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Bank of England PRA

Appendices to CP9/24 – Streamlining the Pillar 2A capital framework and the capital communications process

Consultation paper | CP9/24

September 2024

Draft for consultation

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Draft for consultation

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1: Draft amendments to SS31/15 – The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)

This appendix outlines proposed amendments to Chapter 2 on Expectations of firms undertaking an ICAAP and Chapter 5 on the SREP of SS31/15. Striking through indicates deleted text and underlining indicates new text.

A - Draft amendments proposed to be implemented on 31 March 2025

The following paragraph of SS31/15 is amended as shown to reflect that the PRA would not need to use its powers under sections 55M and 192C of FSMA to prevent firms from meeting the CRD buffers with any CET1 capital maintained to meet their Pillar 2A; rather, the requirement would be set out in the PRA Rulebook:

Draft for consultation

5 The SREP

…

5.18 Under the Capital Buffers Part of the PRA Rulebook, ~~The PRA expects~~ a firm does not meet ~~not to meet~~ the CRD buffers with any CET1 capital maintained to meet its TCR. If a firm agrees with its TCR, the PRA will expect the firm to apply for a requirement under section 55M of the Financial Services and Markets Act 2000 (FSMA) to set the amount and quality of the Pillar 2A capital requirement ~~and prevent the firm from meeting any of the CRD buffers that apply to it with any CET1 capital maintained to meet Pillar 2A~~. The firm will normally be invited to apply for such a requirement at the same time as it is advised of its Pillar 2A capital requirement. If a firm does not apply for such a requirement, the PRA will consider using its powers under section 55M(3) to impose one of its own initiative.

B - Draft amendments proposed to be implemented on 1 January 2026

2 Expectations of firms undertaking an ICAAP

…

IRRBB

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…

2.7A The PRA expects a firm to include small trading book business (as identified under Article 94 ~~of the UK-CRR~~ Derogation for Small Trading Book of the Trading Book (CRR) Part of the PRA Rulebook) as part of its identification, evaluation and management of IRRBB unless its interest rate risk is captured in another risk measure.

Supervisory Actions

2.7B A firm ~~that~~ must, under Internal Capital Adequacy Assessment 9.4A, ~~must~~ immediately notify the PRA if its economic value of equity (EVE) would decline by more than 15% of its Tier 1 capital as a result of the application of the interest rate scenarios in Internal Capital Adequacy Assessment Rule 9.7~~,~~. In that case, it shall be considered an outlier firm. The PRA will review each outlier firm to determine whether the PRA considers that the firm has excessive IRRBB or inadequate management of IRRBB. The PRA may also conduct such a review for firms that are not outlier firms.

General Requirements on IRRBB

…

2.8B The systems and processes should allow the firm to:

…

(v) compare risk figures over different periods (eg by monitoring the impact of changes to the ~~cash-flow slotting criteria~~ way the repricing dates are determined for the purpose of calculating IRRBB);

…

Measurement of IRRBB

…

2.9A A firm should ensure that the internal risk measurement system used to comply with the obligation in the PRA Rulebook captures all material sources of IRRBB exposures. If the PRA determines the internal risk measurement systems of a firm inadequate in risk capture or for other reasons, the firm should take such steps as the PRA may direct or require, including use of the Basel Committee on Banking Supervision's standardised framework under Internal Capital Adequacy Assessment 9.13 when performing the evaluation under Internal Capital Adequacy Assessment 9.2 and 9.4A.

…

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2.12A For building societies, interest rate risk should also be managed with reference to PRA Supervisory Statement SS20/15, 'Supervising building societies' treasury and lending activities'.9[9] Only societies not on the administered or matched approach to financial risk management should incur any significant interest rate risk.

Footnote 9 is updated on the same page–

[9] PRA Supervisory Statement 20/15, 'Supervising building societies' treasury and lending activities', ~~April 2015; https://www.bankofengland.co.uk/prudential-regulation/publication/2015/supervising-building-societies-treasury-and-lendingactivities-ss.~~ January 2021: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2020/ss2015-update-dec-2020.pdf.

…

5 The SREP[1]

…

5.12A Paragraphs 5.12A to 5.12C are no longer applicable from 1 January 2026, except for Interim Capital Regime (ICR) firms and ICR consolidation entities. These paragraphs may be applicable to relevant ICR firms and ICR consolidation entities until [1 January 2027]. For firms using the standardised approach (SA) for credit risk, the PRA will assess whether the capital held by them exceeds the amount necessary to ensure a sound management and coverage of their risks. To this end, the PRA will make an overall assessment of the adequacy of capital, taking into account the outcome of the application of the PRA's own Pillar 2A methodologies, the firm's ICAAP, business model, and whether the firm is considered relatively low-risk and well-managed. The PRA will also conduct a peer group review, including with those firms that use the IRB approach, by using the upper range of the credit risk IRB benchmarks which are set out in the Statement of Policy 'The PRA's methodologies for setting Pillar 2 capital'.[46]

C – Draft amendments proposed to be implemented on the implementation date of the proposals set out in the CP7/24, which is proposed to be 1 January 2027

5 The SREP

…

[1] The implementation date for retiring the refined methodology for ICR firms would align with the implementation date of the proposals set out in the CP7/24, which is proposed to be 1 January 2027. Therefore, the implementation timeline is subject to the outcome of the respective consultation.

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5.12 The PRA will set Pillar 2A capital requirements in light of both the calculations included in a firm's ICAAP and the results of the PRA's own Pillar 2A methodologies. In considering the level of capital that is necessary to capture risks to which the firm is or might be exposed, the PRA also takes into account the extent to which those risks are mitigated by macroprudential buffers. Setting a Pillar 2A capital requirement is subject to peer group reviews to ensure consistency of decisions across firms.

~~5.12A Paragraphs 5.12A to 5.12C are no longer applicable from 1 January 2026, except for Interim Capital Regime (ICR) firms and ICR consolidation entities. These paragraphs may be applicable to relevant ICR firms and ICR consolidation entities until [1 January 2027]. For firms using the standardised approach (SA) for credit risk, the PRA will assess whether the capital held by them exceeds the amount necessary to ensure a sound management and coverage of their risks. To this end, the PRA will make an overall assessment of the adequacy of capital, taking into account the outcome of the application of the PRA's own Pillar 2A methodologies, the firm's ICAAP, business model, and whether the firm is considered relatively low-risk and well-managed. The PRA will also conduct a peer group review, including with those firms that use the IRB approach, by using the upper range of the credit risk IRB benchmarks which are set out in the Statement of Policy 'The PRA's methodologies for setting Pillar 2 capital'.~~[46]

~~5.12B Following this, the PRA will calculate the level of capital that is necessary, in addition to the capital the firm must hold to comply with the CRR (Pillar 1), to capture risks to which the firm is or might be exposed. This may lead to the PRA adjusting the firm's Pillar 2A add-ons, as assessed in accordance with the PRA's own methodologies, downward, taking into consideration how firms' capital relates to the IRB benchmarks considered as part of the peer review. The comparison to the benchmarks is not mechanistic and will depend on the extent to which it reflects firm-specific risk profiles, considering for example differences in Pillar 2A credit concentration risk add-ons between firms using the SA and IRB models.~~

~~5.12C For firms using IFRS 9, the PRA will also consider the extent to which expected credit losses, over a twelve month period, are covered by the Pillar 1 charge under the SA, to inform the setting of Pillar 2A capital requirements.~~

5.13 The PRA will review the firm's records referred to in Internal Adequacy Assessment 13.1 as part of its SREP to judge whether a firm will be able to continue to meet its CRR requirements and the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1 throughout the time horizon used for the capital planning exercise.

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2: Draft amendments to SS45/15 – The UK Leverage Ratio Framework

The following paragraph of SS45/15 is amended as shown to reflect that the PRA would not use its powers under section 55M or section 192C FSMA to set the ALRB. Rather, calculation of the ALRB and related requirements are now set out in the PRA Rulebook. Striking through indicates deleted text and underlining indicates new text.

…

2.3 The ALRB is scaled relative to systemic buffers. ~~Where applicable to a firm, the ALRB and related reporting and disclosure requirements will be set by the PRA using its powers under section 55M of the Financial Services and Markets Act (2000), and will incorporate the ALRB Model Requirements.[8] Where applicable to an approved holding company, the ALRB and related reporting and disclosure requirements will be set by the PRA using its powers under section 192C of the Financial Services and Markets Act (2000), and will incorporate the ALRB Model Requirements.~~ The Leverage Ratio – Capital Requirements and Buffers Part of the PRA Rulebook sets out the calculation of the ALRB and the related obligations when systemic buffers are set by the PRA. The Disclosure (CRR) Part and the Reporting (CRR) Part of the PRA Rulebook set out the disclosure and reporting obligations when an ALRB is set. Where a firm is subject to both a G-SII buffer and an O-SII buffer on the same basis of consolidation, the higher of the two buffers shall apply for the purpose of calculating the ALRB.

…

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3: Draft amendments to statement of policy – The PRA's methodologies for setting Pillar 2 capital

This appendix outlines proposed amendments to Chapters 7 and 8 on Interest rate risk in the banking book and pension obligation risk of the statement of policy. Striking through indicates deleted text and underlining indicates new text.

7 Interest rate risk in the banking book

…

Definition of scope of application

…

7.4 Smaller firms and firms with less complex ~~firms~~ IRRBB exposures are subject to a standard approach, which is based on reviewing their own policy limits for ~~interest rate risk and, where appropriate, basis~~ duration risk, as described in paragraph 7.27. A proportionate approach is applied where a firm demonstrates some aspects of complexity with a detailed review undertaken of the policy limit-setting approach, the potential for any breaches and the ability of the firm to manage the associated risks.

…

Comprehensive methodology for assessing Pillar 2A capital for IRRBB for larger firms or firms with more complex IRRBB exposures

…

Duration risk

…

7.13 Economic value (EV) changes are then summed up across all time buckets in order to assess the change of the firm's EV due to its IRRBB exposure to an interest rate shock. ~~Basis risk.~~

Basis risk

…

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Standard methodology for assessing Pillar 2A capital for IRRBB for smaller firms and firms with less complex IRRBB exposures

7.27 The PRA reviews the internal policy limits used by smaller firms and firms with less complex IRRBB exposures ~~a firm~~. ~~If appropriate (and these are most usually based on the economic impact of a 200 basis point shift in interest rates) the policy limits are used as the basis for determining IRRBB.~~ The capital requirement for IRRBB is a firm's risk appetite for EV sensitivity (or EVE sensitivity where a firm does not calculate EV sensitivity) to parallel up and down shifts in interest rates across the whole yield curve. The size of the shift currently used by the PRA as a benchmark is 200 basis points. The capital requirement is subject to the PRA being comfortable with the way a firm measures sensitivity, including any behavioural assumptions being used, and that the firm has the risk management capabilities and processes in place to manage within its risk appetite.

…

8 Pension obligation risk

…

Definition and scope of application

…

8.5 Pension obligation risk manifests itself in different forms. The PRA's focus is on the impact that changes in the value of a pension scheme could have on Common Equity Tier 1 (CET1). ~~Under CRD, the accounting deficit of a firm's pension scheme is deducted from CET1. Any surpluses are de-recognised.~~ The accounting deficit of a firm's pension scheme is reflected in CET1. Under Article 36(1)(e) of the Own Funds and Eligible Liabilities (CRR) Part of the PRA Rulebook, any surpluses are deducted. Firms are therefore exposed to pension obligation risk because a material increase in the pension scheme's deficit under adverse conditions will have a negative impact on their CET1.

…

Draft for consultation