

Supervisory Statement | SS6/14

Implementing CRD IV: capital buffers

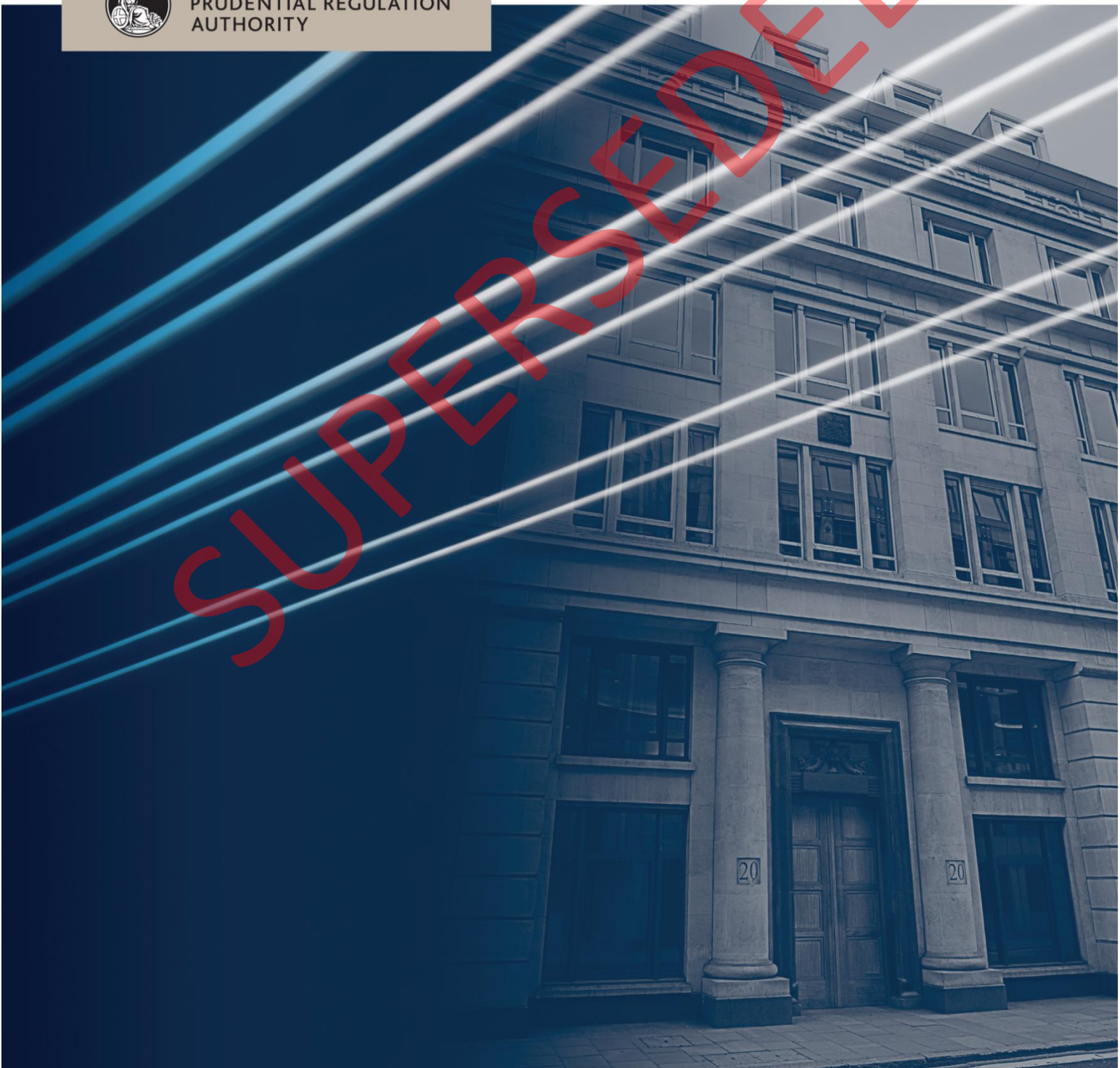
January 2020

(Updating April 2014)



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Introduction

- 1.1 This supervisory statement is aimed at firms to which CRD IV applies.¹
- 1.2 The purpose of this supervisory statement is to set out the expectations of the Prudential Regulation Authority (PRA) on CRD IV capital buffers and provide some clarifications of the PRA rules. This statement complements the requirements set out in Title VII Chapter 4 of the CRD and the capital buffers rules² of the PRA Rulebook and the high-level expectations on capital outlined in The PRA's approach to banking supervision.³

2 Combined buffer

- 2.1 The combined buffer will include the capital conservation buffer, the countercyclical capital buffer (CCB), the buffer for Global Systemically Important Institutions (G-SII buffer) and the systemic risk buffer — if applicable to a firm, as required by CRD IV. The frameworks for the capital conservation buffer, the CCB and capital conservation measures when a firm does not meet its combined buffer are set out in the PRA's capital buffers rules.
- 2.2 The G-SII buffer is firm specific. Where applicable to a firm, the G-SII buffer will be set by the PRA using its powers under section 55M of the Financial Services and Markets Act (2000), which will have the effect of increasing the size of the combined buffer a firm must meet to avoid restrictions on distributions.

3 Capital conservation measures

- 3.1 Firms may use their combined buffer as required in times of stress, but should not use it in the normal course of business or propose to enter it as part of their base business plan. As set out in the PRA's capital buffers rules, firms that do not meet their combined buffer shall face restrictions on their distributions, and be subject to a maximum distributable amount (MDA).⁴ The MDA must be calculated as the product of 60%, 40%, 20% or 0% (depending on which quartile of its combined buffer the firm is in)⁵ and the sum of interim and year-end profits (as defined in Capital Buffers 4.3(5)) generated since the most recent decision on:
 - a) the distribution of profits;
 - b) making a distribution in connection with Common Equity Tier 1 capital;
 - c) creating an obligation to pay variable remuneration or discretionary pension benefits or pay variable remuneration if the obligation to pay was created at a time when the institution failed to meet the combined buffer requirements; or
 - d) making payments on additional Tier 1 instruments.

1 The Capital Requirements Directive (2013/36/EU) (CRD) and the Capital Requirements Regulation (575/2013) (CRR, jointly 'CRD IV').
2 <http://fshandbook.info/FS/html/PRA/D226>.
3 www.bankofengland.co.uk/pru/Pages/supervision/approach/default.aspx.
4 Firms that do meet their combined buffer cannot make a distribution that will cause them to stop meeting it.
5 Where firms are in the first quartile of their combined buffer (when they meet between 75% and 100% of it), 60% of such profits can be distributed. In the second quartile, 40% can be distributed; in the third quartile, 20%; and in the fourth quartile, 0%.

Where these are available, the PRA expects firms to use verified interim (as well as year-end) profits for calculating the MDA. The MDA shall be reduced by any of the actions described in (i) to (iv) above.

- 3.2 This means that where the sum of interim and year-end profits since the above decisions is zero or negative, a firm's MDA will be zero and it will not be able to make any distributions. This will be the case, for example, where a firm makes a loss that initially causes it to stop meeting its combined buffer.
- 3.3 Where a firm does not meet its combined buffer it must prepare a capital conservation plan including the information in Capital Buffers 4.5. The PRA will assess the plan and approve it only if the PRA considers that the plan if implemented would be reasonably likely to conserve or raise sufficient capital to enable the firm to meet its combined buffer within a period which the PRA considers appropriate. In exercising its judgement on what is appropriate the PRA will take into account how far the firm has run into its buffers and the expected duration of the stress. It will also consider the drivers and context of that stress (whether firm specific or systemic) and macroeconomic and financial conditions. Consistent with the PRA's Principle 11.6 a firm should notify the PRA as early as possible in advance where it has identified a material risk to its ability to meet the combined buffer according to the capital conservation plan and timeframe approved by the PRA. The firm's notification should include as minimum:
- a) the MDA;
 - b) if the firm has given a notification under Capital Buffers 4.3(9), an update to that notification containing the information in Capital Buffers 4.3(9); and
 - c) an updated capital conservation plan as in Capital Buffers 4.4.
- 3.4 Where a firm has given to the PRA a notification under Capital Buffers 4.3(9), the firm should give to the PRA an update to that notification — including the updated MDA — at least every six months. Firms and their directors should also have regard to any applicable duties under company law. When a firm does not meet the combined buffer it should notify the PRA before making any statements about its present or future intentions to distribute any of its distributable profits or undertake any action referred to in points (a), (b) and (c) of Capital Buffers 4.3(2). The PRA will generally expect a firm not to fetter its discretion or impede its ability to use profits to enable the firm to meet its combined buffer.
- 3.5 All banks (including new entrants) will be subject to automatic restrictions on distributions if their capital falls below the level of the combined buffer and will have to agree a plan with the PRA to (re)build the combined buffer. Within that plan the PRA will use the discretion available to it to allow new entrants more time to build up the combined buffer.

Annex – SS6/14 updates

This annex details the changes that have been made to this supervisory statement (SS) following its initial publication in April 2014:

2020

23 January 2020

Following publication of Policy Statement 2/20 ‘Pillar 2 Capital: Updating the Framework’⁷, this SS was updated to clarify the usability of buffers and the considerations taken into account in the PRA’s assessment of the use of buffers. This is detailed in paragraphs 3.1 and 3.3.

This policy is effective from Thursday 23 January 2020.

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7 January 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2019/pillar-2-capital-updates-to-the-framework>.