 7A, 7B, and 7C of the Definition of Capital Part of the PRA Rulebook.

- A draft properly reasoned independent legal opinion from an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification as CET 1 (in accordance with 7A.2(3) of Definition of Capital).

- *For pre-issuance notification of Additional Tier 1 instruments:*
  - A written statement confirming compliance with Art. 52(1)(a), (b), and (c) CRR.
  - A draft properly reasoned opinion by your auditor (in accordance with 7B.2(4) of Definition of Capital).
  - A draft properly reasoned independent legal opinion from an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification as Additional Tier 1 (in accordance with 7B.2(3) of Definition of Capital).

- *For post-issuance notification of Tier 2 instruments:*
  - A final properly reasoned independent legal opinion from an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification as Tier 2 (in accordance with 7C.2 of Definition of Capital).

Declaration by a member of the senior management responsible for managing the firm's financial resources[4]:

I confirm that I have reviewed and assessed the capital instrument against the requirements for own funds in title one of part two of the Capital Requirements Regulation (EU) 575/2013 and Commission Delegated Regulation (EU) 241/2014, as amended (including by Regulation (EU) No 2019/876 of the European Parliament and of the Council of 20 May 2019)[5], and the related binding technical standards and any successor regulation.

I confirm that the information given in this form is accurate and complete and that the capital instrument meets the criteria for inclusion in the proposed tier of capital.

Signed (member of the senior management)

Name / position in firm / date

Note: The PRA understands that at the time firms provide notification (at least one month in advance of the intended issue date), they might be able to give only preliminary information about some details. In order to ensure that the PRA receives the necessary information to enable effective supervision, firms will need to provide final confirmation of any such matters no later than on the day that the instrument is issued. This will include details of the final amount and coupon.

[Date to be inserted]

4 A member to whom the prescribed responsibility set out in 4.1(7) or (where applicable) 5.2(5) has been allocated in accordance with the Allocation of Responsibilities Part of the PRA Rulebook.

5 Including CRR Art 79a requirements for institutions to have regard to the substantial features of instruments and not only their legal form when assessing compliance with the requirements in the Regulations.

Appendix 4: Draft amendments to CET1 compliance template

In this Appendix, new text is underlined and deleted text is struck through.

Common Equity Tier 1 compliance template

Complete ALL sections of this template, providing sufficient details and references to support your answers. An incomplete template or insufficient information provided would not constitute a complete notification and will not be processed by the PRA.

Section 1: Features of the issuer's capital structure

1. Describe the overall capital structure of the entity, including the below aspects: - Does the firm have only one class of ordinary share? - If there is more than one share class (including preference shares, if applicable), please list the different share classes and their regulatory classification (e.g. CET1 eligible, or non-regulatory capital). - Please provide a summary of the key rights and entitlements (e.g. voting rights, dividend rights, redemption rights, ranking in insolvency or liquidation etc.), and, if there are multiple share classes, how these rights and entitlements vary across share classes. - Please describe how the residual assets shall be distributed amongst different classes of shares in a winding up/liquidation.	
2. For the proposed CET1 instrument under this notification: a) Please provide the relevant details, e.g. nominal values, quantity, issue price etc.	
b) Is the proposed instrument redeemable solely at the option of the issuer? Is the instrument subject to redemption at a fixed date or a fixed price? If not, please describe.	

c) Are the proposed CET1 instruments the only and most deeply subordinated instrument in the creditor hierarchy in the event of insolvency or liquidation? If not, please describe.	
d) Are there any terms that may restrict the amount and/or timing of the dividend on this instrument, or other instruments? If so, please describe.	
e) Conversely, are there any terms of any other instruments that may restrict the amount and/or timing of the dividend on this instrument? If so, please describe.	
f) Is the instrument subject to any non-cash distributions? If so, you may consider the need to apply to the PRA for a permission under CRR Art 73(1).	
g) Is the instrument subject to any anti-dilution clauses (e.g. requiring the firm to issue additional shares to existing shareholder in case of any new issuances in the future)? If so, please describe.	
h) Do any features of the proposed CET1 instrument potentially hinder the ability of the firm to recapitalise in a period of stress?	

Section 2: CRR eligibility requirements for Common Equity Tier 1 capital

Please provide separately a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification as CET 1 under provisions of the Capital Requirements Regulation (EU) No 575/2013 (as amended, including by Regulation (EU) No 2019/876 of the European Parliament and of the Council of 20 May 2019), and any relevant provisions of the Commission Delegated Regulation (EU) 241/2014, and any successor regulation, in accordance with 7A.2(3) of Definition of Capital. Please have regard to any other relevant guidance, as well as the PRA's rules and supervisory expectations.	*[See enclosed draft/final legal opinion from xxx dated xxx]*

CRR provision	Terms & conditions	Articles of association	National regulation	Comments + reference to document(s)
Article 26				
3. Competent authorities shall evaluate whether issuances of CET1 instruments meet the criteria set out in Article 28 or, where applicable, Article 29. With respect to issuances after 28 June 2013, institutions shall classify capital instruments as Common Equity Tier 1 instruments only after permission is granted by the competent authorities, which may consult EBA.				
Article 27				
1. CET1 items shall include any capital instrument issued by an institution under its statutory terms provided that the following conditions are met:				
(a) the institution is of a type that is defined under applicable national law and which competent authorities consider to qualify as any of the following[1]: (i) a mutual; (ii) a cooperative society; (iii) a savings institution; (iv) a similar institution; (v) a credit institution which is wholly owned by one of the institutions referred to in points (i) to (iv) and has approval from the relevant competent authority to make use of the provisions in this Article, provided that, and for as long as, 100 % of the ordinary shares in issue in the credit institution are held directly or indirectly by an institution referred to in those points;				
(b) the conditions laid down in Articles 28 or, where applicable,				

[1] Please specify the type of institution. If institutions within (v), please provide additional information according to that number

~~Article 29, are met.~~				
~~Those mutuals, cooperative societies or savings institutions recognised as such under applicable national law prior to 31 December 2012 shall continue to be classified as such for the purposes of this Part, provided that they continue to meet the criteria that determined such recognition.~~				
~~**Article 28**~~				
~~1. Capital instruments shall qualify as CET1instruments only if all the following conditions are met:~~				
~~(a) the instruments are issued directly by the institution with the prior approval of the owners of the institution or, where permitted under applicable national law, the management body of the institution;~~				
~~(b) the instruments are paid up and their purchase is not funded directly or indirectly by the institution;~~				
~~(c) the instruments meet all the following conditions as regards their classification:~~				
~~(i) they qualify as capital within the meaning of Article 22 of Directive 86/635/EEC;~~				
~~(ii) they are classified as equity within the meaning of the applicable accounting framework;~~				
~~(iii) they are classified as equity capital for the purposes of determining balance sheet insolvency, where applicable under national insolvency law;~~				
~~(d) the instruments are clearly and separately disclosed on the balance sheet in the financial statements of the institution;~~				
~~(e) the instruments are perpetual;~~				
~~(f) the principal amount of the instruments may not be reduced or repaid, except in either of the~~				

~~following cases[2]:~~				
~~(i) the liquidation of the institution;~~				
~~(ii) discretionary repurchases of the instruments or other discretionary means of reducing capital, where the institution has received the prior permission of the competent authority in accordance with Article 77;~~				
~~(g) the provisions governing the instruments do not indicate expressly or implicitly that the principal amount of the instruments would or might be reduced or repaid other than in the liquidation of the institution, and the institution does not otherwise provide such an indication prior to or at issuance of the instruments, except in the case of instruments referred to in Article 27 where the refusal by the institution to redeem such instruments is prohibited under applicable national law;~~ ~~The condition laid down in point (g) of paragraph 1 shall be deemed to be met notwithstanding the provisions governing the capital instrument indicating expressly or implicitly that the principal amount of the instrument would or might be reduced within a resolution procedure or as a consequence of a write down of capital instruments required by the resolution authority responsible for the institution.~~				
~~(h) the instruments meet the following conditions as regards distributions:~~				
~~(i) there is no preferential distribution treatment regarding the order of distribution payments,~~				

~~2 The condition laid down in point (f) of paragraph 1 shall be deemed to be met notwithstanding the reduction of the principal amount of the capital instrument within a resolution procedure or as a consequence of a write down of capital instruments required by the resolution authority responsible for the institution~~

~~including in relation to other CET1 instruments, and the terms governing the instruments do not provide preferential rights to payment of distributions;~~ ~~For the purposes of point (h)(i) of paragraph 1, differentiated distributions shall only reflect differentiated voting rights. In this respect, higher distributions shall only apply to Common Equity Tier 1 instruments with fewer or no voting rights.~~				
~~(ii) distributions to holders of the instruments may be paid only out of distributable items;~~				
~~(iii) the conditions governing the instruments do not include a cap or other restriction on the maximum level of distributions, except in the case of the instruments referred to in Article 27;~~ ~~The condition laid down in point (h)(iii) of paragraph 1 shall be deemed to be met notwithstanding the instrument paying a dividend multiple, provided that such a dividend multiple does not result in a distribution that causes a disproportionate drag on own funds.~~				
~~(iv) the level of distributions is not determined on the basis of the amount for which the instruments were purchased at issuance, except in the case of the instruments referred to in Article 27;~~				
~~(v) the conditions governing the instruments do not include any obligation for the institution to make distributions to their holders and the institution is not otherwise subject to such an~~				

~~obligation;~~				
~~(vi) non-payment of distributions does not constitute an event of default of the institution;~~				
~~(vii) the cancellation of distributions imposes no restrictions on the institution;~~				
~~(i) compared to all the capital instruments issued by the institution, the instruments absorb the first and proportionately greatest share of losses as they occur, and each instrument absorbs losses to the same degree as all other CET1 instruments;~~[3]				
~~(j) the instruments rank below all other claims in the event of insolvency or liquidation of the institution;~~ ~~The condition set out in point (j) of the first subparagraph shall be deemed to be met, notwithstanding the instruments are included in AT1 or T2 by virtue of Article 484(3), provided that they rank pari passu.~~				
~~(k) the instruments entitle their owners to a claim on the residual assets of the institution, which, in the event of its liquidation and after the payment of all senior claims, is proportionate to the amount of such instruments issued and is not fixed or subject to a cap, except in the case of the capital instruments referred to in Article 27;~~				
~~(l) the instruments are neither secured nor subject to a guarantee that enhances the seniority of the claim by any of the following:~~ ~~(i) the institution or its subsidiaries;~~ ~~(ii) the parent undertaking of the institution or its subsidiaries;~~				

[3] ~~The conditions laid down in point (i) of paragraph 1 shall be deemed to be met notwithstanding a write down on a permanent basis of the principal amount of AT1 or T2 instruments~~

~~(iii) the parent financial holding company or its subsidiaries;~~ ~~(iv) the mixed activity holding company or its subsidiaries;~~ ~~(v) the mixed financial holding company and its subsidiaries;~~ ~~(vi) any undertaking that has close links with the entities referred to in points (i) to (v);~~				
~~(m) the instruments are not subject to any arrangement, contractual or otherwise, that enhances the seniority of claims under the instruments in insolvency or liquidation.~~				
~~The condition set out in point (j) of the first subparagraph shall be deemed to be met, notwithstanding the instruments are included in AT1 or T2 by virtue of Article 484(3), provided that they rank pari passu.~~				