

## Appendix 2

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Draft for consultation

## 1 Draft Glossary EU Exit instrument

### **PRA RULEBOOK: GLOSSARY (CAPITAL REQUIREMENTS DIRECTIVE V) (EU EXIT) INSTRUMENT 2020**

#### **Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) being the appropriate regulator within the meaning of the Financial Regulators’ Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (“the Regulations”), having carried out consultations pursuant to regulation 5 of the Regulations and with the approval of the Treasury to the following instrument, makes the instrument in exercise of the powers conferred by regulation 3 of the Regulations.

#### **Pre-conditions to making**

- B. A draft of this instrument has been approved by the Treasury, having been satisfied that it makes appropriate provision to prevent, remedy or mitigate any failure of retained EU law to operate effectively, or any other deficiency in retained EU law, arising from the withdrawal of the United Kingdom from the European Union.
- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

### **PRA Rulebook: Glossary (Capital Requirements Directive V) (EU Exit) Instrument 2020**

- D. The PRA makes the rules in the Annex to this instrument.

#### **Commencement**

- E. This instrument comes into force on IP completion day, as defined in the European Union (Withdrawal Agreement) Act 2020.

#### **Citation**

- F. This instrument may be cited as the PRA Rulebook: Glossary (Capital Requirements Directive V) (EU Exit) Instrument 2020.

**By order of the Prudential Regulation Committee**  
[DATE]

## Annex

### Amendments to the Glossary

In this Annex new text is underlined and deleted text is struck through.

...

#### ***Article 22(7) relationship***

means a relationship where undertakings are linked by a relationship within the meaning of Article 22(7) of Directive 2013/34/EU.

...

#### ***PRA approved parent holding company***

means ~~an EEA~~ a UK parent financial holding company or ~~EEA UK parent mixed financial holding company~~ that is approved under Part 12B FSMA.

#### ***PRA designated parent holding company***

means ~~an EEA~~ a UK parent financial holding company or ~~EEA UK parent mixed financial holding company~~ that is designated under Part 12B of FSMA.

#### ***PRA approved intermediate holding company***

means a financial holding company or mixed financial holding company within the meaning of points (20) and (21) respectively of Article 4(1) of the CRR that this not ~~an EEA~~ a UK parent financial holding company or ~~an EEA~~ a UK parent mixed financial holding company and that is approved under Part 12B of FSMA.

#### ***PRA designated intermediate holding company***

means a financial holding company or mixed financial holding company within the meaning of points (20) and (21) respectively of Article 4(1) of the CRR that this not ~~an EEA~~ a UK parent financial holding company or ~~an EEA~~ a UK parent mixed financial holding company and that is designated under Part 12B of FSMA.

## 2 Draft Arrangements, Processes and Mechanisms EU Exit instrument

### **PRA RULEBOOK: CRR FIRMS: ARRANGEMENTS, PROCESSES AND MECHANISMS (CAPITAL REQUIREMENTS DIRECTIVE V) (EU EXIT) INSTRUMENT 2020**

#### **Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) being the appropriate regulator within the meaning of the Financial Regulators’ Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (“the Regulations”), having carried out consultations pursuant to regulation 5 of the Regulations and with the approval of the Treasury to the following instrument, makes the instrument in exercise of the powers conferred by regulation 3 of the Regulations.

#### **Pre-conditions to making**

- B. A draft of this instrument has been approved by the Treasury, having been satisfied that it makes appropriate provision to prevent, remedy or mitigate any failure of retained EU law to operate effectively, or any other deficiency in retained EU law, arising from the withdrawal of the United Kingdom from the European Union.
- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

#### **PRA Rulebook: CRR Firms: Amendments, Processes and Mechanisms (Capital Requirements Directive V) (EU Exit) Instrument 2020**

- D. The PRA makes the rules in the Annexes to this instrument.

#### **Commencement**

- E. This instrument comes into force on IP completion day, as defined in the European Union (Withdrawal Agreement) Act 2020.

#### **Citation**

- F. This instrument may be cited as the PRA Rulebook: CRR Firms: Amendments, Processes and Mechanisms (Capital Requirements Directive V) (EU Exit) Instrument 2020

**By order of the Prudential Regulation Committee**  
[DATE]

## Annex A

### Amendments to the Group Risk Systems Part

In this Annex new text is underlined and deleted text is struck through.

#### 1 APPLICATION AND DEFINITIONS

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1.3 In this Part, the following definitions shall apply:

*group*

means, in relation to a *person* ("A"), A and any *person*:

...

(2) who has an ~~Article 22(7) relationship~~ a common management relationship with A;

(3) who has an ~~Article 22(7) relationship~~ a common management relationship with any person in (1);

...

#### 2 GROUP SYSTEMS AND CONTROLS

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...

2.3 An *Article 109 undertaking* must comply with 2.1(2) in relation to any *UK consolidation group* or ~~non-EEAUK~~ *sub-group* of which it is a member, as well as in relation to its *group*.

...

Draft for consultation

## Annex B

### Amendments to the Internal Capital Adequacy Assessment Part

In this Annex new text is underlined and deleted text is struck through.

#### 1 APPLICATION AND DEFINITIONS

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...

1.2 In this Part the following definitions shall apply:

...

*group*

means in relation to a *person* ("A"), A and any *person*:

...

- (c) who has an ~~Article 22(7) relationship~~ a common management relationship with A;
- (d) who has an ~~Article 22(7) relationship~~ a common management relationship with any *person* who falls into (a);

...

14.4A A *PRA approved parent holding company* or a *PRA designated parent holding company* must comply with the *ICAAP rules* on the basis of its *consolidated situation* and a *PRA designated intermediate holding company* or a *PRA designated institution* responsible for meeting *CRR* requirements on a *consolidated basis* must comply with the *ICAAP rules* on the basis of the *consolidated situation* of its UK parent financial holding company ~~in a Member State~~ or UK parent mixed financial holding company ~~in a Member State~~.

14.4B A *PRA designated institution* controlled by a UK parent financial holding company ~~in a Member State~~ or a UK parent mixed financial holding company ~~in a Member State~~ must comply with the *ICAAP rules* on the basis of the *consolidated situation* of that holding company, if the *PRA* is responsible for supervision of the *firm* on a *consolidated basis* under ~~Article 111 of the CRD~~ Part 6 of the Capital Requirements Regulations.

## Annex C

### Amendments to the Internal Liquidity Adequacy Assessment Part

In this Annex new text is underlined and deleted text is struck through.

...

#### 14 APPLICATION OF THIS PART ON AN INDIVIDUAL OR DOMESTIC LIQUIDITY SUB-GROUP BASIS AND A CONSOLIDATED BASIS

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...

14.6 A PRA designated institution ~~that is a UK bank or building society~~ controlled by an ~~EEA~~ a UK parent financial holding company or by an ~~EEA~~ a UK parent mixed financial holding company must comply with this Part on the basis of the consolidated situation of that holding company ~~if the PRA is responsible for supervision of the UK bank or building society on a consolidated basis under Article 111 of the CRD.~~

14.6A A PRA approved parent holding company, a PRA designated parent holding company or a PRA designated intermediate holding company responsible for compliance with the CRR on a consolidated basis must comply on the basis of the consolidated situation of the ~~EEA~~ UK parent financial holding company or ~~EEA~~ UK parent mixed financial holding company.

14.7 A PRA designated institution ~~that is a UK designated investment firm~~ controlled by an ~~EEA parent financial holding company~~ or by an ~~EEA parent mixed financial holding company~~ must comply with this Part on the basis of the consolidated situation of that holding company if:

(1) ~~there is no subsidiary~~ of the holding company which is a credit institution to which 14.6 applies; and

(2) ~~the PRA is responsible for the supervision of the UK designated investment firm on a consolidated basis under Article 111 of the CRD.~~ [Deleted.]

...

### 3 Draft Capital Buffers instrument

#### **PRA RULEBOOK: CRR FIRMS: CAPITAL BUFFERS (CAPITAL REQUIREMENTS DIRECTIVE V) No2 AMENDMENT INSTRUMENT 2020**

##### **Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
  - (1) section 137G (The PRA’s general rules); and
  - (2) section 137T (General supplementary powers).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

##### **Pre-conditions to making**

- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

#### **PRA Rulebook: CRR Firms: Capital Buffers (Capital Requirements Directive V) No2 Amendment Instrument 2020**

- D. The PRA makes the rules in the Annex to this instrument.

##### **Commencement**

- E. This instrument comes into force on IP completion day, as defined in the European Union (Withdrawal Agreement) Act 2020.

##### **Citation**

- F. This instrument may be cited as the PRA Rulebook: CRR Firms: Capital Buffers (Capital Requirements Directive V) No2 Amendment Instrument 2020

**By order of the Prudential Regulation Committee**

[DATE]



## Annex

### Amendments to the Capital Buffers Part

In this Annex new text is underlined and deleted text is struck through.

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#### 4 CAPITAL CONSERVATION MEASURES

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...

##### Restrictions on distributions

- 4.2 ~~A firm that meets the combined buffer must not make a distribution in connection with common equity tier 1 capital to an extent that would decrease its common equity tier 1 capital to a level where the combined buffer is no longer met.~~

[Note: Art 141(1) of the CRD]

[Deleted.]

4.3 ...

- (5) ~~The sum to be multiplied in accordance with (4) shall consist of:~~ be the sum of the profits earned in each of the past four calendar quarters less, in each case:

~~(i) any distributions of profits or payments resulting from the actions referred to in points (a), (b) or (c) of (2), or~~

~~(ii) amounts which would be payable by tax if the undistributed profits of the past four calendar quarters were to be retained.~~

~~(a) any interim profits not included in common equity tier 1 capital pursuant to Article 26(2) of the CRR net of any distribution of profits or any payment resulting from the actions referred to in points (a), (b) or (c) of (2);~~

plus

~~(b) any year-end profits not included in common equity tier 1 capital pursuant to Article 26(2) of the CRR net of any distribution of profits or any payment resulting from the actions referred to in points (a), (b) or (c) of (2);~~

minus

~~(c) amounts which would be payable by tax if the items specified in points (a) and (b) were to be retained.~~

...

## 4 Draft Groups (Methods) EU Exit instrument

### PRA RULEBOOK: CRR FIRMS: GROUPS (METHODS) (EU EXIT) INSTRUMENT 2020

#### Powers exercised

- A. The Prudential Regulation Authority (“PRA”) being the appropriate regulator within the meaning of the Financial Regulators’ Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (“the Regulations”), having carried out consultations pursuant to regulation 5 of the Regulations and with the approval of the Treasury to the following instrument, makes the instrument in exercise of the powers conferred by regulation 3 of the Regulations.

#### Pre-conditions to making

- A. A draft of this instrument has been approved by the Treasury, having been satisfied that it makes appropriate provision to prevent, remedy or mitigate any failure of retained EU law to operate effectively, or any other deficiency in retained EU law, arising from the withdrawal of the United Kingdom from the European Union.
- B. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

### PRA Rulebook: CRR Firms: Groups (Methods) (EU Exit) Instrument 2020

- C. The PRA makes the rules in the Annex to this instrument.

#### Commencement

- D. This instrument comes into force on IP completion day, as defined in the European Union (Withdrawal Agreement) Act 2020.

#### Citation

- E. This instrument may be cited as the PRA Rulebook: CRR Firms: Groups (Methods) (EU Exit) Instrument 2020.

By order of the Prudential Regulation Committee  
[DATE]

## Annex

### Amendments to the Groups Part

In this Annex new text is underlined and deleted text is struck through.

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#### **2 METHODS OF PRUDENTIAL CONSOLIDATION**

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2.1 (1) In carrying out the calculations in (Part One, Title II, Chapter 2 of the *CRR*) for the purposes of prudential consolidation, a *firm* must include the relevant proportion of an undertaking with whom it has an:

(a) ~~Article 22(7) common management relationship;~~ or

...

...  
[Note: Art 18(3) and (6) of the *CRR*]

...

Draft for consultation

## 5 Draft Interest Rate Risk Arising from Non-trading Activities instrument

### **PRA RULEBOOK: CRR FIRMS: INTEREST RATE RISK ARISING FROM NON TRADING ACTIVITIES INSTRUMENT 2020**

#### **Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137G (The PRA’s general rules); and
  - (1) section 137T (General supplementary powers).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

#### **Pre-conditions to making**

- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

### **PRA Rulebook: CRR Firms: Interest Rate Risk Arising from Non Trading Activities Instrument 2020**

- D. The PRA makes the rules in the Annex to this instrument.

#### **Commencement**

- E. This instrument comes into force on IP completion day, as defined in the European Union (Withdrawal Agreement) Act 2020.

#### **Citation**

- F. This instrument may be cited as the PRA Rulebook: CRR Firms: Interest Rate Risk Arising from Non Trading Activities Instrument 2020.

**By order of the Prudential Regulation Committee**  
[DATE]

## Annex

### Amendments to the Internal Capital Adequacy Assessment Part

In this Annex new text is underlined and deleted text is struck through.

## Internal Capital Adequacy Assessment

### 1 Application and Definitions

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...

1.2 In this Part the following definitions shall apply:

Credit spread risk

means the risk driven by changes in the market perception about the price of *credit risk*, liquidity premium and potentially other components of credit-risky instruments inducing fluctuations in the price of *credit risk*, liquidity premium and other potential components, which is not explained by interest rate risk arising from non-trading book activities or by expected credit/(jump-to-)default risk.

EVE

means the economic value of equity of a *firm*.

Option risk

means risk arising from option derivative positions or from optional elements embedded in a *firm's* assets, liabilities and off-balance sheet items, where the *firm* or its counterparty can alter the level and timing of their cash flows.

...

### 9 INTEREST RATE RISK ARISING FROM NON-TRADING BOOK ACTIVITIES

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#### General Requirements

9.1 A *firm* must implement systems to identify, evaluate and manage the risk arising from potential changes in interest rates that affect a *firm's* non-trading activities including the risks of such changes impacting either or both of the following:

- (1) the economic value of the *firm's* non-trading activities;
- (2) the earnings in respect of the *firm's* not-trading activities.

9.1A A *firm* must in addition implement systems to monitor and assess *credit spread risk* in respect of its non-trading activities.

9.1B As an alternative to implementing internal systems under 9.1(1), and only where appropriate to its nature, size and complexity as well as business activities and overall risk profile, a *firm* may elect to implement the standardised framework set out in 9.13 to 9.43 to identify, evaluate and manage the risk arising from potential changes in interest rates that affect the economic value of the *firm's* non-trading activities.

9.1C A *firm* shall notify the *PRA* prior to any implementation of the standardised framework pursuant to 9.1B or, if it elects to cease implementing the standardised framework, prior to doing so.

- 9.2 As part of its obligations under the overall Pillar 2 rule in 3.1, a *firm* must carry out an evaluation of its exposure to the interest rate risk arising from its non-trading activities, including an evaluation of its exposure to risk arising from potential changes in interest rates that affect either or both of the following:
- (1) the economic value of the *firm's* non-trading activities; and
  - (2) the earnings in respect of the *firm's* non-trading activities.
- 9.3 ~~The evaluation under 9.2 must cover the effect of a sudden and unexpected change in interest rates of 200 basis points in both directions. [Deleted.]~~
- 9.4 ~~A *firm* must immediately notify the *PRA* if any evaluation under this *rule* suggests that, as a result of the change in interest rates described in 9.3, the economic value of the *firm* would decline by more than 20% of its *own funds*. [Deleted.]~~
- 9.4A A *firm* must regularly carry out an evaluation in respect of the interest rate shock scenarios in 9.7 and immediately notify the *PRA* if any evaluation under this rule indicates that, as a result of the application of the interest rate scenarios in 9.7, the *EVE* would decline by more than 15% of its Common Equity Tier 1 capital.
- 9.5 A *firm* must carry out the evaluation under 9.2 as frequently as necessary for it to be reasonably satisfied that it has at all times a sufficient understanding of the degree to which it is exposed to the risks referred to in 9.2 and the nature of that exposure. In any case it must carry out those evaluations no less frequently than once a year.
- 9.6 ~~A *firm's management body* must oversee and approve the *firm's* risk appetite and risk management framework for managing interest rate risk from non-trading book activities.~~

#### **Interest rate shock scenarios**

- 9.7 For the purposes of the evaluation in 9.4A, a *firm* must apply the following prescribed interest rate scenarios to all material currencies as determined in 9.8:
- scenario 0: current interest rates;
  - scenario 1: parallel shock up;
  - scenario 2: parallel shock down;
  - scenario 3: steeper shock (short rates down and long rates up);
  - scenario 4: flattener shock (short rates up and long rates down);
  - scenario 5: short rates shock up; and
  - scenario 6: short rates shock down.
- 9.8 For the purposes of 9.7 and 9.15, a *firm* shall determine which currencies are material currencies using the following tests:
- (1) Each currency that has non-trading book assets in that currency more than 5% of total non-trading book assets shall be a material currency;
  - (2) Where the sum of non-trading book assets in material currencies as identified under (1) does not exceed 90% of total non-trading book assets, a firm must select additional currencies to be deemed material currencies such that the sum of non-trading book assets in material currencies as identified under (1) and (2) is at least 90% of total non-trading book assets;
  - (3) Each currency that has non-trading book liabilities in that currency more than 5% of total non-trading book liabilities shall be a material currency; and

- (4) Where the sum of non-trading book liabilities in material currencies as identified under (3) does not exceed 90% of total non-trading book liabilities, a firm must select additional currencies to be deemed material currencies such that the sum of non-trading book liabilities in material currencies as identified under (3) and (4) is at least 90% of total non-trading book liabilities.

9.9 For the interest rate scenarios specified in 9.7, a firm shall determine the change to interest rates in accordance with the following formulae:

For scenario 0:  $\Delta R_c(t_k) = 0$

for scenario 1:  $\Delta R_c(t_k) = +\bar{R}_c^{parallel}$

for scenario 2:  $\Delta R_c(t_k) = -\bar{R}_c^{parallel}$

for scenario 3:  $\Delta R_c(t_k) = -0.65 \cdot |\Delta R_{short,c}(t_k)| + 0.9 \cdot |\Delta R_{long,c}(t_k)|$

for scenario 4:  $\Delta R_c(t_k) = +0.8 \cdot |\Delta R_{short,c}(t_k)| - 0.6 \cdot |\Delta R_{long,c}(t_k)|$

for scenario 5:  $\Delta R_c(t_k) = +\Delta R_{short,c}(t_k)$

for scenario 6:  $\Delta R_c(t_k) = -\Delta R_{short,c}(t_k)$

Where:

$c$  = the index that denotes currency

$k$  = the index that denotes the buckets in accordance with Table 2 in 9.17 below

$t_k$  = the bucket midpoint of bucket  $k$ , measured in years

$\Delta R_c(t_k)$  = the change in interest rate at the point  $t_k$  for currency  $c$

$\bar{R}_c^{parallel}$  = the prescribed parallel interest rate shock for currency  $c$  determined in accordance with column two of Table 1 in 9.11

$\Delta R_{short,c}(t_k)$  = the change in short interest rate at the point  $t_k$  for currency  $c$  determined in accordance with the formulae in 9.10

$\Delta R_{long,c}(t_k)$  = the change in long interest rate at the point  $t_k$  for currency  $c$  determined in accordance with the formulae in 9.10.

9.10 For the purposes of 9.9, a firm shall determine the value of  $\Delta R_{short}(t_k)$  and  $\Delta R_{long}(t_k)$  in accordance with the following formulae:

(1) for  $\Delta R_{short,c}(t_k)$ :  $\Delta R_{short,c}(t_k) = +\bar{R}_{short,c} \cdot e^{-\frac{t_k}{x}}$

(2) for  $\Delta R_{long,c}(t_k)$ :  $\Delta R_{long,c}(t_k) = +\bar{R}_{long,c} \cdot \left(1 - e^{-\frac{t_k}{x}}\right)$

Where:

$c$  = the index that denotes currency

$k$  = the index that denotes the buckets in accordance with Table 2 in 9.17 below

$e$  = the mathematical constant that is the base of the natural logarithm

$x = 4$

$t_k$  = the bucket midpoint of bucket  $k$ , measured in years

$\Delta R_{short,c}(t_k)$  = the change in short interest rate at the point  $t_k$  for currency  $c$

$\Delta R_{long,c}(t_k)$  = the change in long interest rate at the point  $t_k$  for currency  $c$

$\bar{R}_c^{short}$  = the prescribed short interest rate shock for currency  $c$  determined in accordance with column three of Table 1 in 9.11

$\bar{R}_c^{long}$  = the prescribed long interest rate shock for currency  $c$  determined in accordance with column four of Table 1 in 9.11.

9.11 For the purposes of 9.9, the interest rate shock scenarios for individual currencies are those in Table below:

Table 1. Specified size of interest rate shocks for each currency (bps)

<u>Currency</u>	<u>Parallel</u>	<u>Short</u>	<u>Long</u>
ARS	400	500	300
AUD	300	450	200
BRL	400	500	300
CAD	200	300	150
CHF	100	150	100
CNY	250	300	150
EUR	200	250	100
GBP	250	300	150
HKD	200	250	100
IDR	400	500	350
INR	400	500	300
JPY	100	100	100
KRW	300	400	200
MXN	400	500	300
RUB	400	500	300
SAR	200	300	150
SEK	200	300	150
SGD	150	200	100
TRY	400	500	300
USD	200	300	150
ZAR	400	500	300



9.12 For material positions in currencies not listed in 9.11, a firm must develop appropriate shocks for the scenarios listed in 9.7.

## **Standardised Framework**

### Calculating Loss in Economic Value

9.13 Using the standardised framework, a firm shall carry out the evaluation in 9.1(1) by calculating the loss in EVE ( $EVE_{loss}$ ) in accordance with the following formula:

$$EVE_{loss} = \max_{i \in \{1,2,\dots,6\}} \left\{ \sum_{c: \Delta EVE_{i,c} > 0} \Delta EVE_{i,c} \right\}$$

Where:

$i$  = the index that denotes the interest rate shock scenarios in accordance with 9.15

$c$  = the index that denotes the material currencies in accordance with 9.15

$\Delta EVE_{i,c}$  = the change in economic value in currency  $c$  for interest rate scenario  $i$  as calculated in accordance with 9.14.

9.14 For the purposes of 9.13, a firm must calculate the change in economic value in a given currency for a given interest rate scenario in accordance with the following formula:

$$\Delta EVE_{i,c} = NAO_{i,c} + KAO_{i,c}$$

i. Where:

ii.  $i$  = the index that denotes the interest rate shock scenarios in accordance with 9.15

iii.  $c$  = the index that denotes the material currencies in accordance with 9.15

iv.  $\Delta EVE_{i,c}$  = the change in economic value in currency  $c$  for interest rate scenario  $i$

v.  $NAO_{i,c}$  = the non-automatic option risk in currency  $c$  for interest rate scenario  $i$  as calculated in accordance with 9.16

vi.  $KAO_{i,c}$  = the automatic option risk in currency  $c$  for interest rate scenario  $i$  as calculated in accordance with 9.41.

9.15 For the purposes of 9.13 and 9.14, a firm must calculate the change in economic value in a given currency for a given interest rate scenario,  $\Delta EVE_{i,c}$ , for every possible pair of:

i. (1) interest rate scenarios,  $i$  in 9.7; and

ii. (2) each material currency,  $c$  as determined in 9.8.

9.16 For the purposes of 9.14, a firm must calculate the non-automatic option risk in currency  $c$  for interest rate scenario  $i$  ( $NAO_{i,c}$ ) in accordance with the following formula:

$$NAO_{i,c} = \sum_{k=1}^{19} CF_{0,c}(k) \cdot DF_{0,c}(t_k) - \sum_{k=1}^{19} CF_{i,c}(k) \cdot DF_{i,c}(t_k)$$

vii. Where:

viii.  $i$  = the index that denotes the interest rate shock scenarios in accordance with 9.15

ix.  $c$  = the index that denotes the material currencies in accordance with 9.15

x.  $k$  = the index that denotes the buckets in accordance with Table 2 in 9.17

xi.  $DF_{i,c}(t_k)$  (respectively  $DF_{0,c}(t_k)$ ) = the discount factor for bucket  $k$  in currency  $c$  for interest rate scenario  $i$  (respectively for interest rate scenario 0), calculated in accordance with 9.18

xii.  $CF_{i,c}(k)$  (respectively  $CF_{0,c}(k)$ ) = the net repricing cash flow for bucket  $k$  in currency  $c$  for interest rate scenario  $i$  (respectively for interest rate scenario 0), calculated in accordance with 9.19 to 9.40.

9.17 For the calculation of discount factors and notional repricing cash flows in 9.18 and 9.19, a firm must project all notional repricing cashflows on to the following bucket intervals or bucket midpoints:

Table 2

Time bucket intervals and mid points (M = months, Y = years)			
	Bucket number (k)	Bucket interval	Bucket midpoint
Short-term rates	1	Overnight	0.0028Y
	2	> Overnight and <= 1M	0.0417Y
	3	> 1M and <= 3M	0.1667Y
	4	> 3M and <= 6M	0.375Y
	5	> 6M and <= 9M	0.625Y
	6	> 9M and <= 1Y	0.875Y
	7	> 1Y and <= 1.5Y	1.25Y
	8	> 1.5Y and <= 2 Y	1.75Y
Medium-term rates	9	>2 Y and <= 3Y	2.5Y
	10	> 3Y and <= 4Y	3.5Y
	11	> 4Y and <= 5Y	4.5Y
	12	> 5Y and <= 6Y	5.5Y
	13	> 6Y and <= 7Y	6.5Y
Long-term rates	14	> 7Y and <= 8Y	7.5Y
	15	> 8Y and <= 9Y	8.5Y
	16	>9 Y and <= 10Y	9.5Y
	17	> 10Y and <= 15Y	12.5Y
	18	> 15Y and <= 20Y	17.5Y
	19	> 20Y	25Y

9.18 (1) For the purposes of 9.16, a firm must calculate the discount factor for bucket  $k$  in currency  $c$  for interest rate scenario  $i$  ( $DF_{i,c}(t_k)$ ) in accordance with the following formula:

xiii.  $DF_{i,c}(t_k) = e^{-R_{i,c}(t_k) \cdot t_k}$

xiv. Where:

xv.  $i$  = the index that denotes the interest rate shock scenarios in accordance with 9.15

xvi.  $c$  = the index that denotes the material currencies in accordance with 9.15

xvii.  $k$  = the index that denotes the buckets in accordance with Table 2 in 9.17

- xviii.  $e$  = the mathematical constant that is the base of the natural logarithm
- xix.  $t_k$  = the bucket midpoint of bucket  $k$  in accordance with Table 2 in 9.17
- xx.  $R_{i,c}(t_k)$  = subject to (2), the risk-free zero coupon rate at bucket midpoint  $t_k$  in currency  $c$  for interest rate scenario  $i$ , including any commercial margin and other spread components.

(2) A firm may elect to use the risk-free zero coupon rate  $R_{i,c}(t_k)$  excluding commercial margin and other spread components, provided the firm implements a prudent and transparent methodology for deducting commercial margins and other spread components from the initial repricing cash flows  $CF^a$  in 9.26.

9.19 In accordance with 9.21, 9.22, 9.23 and 9.24, a firm must assign each interest rate risk position arising from non-trading activities to one of the following categories:

- Category 1: Automatic interest rate options;
- Category 2: Non-maturing deposits;
- Category 3: Fixed rate loans with retail customers that are subject to prepayment risk;
- Category 4: Term deposits with retail customers subject to early redemption risk; and
- Category 5: Other positions.

9.20 A firm must perform the allocation in 9.19 for all interest rate-sensitive non-trading book:

- (1) assets, excluding assets that are:
  - (a) deducted from Common Equity Tier 1 capital;
  - (b) fixed assets, including real estate and intangible assets; or
  - (c) equity exposures in the non-trading book;
- (2) liabilities, including all non-remunerated deposits and excluding CET1 capital; and
- (3) off-balance sheet items.

9.21 Under 9.19, term deposits that satisfy either of the following conditions may be treated as other positions in 9.19:

- (1) the depositor has no legal right to withdraw the deposit; or
- (2) an early withdrawal results in a significant penalty that at least compensates for the loss of interest between the date of withdrawal and the contractual maturity date and the economic cost of breaking the contract.

9.22 For the purposes of 9.19, and subject to 9.23, a firm must bifurcate any position with an embedded automatic interest rate option into two positions:

- xxi. (1) a position excluding the embedded automatic interest rate option, which must be allocated to the other positions category in 9.19, and
- xxii. (2) the embedded automatic interest rate option, which must be allocated to the category of automatic interest rate options in 9.19.

9.23 Where a firm is able to demonstrate that the embedded optionality is not material, the firm may choose not to perform the bifurcation in 9.22 and may directly allocate the position to the other positions category in 9.19.

9.24 For the purposes of 9.19, automatic interest rate options include:

- xxiii. (1) term deposits with wholesale customers that do not meet the conditions in 9.21;
- xxiv. (2) wholesale fixed rate loans subject to prepayment risk; and
- xxv. (3) mortgage loans with embedded caps and/or floors.

9.25 For each position allocated to the categories 2 to 5 in 9.19, a firm must determine a set of initial repricing cash flows,  $CF^\alpha$ , per currency, in accordance with 9.26 and 9.27.

9.26 For each position, a firm must determine a set of initial repricing cash flows  $CF^\alpha$  as:

- xxvi. (1) any repayment of principal;
- xxvii. (2) any repricing of principal; and
- xxviii. (3) any interest payment on a tranche of principal that has not yet been repaid or repriced.

9.27 A firm must determine the set of initial repricing cash flows  $CF^\alpha$  for floating rate positions as:

- xxix. (1) a series of coupon payments until the next repricing; and
- xxx. (2) a par notional cash flow at the point of the next repricing.

9.28 In accordance with 9.32 to 9.40 for each material currency  $c$  identified in accordance with 9.15 and for interest rate scenario  $i$ , a firm must allocate each notional repricing cash flow  $CF_{i,c}$  to one of the buckets in Table 2 in 9.17 based on the repricing date, where repricing date means the date of each repayment, repricing or interest payment.

9.29 A firm may first choose to split an initial repricing cash flow determined in 9.25,  $CF^\alpha$ , into two cash flows with tenors equal to the two bucket mid-point tenors in column 4 of Table 2 in 9.17 that are adjacent to the tenor of the initial repricing cash flow  $CF^\alpha$ .

9.30 Where a firm chooses to apply the methodology in 9.29, that firm must:

- (1) Split each initial repricing cash flow determined in 9.25,  $CF^\alpha$  such that:
  - (a) the sum of the resulting two cash flows is equal to the initial repricing cash flow,  $CF^\alpha$ ; and
  - (b) the weighted average maturity of the resulting two cash flows equals the initial repricing cash flows' maturity;
- (2) document the methodology that the firm implements to split cash flows.

9.31 For 9.16, the net repricing cash flow for bucket  $k$  in currency  $c$  for interest rate scenario  $i$ , ( $CF_{i,c}(k)$ ) shall be determined as the sum of  $CF_{i,c}$  as determined in 9.28 which:

- (1) are derived from initial repricing cash flows  $CF^\alpha$  that are allocated to currency  $c$  for interest rate scenario  $i$  in accordance with 9.28; and
  - i.
- (2) allocated to bucket  $k$  in accordance with Table 2 in 9.17.

### **Non Maturing Deposits**

9.32 For non-maturing deposits as determined in 9.19, a firm must allocate each position into one of the following categories:

- xxxi. (1) Retail deposits defined as deposits placed with a firm by an individual person and where either regular transactions are carried out or the deposits are non-interest bearing;
- xxxii. (2) Any other deposits with a firm by an individual person which are not covered in (1);

xxxiii. (3) Other deposits.

9.33 For the purposes of 9.32(1) deposits made by small business customers, legal entities, sole proprietorships or partnerships managed as retail exposures provided the total aggregated liabilities are less than £877,000 may also be treated as retail deposits.

9.34 For each category in 9.32, a firm must allocate each position to the following categories:

- (1) The core portion, consisting of deposits that are found to remain undrawn with a high degree of likelihood over the past 10 years, and unlikely to reprice even under significant changes in the interest rate environment; and
- (2) The non-core portion, consisting of deposits not allocated to the core portion.

9.35 For non-maturing deposits as determined in 9.34, the notional repricing cash flows in currency  $c$  for each interest rate scenario  $i$ ,  $CF_{i,c}$ , must be:

xxxiv. (1) For the core portion, the initial notional repricing cash flows  $CF_{i,c}^\alpha$  in currency  $c$  for interest rate scenario  $i$  with the firm's own estimates of tenors;

xxxv. (2) For the non-core portion, the initial notional repricing cash flows  $CF_{i,c}^\alpha$  in currency  $c$  for interest rate scenario  $i$  with an overnight tenor.

9.36 For the allocation in 9.34 and the calculation of  $CF_i$  in 9.35, a firm must ensure that the proportion and average repricing date of core deposits is no greater than the caps in Table 3:

Table 3: Caps on core deposits

	<u>Cap on proportion of core deposits (%)</u>	<u>Cap on average repricing date of core deposits (years)</u>
<u>Transactional retail deposits (as referred to in 9.32(1))</u>	<u>90</u>	<u>5</u>
<u>Other retail deposits (as referred to in 9.32(2))</u>	<u>70</u>	<u>4.5</u>
<u>Other deposits (as referred to in 9.32(3))</u>	<u>50</u>	<u>4</u>

**Fixed Rate Loans**

9.37 For fixed rate loans with customers that are subject to prepayment risk as determined in 9.19, a firm must:

- (1) allocate each position to a single portfolio of homogeneous positions  $p$  denominated in a single currency  $c$ ;

- xxxvi. (2) for each portfolio of homogeneous positions, determine and notify the *PRA* a baseline monthly conditional prepayment rate ( $CPR_{0,c}^p$ ) in currency  $c$  under the current term structure of interest rates;
- xxxvii. (3) For each portfolio of homogeneous positions, determine the conditional prepayment rate in currency  $c$  for interest rate scenario  $i$ , ( $CPR_{i,c}$ ) in accordance with the following formula:

$$CPR_{i,c}^p = \min(1, \gamma_i \cdot CPR_{0,c}^p)$$

where  $\gamma_i$  refers to the prescribed scalar multiplier for each interest rate shock scenarios given in Table 4 below.

Table 4

Scenario number $i$	Interest rate shock scenarios	$\gamma_i$ (scenario multiplier)
0	Current interest rates	1
1	Parallel up	0.8
2	Parallel down	1.2
3	Steepener	0.8
4	Flattener	1.2
5	Short rate up	0.8
6	Short rate down	1.2

- (4) For each portfolio of homogeneous positions, determine the notional repricing cash flows  $CF_{i,c}$  allocated to bucket 1 in accordance with Table 2 in 9.17,  $CF_{i,c}(1)$ , in accordance with the following formula:

$$CF_{i,c}(1) = CF_{i,c}^\alpha(1) + 0.05 \cdot CPR_{i,c} \cdot N_i(0)$$

Where:

$CF_{i,c}^\alpha(1)$  = the initial repricing cash flows  $CF^\alpha$  for interest rate scenario  $i$  with tenor that corresponds to bucket 1 in accordance with Table 2 in 9.17; and

$N_i(0)$  = the notional currently outstanding before any repayments.

- (5) For each portfolio of homogeneous positions, determine the notional repricing cash flows  $CF_{i,c}$  allocated to each bucket  $k$  in Table 2 where  $k > 1$ ,  $CF_{i,c}(k)$ , in accordance with the following recursive formula:

$$CF_{i,c}(k) = \min \left( \frac{CF_{i,c}^\alpha(k) + \min(1, W(k) \cdot CPR_{i,c}) \cdot N_i(k-1)}{\sum_{k=1}^{19} CF_{i,c}^\alpha(k) - \sum_{q=1}^{k-1} CF_{i,c}(q)} \right)$$

Where:

$k$  = the index that denotes the buckets in accordance with Table 2 in 9.17;

$W(k)$  = the width of bucket  $k$  measured in months and capped at 1200;

$CF_{i,c}^{\alpha}(k)$  = the initial repricing cash flows  $CF^{\alpha}$  in currency  $c$  for interest rate scenario  $i$  with tenor that corresponds to bucket  $k$ ;

$N(k - 1)$  = the notional outstanding after notional repricing cash flows in bucket  $k - 1$  have transpired; and

$\sum_{q=1}^{k-1} CF_{i,c}(q)$  = the sum of  $CF_i$  determined for preceding buckets 1 to  $k - 1$ .

9.38 For the purpose of 9.37, firms may adjust the formulas in 9.37 (4) and (5) to reflect a base monthly conditional prepayment rate  $CPR_{0,c}^p(k)$  that varies over the life of each loan in the portfolio. In that case, it is denoted as for each time bucket  $k$  or time bucket midpoint  $tk$  in accordance with Table 2 in 9.17.

### **Term Deposits Subject to Early Redemption Risk**

9.39 For term deposits with customers subject to early redemption risk as determined in 9.19, a firm must:

- xxxviii. (1) allocate each position to a single portfolio of homogeneous positions  $p$  denominated in each material currency  $c$ ;
- xxxix. (2) for each portfolio of homogeneous positions, determine and notify the PRA a baseline term deposit redemption ratio ( $TDRR_{0,c}^p$ ) in currency  $c$  under the current term structure of interest rates;
- xl. (3) for each portfolio of homogeneous loans, determine the conditional term deposit redemption ratio in currency  $c$  for interest rate scenario  $i$ , ( $TDRR_{i,c}^p$ ) in accordance with the following formula:
- xli.  $TDRR_{i,c}^p = \min(1, u_i, TDRR_{i,c}^p)$
- xlii. where  $u_i$  refers to the prescribed scalar multiplier for each interest rate shock scenarios given in Table 5 below.
- xliii.

Table 5.

Scenario number ( $i$ )	Interest rate shock scenarios	$u_i$ (scenario multiplier)
<u>0</u>	<u>Current interest rates</u>	<u>1</u>
<u>1</u>	<u>Parallel up</u>	<u>1.2</u>
<u>2</u>	<u>Parallel down</u>	<u>0.8</u>
<u>3</u>	<u>Steeper</u>	<u>0.8</u>
<u>4</u>	<u>Flattener</u>	<u>1.2</u>
<u>5</u>	<u>Short rate up</u>	<u>1.2</u>
<u>6</u>	<u>Short rate down</u>	<u>0.8</u>

- (4) For each portfolio of homogeneous positions, determine the notional repricing cash flows  $CF_{i,c}$  allocated to bucket 1 in Table 2 in 9.17,  $CF_{i,c}(1)$ , in accordance with the following formula:

$$CF_{i,c}(1) = CF_{i,c}^{\alpha}(1) + TDRR_{i,c}^p \cdot TD_c$$

- ii. Where:

$CF_{i,c}^{\alpha}(1)$  = the initial repricing cash flows  $CF^{\alpha}$  in currency  $c$  for interest rate scenario  $i$  with tenor that corresponds to bucket 1 in accordance with Table 2 in 9.17; and

$TD_c$  = the total term deposits subject to early redemption for currency  $c$ .

- (5) For each portfolio of homogeneous positions, determine the notional repricing cash flows  $CF_i$  allocated to bucket  $k$  in Table 2 other than bucket 1,  $CF_i(k)$ , in accordance with the following formula:

$$CF_{i,c}(k) = CF_{i,c}^\alpha(k) \cdot (1 - TDRR_{i,c}^p)$$

Where:

$k$  = the index that denotes the buckets in accordance with Table 2 in 9.17; and

$CF_{i,c}^\alpha(k)$  = the initial repricing cash flows  $CF^\alpha$  in currency  $c$  for interest rate scenario  $i$  with tenor that corresponds to bucket  $k$ .

### **Other positions**

- 9.40 For other positions as determined in 9.19, a firm must determine the notional repricing cash flows  $CF_{i,c}$  allocated to bucket  $k$  in Table 2 other than bucket 1,  $CF_i(k)$ , in accordance with the following formula:

$$CF_{i,c}(k) = CF_{i,c}^\alpha(k)$$

Where:

$k$  = the index that denotes the buckets in accordance with Table 2 in 9.17; and

$CF_{i,c}^\alpha(k)$  = the initial repricing cash flows  $CF_{i,c}^\alpha$  in currency  $c$  for interest rate scenario  $i$  with tenor that corresponds to bucket  $k$ .

### **Automatic interest rate options**

- 9.41 For 9.14, and subject to 9.42, a firm must determine the automatic option risk in currency  $c$  for interest rate scenario  $i$  ( $KAO_{i,c}$ ) for all automatic interest rate options as determined in 9.19 and 9.22 in accordance with the following formula:

$$KAO_{i,c} = \sum_{p=1}^{n_c} \Delta FVAO_{i,c}^p - \sum_{q=1}^{m_c} \Delta FVAO_{i,c}^q$$

Where:

$n_c$  = the index that denotes the number of all sold automatic options in currency  $c$ ;

$m_c$  = the index that denotes the number of all bought automatic options in currency  $c$ ;

$\Delta FVAO_{i,c}^p$  = the change in value of sold automatic option  $p$  for interest rate scenario  $i$ , calculated in accordance with 9.43; and

$\Delta FVAO_{i,c}^q$  = the change in value of bought automatic option  $q$  for interest rate scenario  $i$ , calculated in accordance with 9.43.

- 9.42 A firm may choose to include in the calculation of  $\sum_{q=1}^{m_c} \Delta FVAO_{i,c}^q$  only bought automatic options that are used for hedging sold automatic interest rate options, provided that the firm must add to  $KAO_{i,c}$  in 9.41 the value of bought automatic options that are not for hedging sold automatic interest rate options that is included in the firm's own funds.



9.43 (1) For 9.41, a firm must calculate the change in value of sold automatic option  $p$  (respectively bought automatic option  $q$ ) for interest rate scenario  $i$  other than interest rate scenario 0,  $\Delta FVAO_{i,e}^p$  (respectively  $\Delta FVAO_{i,e}^q$ ), as the increase in value of the option to the option holder:

- iii. (a) \_\_\_\_\_ from the value of the option for interest rate scenario 0;
- iv. (b) \_\_\_\_\_ to the value of the option for interest rate shock scenario  $i$  with a relative increase in implied volatility of 25%.

(2) For 9.41, a firm must set the change in value of sold automatic option  $p$  (respectively bought automatic option  $q$ ) for interest rate scenario 0,  $\Delta FVAO_{0,e}^p$  (respectively  $\Delta FVAO_{0,e}^q$ ), as 0.

(3) A firm must notify the PRA of the methodology used to estimate the value of automatic options in (1).

Draft for consultation

## 6 Draft Remuneration EU Exit instrument

### PRA RULEBOOK: CRR FIRMS: REMUNERATION (CAPITAL REQUIREMENTS DIRECTIVE V) (EU EXIT) (No.2) INSTRUMENT 2020

#### Powers exercised

- A. The Prudential Regulation Authority (“PRA”) being the appropriate regulator within the meaning of the Financial Regulators’ Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (“the Regulations”), having carried out consultations pursuant to regulation 5 of the Regulations and with the approval of the Treasury to the following instrument, makes the instrument in exercise of the powers conferred by regulation 3 of the Regulations.

#### Pre-conditions to making

- B. A draft of this instrument has been approved by the Treasury, having been satisfied that it makes appropriate provision to prevent, remedy or mitigate any failure of retained EU law to operate effectively, or any other deficiency in retained EU law, arising from the withdrawal of the United Kingdom from the European Union.
- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

#### PRA Rulebook: CRR Firms: Remuneration (Capital Requirements Directive V) (EU Exit) Instrument (No.2) 2020

- D. The PRA makes the rules in the Annexes to this instrument.

#### Commencement

- E. This instrument comes into force on IP completion day, as defined in the European Union (Withdrawal Agreement) Act 2020.

#### Citation

- F. This instrument may be cited as the PRA Rulebook: CRR Firms: Consolidated Requirements (Capital Requirements Directive V) (EU Exit) (No.2) Instrument 2020.

#### By order of the Prudential Regulation Committee

[DATE]

## Annex

### Amendments to the Remunerations Part

In this Annex new text is underlined and deleted text is struck through.

#### 1 APPLICATION AND DEFINITIONS

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...

1.3 In this Part, the following definitions shall apply:

*consolidation group entity*

means an *institution* or *financial institution* which is:

- (1) an *undertaking responsible for consolidation*;
- (2) a subsidiary of an *undertaking responsible for consolidation*; or
- (3) where the *consolidation group* contains a *PRA designated institution*, a subsidiary of the ~~EEA~~ *parent financial holding company* or ~~EEA~~ *parent mixed financial holding company* by which the ~~CRR firm responsible for consolidation~~ *PRA designated institution* is controlled.

...

#### 4 GROUPS

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...

4.2 A *firm* that is a member of a *group* must:

...

- (1B) comply, and ensure that the other members of the *group* comply, with the obligations set out in this Part on a *consolidated basis* or *sub-consolidated basis* including those members of the *group* established in a country or territory which is not in the UK ~~an EEA State~~;

...

#### 18 HIGH EARNERS REPORTING REQUIREMENT

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...

18.4 A *firm* that is not , and does not have in its *consolidation group*, ~~an~~ *undertaking responsible for consolidation* must complete that report on an unconsolidated basis in

respect of *remuneration* awarded in the last completed financial year to all *high earners* of the *firm* who mainly undertook their professional activities within the UK EEA.

18.5 An *undertaking responsible for consolidation* must complete that report on a *consolidated basis* in respect of *remuneration* awarded in the last completed financial year to all *high earners* who mainly undertook their professional activities within the UK EEA at:

- (1) the *PRA approved holding company*, *PRA designated holding company*, *PRA approved intermediate holding company*, a *PRA designated intermediate holding company* or *PRA designated institution* of the *consolidation group*;
- (2) each *consolidation group entity* that has its registered office (or if it has no registered office, its head office) in the UK an EEA State; and
- (3) each *branch* of any other *consolidation group entity* that is established or operating in the UK an EEA State.

...

Draft for consultation