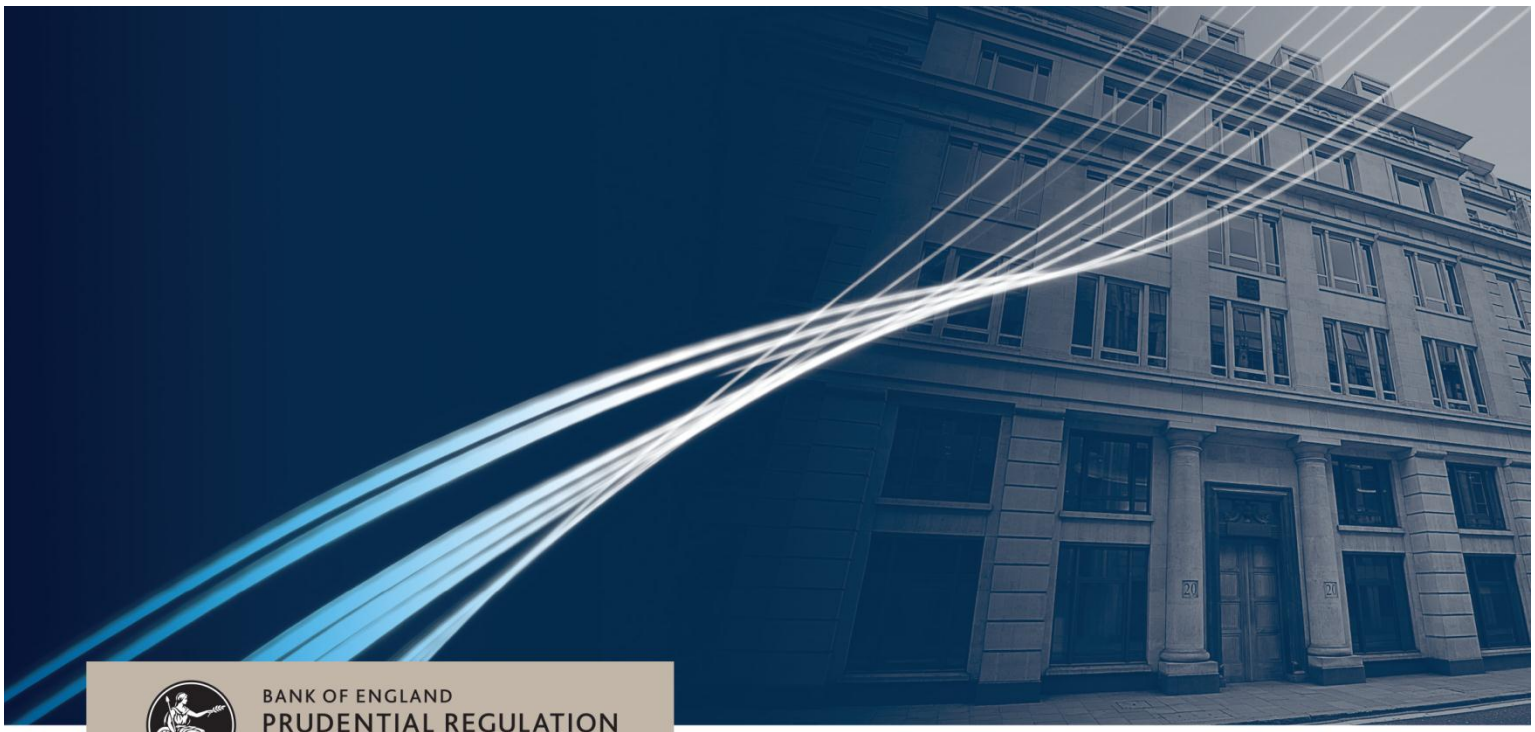

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Consultation Paper| CP29/15

Occasional Consultation Paper

August 2015

Prudential Regulation Authority
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London EC2R 6DA

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Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure, in accordance with access to information regimes under the Freedom of Information Act 2000 or the Data Protection Act 1998 or otherwise as required by law or in discharge of our statutory functions.

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Responses are requested by:
14 September for Chapter 1; and
14 November for Chapters 2 to 6.

Please address any comments or enquiries to:
Email: OCPresponses@bankofengland.co.uk

Contents

1 Deletion of administrative fee for late regulatory reporting

1 Introduction

1.1 The chapter is relevant to all firms supervised by the PRA.

1.2 This chapter sets out the proposal to delete the administrative fee rule for late regulatory reporting (SUP 16.3.14) from the Prudential Regulation Authority (PRA's) Handbook. The PRA is proposing to delete the Handbook rule that imposes an administrative fee on firms who submit regulatory data items after the submission deadline (late fees).

1.3 The PRA requires firms to submit accurate and timely reports. However, the PRA no longer feels it is appropriate to levy late fees. Instead, the PRA will continue to identify and monitor when reports are submitted late and, together with consideration of data accuracy, will consider late returns as part of its assessment of the adequacy of a firm's management and governance. Evidence of deficiencies in reporting processes may lead to supervisory intervention using existing supervisory powers, including skilled person reviews under FSMA s166.

1.4 The Financial Conduct Authority (FCA) has an equivalent rule that will remain, and will therefore still apply to those firms who are regulated solely by the FCA. For firms who are lead regulated by the PRA, it is proposed that the fee will no longer be collected in respect of prudential reports.

1.5 Other than the removal of late fees, this proposal does not represent a substantive change in policy. The PRA considers that there will be no increase of costs for firms as a result of these changes and therefore has not produced a full cost-benefit analysis.

1.6 The proposed Handbook rule changes are presented in Appendix 1.

2 Statutory obligations

2.1 The PRA has considered matters to which it is required to have regard and believes that this proposal is compatible with the regulatory principles.

2.2 The PRA considers the impact of this proposal on effective competition in those markets for activities provided by PRA authorised firms to be neutral and has not identified any constraint on competition from this proposal. The proposed removal of late fees applies equally to all firms regulated by the PRA and thus the impact on mutuals will not be significantly different from the impact on other firms.

2.3 The PRA considers that there are no equality or diversity issues arising from this proposal.

2 Amendments to Reporting Pillar 2

1 Introduction

1.1 This chapter sets out proposed amendments to the Reporting Pillar 2 Part of the Rulebook. The proposals are relevant to banks, building societies and designated investment firms subject to the Reporting Pillar 2 Part of the Rulebook.

1.2 The Prudential Regulation Authority (PRA) proposes to insert both a definition of 'data item' and an interpretative provision to make it clearer that terms defined in the CRR and not otherwise defined in the Part shall have the meaning given in the CRR.

1.3 Proposed amendments to the rules are presented in Appendix 2.

2 Cost-benefit analysis

2.1 The PRA considers that there will be no increase of costs for firms as a result of these changes and therefore has not produced a full cost-benefit analysis.

3 Statutory obligations

3.1 These proposals contribute to the PRA's general objective to promote the safety and soundness of firms as they are intended to ensure certainty and consistency of application of the rules relating to the reporting of data for Pillar 2 purposes. The PRA has considered matters to which it is required to have regard and believes that these amendments to the Reporting Pillar 2 Part of the Rulebook are compatible with the Regulatory Principles.

3.2 In light of its statutory secondary competition objective, the PRA has also assessed whether the content of this consultation facilitates effective competition in markets for services provided by PRA-authorised persons in carrying on regulated activities. These proposals are designed to ensure certainty and consistency of application of the rules relating to the reporting of data for Pillar 2 purposes. The PRA therefore considers the content of this consultation to be compatible with the facilitation of competition.

3.3 These proposals apply to banks, building societies and designated investment firms subject to the Reporting Pillar 2 Part of the Rulebook, including mutuals. The impact on mutual societies is not expected to be different to that on other types of authorised person.

3 Amendments to SS 13/13 on Market Risk

1 Introduction

1.1 This chapter sets out proposed amendments to the Prudential Regulation Authority (PRA) supervisory statement on Market Risk (SS13/13). It is relevant to banks, building societies and PRA designated investment firms.

1.2 The amendments to the supervisory statement bring to the attention of PRA-authorised firms the PRA's expectations for firms applying for: the use of own estimates of delta in the standardised approach for options; the use of sensitivity models under Article 331 of the Capital Requirements Regulation (CRR);[1] and the exclusion of positions from the calculation of net open currency positions under Article 352(2) of the CRR. The amendments clarify the criteria expected of firms to satisfy the standards set out in the relevant CRR articles. There are also minor amendments, which are not of substantive effect, to 3.1 and 3.2 to align the drafting.

1.3 The updated supervisory statement is presented in Appendix 3. There are changes to Chapter 3.1, 3.2 and an additional Chapter 4.

2 Cost benefit analysis

2.1 The proposed additions to the supervisory statement clarify the PRA's expectations for firms seeking permission approval under CRR Articles 331 and 352(2). These changes seek to ensure consistency in the assessment of these permissions. The changes to the supervisory statement clarify expectations and as such there should be no additional costs to firms.

3 Statutory obligations

3.1 In discharging its general functions of making rules, and determining the general policy and principles by reference to which it performs particular functions, the PRA must, so far as reasonably possible, act in a way that advances its general objective to promote the safety and soundness of the firms it regulates. The proposed amendments to SS13/13 will enable the PRA to make judgements that will enhance transparency of the application process for those permissions set out under CRR Articles 331 and 352(2).

3.2 In developing the amendments to the supervisory statement, the PRA has had regard to the Regulatory Principles as set out in the Financial Services & Markets Act 2000 (FSMA).[2] The clarified process seeks to further efficient use of PRA resources in a transparent way. 3.3 When discharging its general functions in a way that advances its primary objectives, the PRA has, as a secondary objective, a duty to facilitate effective competition in the markets for services provided by PRA-authorised persons. The PRA does not anticipate that there will be an impact on competition as a result of the proposals in this consultation paper.

[1] http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1438081856601&uri=CELEX:32013R0575R(02).
[2] http://www.legislation.gov.uk/ukpga/2012/21/section/6.

3.4 The PRA has considered the equality and diversity implications that may arise from the proposals in this consultation. The PRA considers that the proposals do not give rise to discrimination issues and are of low relevance to the equality agenda.

4 Amendments to SS 12/13 Counterparty Credit Risk

1 Introduction

1.1 This chapter sets out proposed amendments to the Prudential Regulation Authority (PRA) supervisory statement on Counterparty Credit Risk (SS12/13). It is relevant to banks, building societies and PRA designated investment firms.

1.2 The amendments to the supervisory statement bring to the attention of PRA-authorised firms changes to the transitional period for qualifying central counterparties (QCCP). The amendments also clarify that further information on central counterparties (CCPs) can be found on the European Securities and Markets Authority (ESMA) website and PRA expectations when a CCP no longer reports its hypothetical capital (Kccp).

1.3 The updated supervisory statement is presented in Appendix 4.

2 Cost benefit analysis

2.1 The proposed additions to the supervisory statement clarify that information on QCCPs can be found through the ESMA website.[3] These changes seek to ensure clarity for institutions with exposure to CCPs and as such there should be no additional costs to firms.

3 Statutory obligations

3.1 In discharging its general functions of making rules, and determining the general policy and principles by reference to which it performs particular functions, the PRA must, so far as reasonably possible, act in a way that advances its general objective to promote the safety and soundness of the firms it regulates. The proposed amendments to SS12/13 will enable the PRA to make judgements that will enhance transparency of CCP information relevant for CRR Article 308.

3.2 In developing the amendments to the supervisory statement, the PRA has had regard to the Regulatory Principles as set out in the Financial Services & Markets Act 2000 (FSMA).[4] The clarified process seeks to further efficient use of PRA resources in a transparent way.

3.3 When discharging its general functions in a way that advances its primary objectives, the PRA has, as a secondary objective, a duty to facilitate effective competition in the markets for services provided by PRA-authorised persons. The PRA does not anticipate that there will be an impact on competition as a result of the proposals in this consultation paper. The PRA has considered the equality and diversity implications that may arise from the proposals in this consultation. The PRA considers that the proposals do not give rise to discrimination issues and are of low relevance to the equality agenda.

[3] http://www.esma.europa.eu/page/Central-Counterparties
[4] http://www.legislation.gov.uk/ukpga/2012/21/section/6

5 Amendments to the Certification Part

1 Introduction

1.1 This chapter sets out proposed amendments to the Prudential Regulation Authority (PRA) definition of 'significant risk taker', which is used in the Certification Part of the PRA Rulebook to define the 'certification functions' which fall within scope of the PRA's Certification Regime. This change would bring the definition of 'significant risk taker' into line with the definition of a 'material risk taker' used in the Remuneration rules recently published in PS12/15,[5] and therefore fulfil the longstanding policy intention of aligning the scope of the Certification regime as closely as possible with the material risk taker population. The PRA's intention to base the scope of the Certification regime on the criteria used to define material risk takers was originally set out in July 2014 in CP14/14,[6] and was recently reconfirmed in PS16/15, which noted the PRA's intention to consult on the amendment proposed here.[7]

1.2 The proposed change to the definition of 'significant risk taker' would only affect firms subject to the Capital Requirements Regulation (CRR firms). It amends the reference to Commission Delegated Regulation (EU) No 604/2014 (the Material Risk Takers Regulation); the current definition states that an employee who meets any of the criteria set out in Articles 3 to 5 of the Material Risk Takers Regulation will be a significant risk taker. Under the revised wording, the definition would be widened to include any employee 'whose professional activities have a material impact on the firm's risk profile' including those who meet the criteria in Articles 3 to 5. This is the same wording used to define a 'material risk taker' in Remuneration 3.1.

1.3 The PRA also proposes to make an equivalent update to the definition of significant risk taker used for a non-EEA branch, subject to the provisions of Remuneration 3.2 which permit the non-EEA branch to deem some employees not to be material risk takers who would otherwise be treated as so, provided the non-EEA branch notifies the PRA in a prescribed manner. This would involve an amendment to the near-final rules for non-EEA branches recently published in PS20/15.[8]

2 Cost Benefit Analysis

2.1 As this is a widening of the definition, this change could increase the number of employees firms are required to certify, and therefore increase the costs for firms. However, as the stated policy intention has always been to ensure that the Certification regime is aligned as closely as possibly with the material risk taker population, the PRA does not believe that this will have material effect on the previously published cost benefit analysis; rather it is a correction to ensure that the rules fully deliver the previously declared policy.

2.2 Similarly, the PRA understands that the work firms have undertaken so far to prepare for the Certification Regime has assumed that they should use their entire material risk taker population as

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5 PRA Policy Statement PS12/15, 'Strengthening the alignment of risk and reward: new remuneration rules', June 2015; http://www.bankofengland.co.uk/pra/Pages/publications/ps/2015/ps1215.aspx

6 PRA Consultation Paper CP14/14, 'Strengthening accountability in banking: a new regulatory framework for individuals', July 2015, Chapter 3; http://www.bankofengland.co.uk/pra/Pages/publications/cp/2014/cp1414.aspx

7 PRA Policy Statement PS16/15, 'Strengthening individual accountability in banking: responses to CP14/14, CP28/14 and CP7/15', July 2015, paragraph 3.33; http://www.bankofengland.co.uk/pra/Pages/publications/ps/2015/ps1615.aspx

8 PRA Policy Statement PS20/15, 'Strengthening individual accountability in banking: UK branches of non-EEA banks, August 2015; http://www.bankofengland.co.uk/pra/Pages/publications/ps/2015/ps2015.aspx

the starting point for identifying staff in the certification regime. Therefore the PRA does not expect this change to require firms to materially revise any work they have undertaken so far to identify staff performing certification functions.

3 Statutory Obligations

3.1 The proposals are compatible with the PRA's statutory objectives under the Financial Services and Markets Act 2000 (FSMA): to promote the safety and soundness of PRA-authorised firms.[9]

3.2 In making its rules and establishing its practices and procedures, the PRA must have regard to the Regulatory Principles as set out in the Financial Services and Markets Act 2000 (FSMA). The PRA may not act in an unlawfully discriminatory manner. It is required, under the Equalities Act 2010, to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions. To meet this requirement, the PRA has performed an assessment of the policy proposals and does not consider that the proposals give rise to equality and diversity implications.

3.3 When discharging its general rule-making function, the PRA is legally required, so far as is reasonably possible, to facilitate effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities. The PRA does not consider that the proposed amendment will either hinder or promote effective competition.

3.4 The proposed amendment would affect some firms which are mutual societies – although it only applies to firms subject to the Capital Requirements Regulation and therefore does not affect credit unions.[10] The PRA does not consider that the impact of the proposal on mutual societies will be significantly different from the impact on other firms.

[9] See s.2B(1) and s.2B(2) FSMA.
[10] Capital Requirements Regulation: Regulation (EU) No 575/2013; http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R0575

6 Amendments to the Pre-Issuance Notification (PIN) Regime Applicable to CRR Firms And Insurers

1 Introduction

1.1 This chapter sets out proposed amendments to the Pre Issuance Notification (PIN) rules applicable to CRR firms[11] and insurers[12], which would take effect on 1 January 2016.

1.2 PIN rules have been in place since 2012. They are intended to enhance the quality of firms' capital resources by providing the PRA with the opportunity to review and comment on the terms and conditions of proposed capital instruments prior to such instruments' issuance.

1.3 In particular, the following rules would be subject to change: (i) Definition of Capital, Chapter 7 (PIN rules applicable to CRR firms); and (ii) PRA Rulebook: Solvency II Firms: Own Funds Instrument 2015, chapter 5 – Notification of issuance of own funds items and Group Supervision Instrument 2015, chapter 6 – Notification of issuance of own funds items by group member (PIN rules applicable to insurers subject to Solvency II (Solvency II firms)). The PRA also proposes to recast existing rules and to make new rules regarding pre issuance notification that will apply to insurers not subject to Solvency II (non-Directive firms but excluding friendly societies).

2 Summary of proposals

2.1 The PRA's proposals can be divided into four categories.

(a) Changes that apply to both Solvency II insurers and Non-Directive Firms that would align PIN rules applicable to these firms with requirements applicable to CRR firms. In particular insurance firms would be required to:

- submit a legal opinion regarding the compliance of a proposed capital instrument (other than ordinary share capital) with the applicable quality of capital requirements; and
- provide the PRA with at least one month's notice prior to amending an insurance capital instrument.

2.2 GENPRU 2.2.118 and 2.2.159(12) require firms to obtain legal opinions for innovative Tier 1 and Tier 2 capital instruments prior to including these items in their capital resources. These requirements will not apply after 31 December 2015. The PRA proposes to require insurers (including non-Directive firms) to obtain legal advice regarding proposed instruments' compliance with the PRA's rules regarding capital quality, and to submit a copy of that advice as part of the PIN process.

[11] These include banks, building societies and PRA UK designated investment firms.
[12] These include Solvency II Firms and Non-Directive Firms.

2.3 (b) Changes that apply to both CRR firms and insurers, and that would maintain consistency between the regimes:

- The PRA proposes to require CRR firms and insurers to provide the PRA with at least one month's notice prior to issuing a capital instrument pursuant to a note issuance programme, regardless of whether the note issuance programme previously has been subject to the PIN process. Currently, individual drawdowns pursuant to note issuance programmes are exempt from the one month notification requirement. The PRA proposes to remove this exemption. Note issuance programmes provide firms with flexibility to issue capital instruments containing a variety of features. It is often unclear whether individual drawdowns will meet the PRA's rules and expectations regarding capital quality until the relevant final terms are specified. Accordingly, the PRA proposes to exclude note issuance programmes from the PIN rules and apply the rules instead to individual drawdowns.

- The PRA proposes to require CRR firms and Solvency II firms to submit an accounting opinion when issuing Additional Tier 1 (AT1) (CRR firms) or Restricted Tier 1 (RT1)[13] (Solvency II firms) capital instruments. This is in order to identify whether such instruments would be treated as liabilities given the incentives and complexities that may arise. For example, an instrument's treatment as a liability may incentivise the issuer to hedge currency or other exposures. The existence of such hedges may impact flexibility of payments under the capital instrument and give rise to other concerns regarding capital quality. Also, for firms that issue liabilities, fair valuing any embedded derivative element of the capital instrument may be very complex.

2.4 (c) Changes which apply to CRR firms

- The PRA proposes to require CRR firms to provide the PRA with at least one month's notice prior to every issuance of a Common Equity Tier 1 (CET1) instrument. Currently, ordinary shares with voting rights that do not contain any new features are excluded from the one month notification requirement. The PRA proposes to remove this exclusion. Moreover, the PRA would seek to replace the legal opinion requirement currently applicable to CET1 instruments with a requirement for CRR firms to complete a CET1 compliance template. The CET1 compliance template would need to be completed by an independent legal advisor. CRR firms would confirm that a proposed instrument meets the conditions for qualification as CET1 capital.[14]

2.5 (d) Changes to PIN forms

- As a result of the proposed changes, the current PIN form will be split into separate forms for CRR firms and insurers tailored to the information the PRA requests from each type of firm. Annex B and C of Appendix 6 contain the proposed new forms. For CRR firms, the PIN form will be part of the Definition of Capital rules.

2.6 The changes that the PRA proposes should decrease the risk of firms issuing capital instruments that are not compliant with CRR, Solvency II, or PRA requirements and expectations regarding capital quality. However, the PIN regime is not a pre-approval process. It remains the responsibility of firms to ensure compliance with applicable rules.

3 Cost-benefit analysis

[13] See Article 82(3) of the Solvency II Regulations. These are items which are only eligible up to 20% of total tier 1 own funds.
[14] See Appendix 6 (proposed CET1 compliance template)

3.1 The additional cost to firms of implementing the proposed requirements are expected to be modest:

3.2 As discussed above, the PRA already requires insurers to obtain legal opinions for Innovative Tier 1 and Tier 2 instruments.[15]

3.3 The PRA already requires insurers to notify the PRA of proposed amendments to Tier 2 instruments.[16] The PRA does not believe that extending this requirement to other tiers of capital instruments will entail substantial additional costs.

3.4 The PRA already requires firms issuing capital instruments pursuant to note issuance programmes to provide the PRA with notice of the issuance, albeit not one month in advance of issuance.[17] Firms would be free to submit their draft final terms earlier than this in order to preserve flexibility regarding their intended issue date.

3.5 The PRA already requests that CRR firms provide independent accounting opinions explaining the treatment of proposed AT1 capital instruments in the firm's accounts. Most firms already provide this on a voluntary basis. The PRA expects that in most cases any firm issuing an AT1 or RT1 instrument would seek an accounting opinion to provide clarity regarding the impact of the instrument upon its accounting balance sheet. Firms' provision of accounting opinions has assisted in identifying and addressing the issues outlined in the second bullet point of 2.4 above.

3.6 The PRA does not expect that requiring CRR firms to submit PIN applications one month in advance of issuing CET1 instruments will reduce the flexibility of CRR firms to issue CET1 instruments when market conditions are favourable. CRR firms may submit a PIN for a CET1 instrument, and delay issuance of the instrument until suitable market conditions exist. Moreover, CRR firms should identify the need to raise CET1 capital as part of their capital planning process, far in advance of issuing CET1 instruments. In exceptional circumstances, the PRA may be prepared to accept less than one month's notice. Completion of the CET1 compliance template by an independent legal counsel would involve similar costs as those required to produce independent legal opinions. Moreover, if a CRR firm issues a CET1 instrument substantively similar to one it has issued in the past, the firm could duplicate the information contained on the previous CET1 compliance form, appropriately updated. This should result in a cost savings for firms. The PRA particularly invites comments on how this proposal may affect regular issuances of CET1 instruments (e.g., scrip dividends and ordinary shares issued for remuneration purposes).

3.7 The PRA does not expect that the proposed changes to the PIN form will lead to an increase in costs for firms, since the newly required information should be readily available to firms.

4 Statutory obligations

4.1 The PRA's proposals would contribute to the PRA's general objective to promote the safety and soundness of firms,[18] by helping the PRA supervise the quality of proposed regulatory capital.

4.2 The PRA's proposals would enable firms and the PRA to make judgments which advance the PRA's objectives. As such, the PRA has considered matters to which it is required to have regard and believes that these amendments are compatible with the regulatory principles. The PRA has

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15 See GENPRU 2.2.118 and GENPRU 2.2.159(12).
16 See GENPRU 2.2.171.
17 See GENPRU 2.2.61F and INSPRU 6.1.43F (insurers), DC 6.4 (CRR firms).
18 Section 2B(1) and 2B(2) of FSMA 2000.

assessed whether the proposals in this consultation facilitate effective competition in the markets for services provided by PRA-authorised persons in carrying out regulated activities. This consultation does not constrain firm behaviour. The PRA has not identified any constraints on competition related to these proposals.

4.3 These proposals apply to banks, building societies, PRA UK designated investment firms, including mutuals and insurers, which are unlikely to be affected any differently from other firms.

4.4 The PRA does not consider that these proposals give rise to any discrimination issues.

Appendices

1	HANDBOOK (SUPERVISION: LATE REPORTING) INSTRUMENT 2015
2	PRA RULEBOOK: CRR FIRMS: REPORTING PILLAR 2 (AMENDMENT) INSTRUMENT [YEAR]
3	SS 13/13 MARKET RISK
4	SS 12/13 Counterparty Credit Risk
5	SS 13/13 MARKET RISK
6	PRA RULEBOOK: CRR FIRMS: DEFINITION OF CAPITAL AMENDMENT INSTRUMENT 2015
7	PRA RULEBOOK: SOLVENCY II FIRMS: OWN FUNDS (NOTIFICATION OF ISSUANCE – AMENDMENTS) INSTRUMENT 2015
8	PRA RULEBOOK: SOLVENCY II FIRMS: GROUP SUPERVISION (NOTIFICATION OF ISSUANCE – AMENDMENTS) INSTRUMENT 2015
9	PRA RULEBOOK: NON-SOLVENCY II FIRMS: INSURANCE COMPANIES – CAPITAL RESOURCES (NOTIFICATION OF ISSUANCE – AMENDMENTS) INSTRUMENT 2015
10	PRE ISSUANCE NOTIFICATION (PIN) FORM FOR INSURANCE FIRMS

Appendix 1

HANDBOOK (SUPERVISION: LATE REPORTING) INSTRUMENT 2015

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);
(2) section 137T (General supplementary powers); and
(3) paragraph 31 of Schedule 1ZB (Fees);

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.

Handbook (Supervision: Late Reporting) Instrument 2015

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

Commencement

E. This instrument comes into force on [**DATE**].

Citation

F. This instrument may be cited as the Handbook (Supervision: Late Reporting) Instrument 2015.

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

Amendments to Supervision (SUP)

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

…

Failure to submit reports

~~16.3.14 R~~ ~~(1) If a *firm* does not submit a complete report by the date on which it is due in accordance with the *rules* in, or referred to in, this chapter or the provisions of relevant legislation and any prescribed submission procedures, the *firm* must pay an administrative fee of £250.~~

~~(2) The administrative fee in (1) does not apply in respect of quarterly reports required to be submitted by *credit unions* whose liability to pay a periodic fee under FEES 4.2.1 R in respect of the A.1 activity group in FEES 4 Annex 1A and FEES 4 Annex 1B R, for the financial year prior to the due date for submission of the report, was limited to the payment of the minimum fee.~~

~~16.3.14A G~~ ~~Failure to submit a report in accordance with the *rules* in, or referred to in this chapter or the provisions of relevant legislation may also lead to the imposition of a financial penalty and other disciplinary sanctions. A *firm* may be subject to reporting requirements under relevant legislation other than the *Act*, not referred to in this chapter. An example of this is reporting to the *appropriate regulator* by *building societies* under those parts of the Building Societies Act 1986 which have not been repealed (see SUP 16.1.4 G). If it appears to the *appropriate regulator* that, in the exceptional circumstances of a particular case, the payment of any fee would be inequitable, the *appropriate regulator* may reduce or remit all or part of the fee in question which would otherwise be payable (see 23FEES 2.3).~~

16.3.14B G Failure to submit a report in accordance with the *rules* in, or referred to in this chapter or the provisions of relevant legislation may lead to the imposition of a financial penalty and other disciplinary sanctions. A *firm* may be subject to reporting requirements under relevant legislation other than the *Act*, not referred to in this chapter. An example of this is reporting to the *appropriate regulator* by *building societies* under those parts of the Building Societies Act 1986 which have not been repealed (see SUP 16.1.4 G).

…

Appendix 2

PRA RULEBOOK: CRR FIRMS: REPORTING PILLAR 2 (AMENDMENT) INSTRUMENT [YEAR]

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"):

(4) section 137G (the PRA's general rules); and
(5) 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: Reporting Pillar 2 (Amendment) Instrument [Year]

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

Commencement

E. This instrument comes into force on [DATE].

Citation

F. This instrument may be cited as the PRA Rulebook: CRR Firms: Reporting Pillar 2 (Amendment) Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex

Amendments to the Reporting Pillar 2 Part of the PRA Rulebook

In this Annex new text is underlined.

1 APPLICATION AND DEFINITIONS

…

1.6 In this Part the following definitions shall apply:

…

data item

means the information relating to a particular risk or risk assessment grouped together into a prescribed format and required to be submitted to the *PRA* by a *firm* under Chapter 2.

…

1.7 Unless otherwise defined, any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*.

Appendix 3

SS 13/13

Introduction

1.1 This Supervisory Statement is aimed at firms to which CRD IV applies.

1.2 It sets out the Prudential Regulation Authority's (PRA's) expectations of firms in relation to market risk and should be considered in addition to requirements set out in CRD IV Articles 325–377, the market risk rules of the PRA Rulebook and the high-level expectations outlined in *The PRA's approach to banking supervision*[19]

1.3 This statement details the PRA's expectations with regard to the following:

• Material deficiencies in risk capture by an institution's internal approach.

• Standardised approach for options.

• Netting a convertible with its underlying instrument.

• Offsetting derivative instruments.

• Exclusion of backtesting exceptions when determining multiplication factor addends.

• Derivation of notional positions for standardised approaches.

• Qualifying debt instruments.

• Expectations relating to internal models.

• Value-at-Risk (VaR) and stressed VaR (sVaR) calculation.

• Requirement to have an internal incremental risk charge (IRC) model.

• Annual SIF attestation of market risk internal models.

2 Material deficiencies in risk capture by an institution's internal approach

2.1 This section sets out the PRA's requirements for the calculation of additional own funds for the purposes of implementing CRD Article 101, which applies where a firm has permission to calculate own funds requirements for one or more categories of market risk under CRR Part 3 Title IV Chapter 5. It requires firms to identify any risks which are not adequately captured by those models and to hold additional own funds against those risks. The methodology for the identification of those risks and the calculation of those additional own funds for VaR and sVaR models is referred to as the 'RNIV framework'.

2.2 Firms are responsible for identifying these additional risks, and this should be seen as an opportunity for risk managers and management to better understand the shortcomings of the firm's models. Following this initial assessment, the PRA will engage with the firm to provide challenge and so ensure an appropriate outcome.

Scope of the Risks not in VaR (RNIV) framework

2.3 The RNIV framework is intended to ensure that own funds are held to meet all risks which are not captured, or not captured adequately, by the firm's VaR and sVaR models.

These include, but are not limited to missing and/or illiquid risk factors such as cross-risks, basis risks, higher-order risks, and calibration parameters. The RNIV framework is also intended to cover event risks that could adversely affect the relevant business.

Identification and measurement framework

19 www.bankofengland.co.uk/pra/Pages/supervision/approach/default.aspx.

2.4 The PRA expects firms to systematically identify and measure all non-captured or poorly captured risks. This analysis should be updated at least quarterly, or more frequently at the request of the PRA. The measurement of these risks should capture the losses that could arise due to the risk factor(s) of all products that are within the scope of the relevant internal model permission, but are not adequately captured by the relevant internal models.

Identification of risk factors

2.5 The PRA expects firms to, on a quarterly basis, identify and assess individual risk factors covered by the RNIV framework. The PRA will review the results of this exercise and may require that firms identify additional risk factors as being eligible for measurement.

Measurement of risk factors

2.6 Where sufficient data is available, and where it is appropriate to do so, the PRA expects firms to calculate a VaR and sVaR metric for each risk factor within scope of the framework. The stressed period for the RNIV sVaR should be consistent with that used for sVAR. No offsetting or diversification may be recognised across risk factors included in the RNIV framework. The multipliers used for VaR and sVaR should be applied to generate an own funds requirement.

2.7 If it is not appropriate to calculate a VaR and sVaR metric for a risk factor, a firm should instead measure the size of the risk based on a stress test. The confidence level and capital horizon of the stress test should be commensurate with the liquidity of the risk, and should be at least as conservative as comparable risk factors under the internal model approach.

The capital charge should be at least equal to the losses arising from the stress test.

Reporting of RNIV

2.8 Firms that are required to compute RNIV should complete FSA005 — in addition to the MRK IM COREP reporting template — for the relevant rows. When submitting FSA005, firms are advised to complete the fields as follows:

• populate the table under element 63, filling in both fields in each row;

• element 64 should be the total of all values entered in 63 column B; and

• in order for the form to validate, the value entered in 64 should also be entered in 61 and 62.

2.9 Firms that are required to compute RNIV should complete the MKR IM COREP reporting template in addition to FSA005, and include the own funds required in their COREP reporting.

The components of RNIV should be included within C24.00 as follows:

• RNIV from VaR should be added to [C24.00, {c030}, r010] and [C24.00, {c040}, r010];

• RNIV from sVaR should be added to [C24.00, {c050}, r010] and [C24.00, {c060}, r010]; and

• RNIV from stress tests should be added to [C24.00, {c050}, r010] and [C24.00, {c060}, r010].

3 Standardised approach for options

3.1 Firms that need to use own estimates of delta for the purposes of the standardised approach for options, should provide the PRA with confirmation that they meet the minimum standards set out below for each type of option for which they calculate delta. Firms should only provide this confirmation if they meet the minimum standards. Where a firm meets the minimum standards, they will be permitted to use own estimates of delta for the relevant option. Firms should read the requirements for the grant of the permissions set out in CRR Articles 329, 352, and 358, as appropriate, before applying for any of these permissions.

3.2 If a firm has a permission under any of these articles but ceases to be able to provide assurance with regard to a particular option type which is currently within its permissions, a capital add-on may be applied and a rectification plan agreed. If a firm is unable to comply with the rectification plan within the mandated time-frame, further supervisory measures may be taken. This may include variation of permissions so that they are no longer allowed to trade those particular types of option for which they do not meet the minimum standards.

Minimum standards

3.3 The level of sophistication of the pricing models, which are used to calculate own estimates of delta for use in the standardised approach for options, should be proportionate to the complexity and risk of each option and the overall risk of the firm's options trading business. In general, it is considered that the risk of sold options will be higher than the risk of the same options when bought.

3.4 Delta should be recalculated at least daily. Firms should also recalculate delta promptly following significant movements in the market parameters used as inputs to calculate delta.

3.5 The pricing model used to calculate delta should be:

- based on appropriate assumptions which have been assessed and challenged by suitably qualified parties independent of the development process;
- independently tested, including validation of the mathematics, assumptions, and software implementation; and
- developed or approved independently of the trading desk.

3.6 A firm should use generally accepted industry standard pricing models for the calculation of own deltas where these are available, such as for relatively simple options.

3.7 The IT systems used to calculate delta should be sufficient to ensure that delta can be calculated accurately and reliably.

3.8 Firms should have adequate systems and controls in place when using pricing models to calculate deltas. This should include the following documented policies and procedures:

- clearly defined responsibilities of the various areas involved in the calculation;
- frequency of independent testing of the accuracy of the model used to calculate delta; and
- guidelines for the use of unobservable inputs, where relevant.

3.9 A firm should ensure its risk management functions are aware of weaknesses of the model used to calculate deltas. Where weaknesses are identified, the firm should ensure that estimates of delta result in prudent capital requirements being held. The outcome should be prudent across the whole portfolio of options and underlying positions at a given time.

4. Sensitivity Models for Interest Rate Risk

4.1 Firms intending to use sensitivity models to calculate the positions on derivative instruments covered in Articles 328 to 330 of the CRR are expected to demonstrate that they meet the requirements for granting of the relevant permission by providing the PRA with confirmation that they meet the minimum standards set out in paragraphs 4.3-4.9 below. Where a firm meets the minimum standards, it will be permitted to use sensitivity models to calculate the positions referred to in those Articles and may use them for any bond which is amortised over its residual life rather than via one final repayment of principal. Firms should read CRR Article 331 before applying for this permission.

4.2 If a firm has a permission under any of these articles but ceases to be able to provide assurance with regard to a particular position which is currently within its permissions, a capital add-on may be applied and a rectification plan agreed. If a firm is unable to comply with the rectification plan within the mandated time-frame, further supervisory measures may be taken.

Minimum standards

4.3 Firms should indicate the instruments for which net sensitivity positions are used and the currencies in which those positions are denominated. In addition, for the product scope requested:

- Firms should confirm that the interest rate risk is managed on a discounted-cash-flow basis.
- Firms should briefly indicate any growth plans for the exposures.

4.4 Firms should confirm that all models generate positions which have the same sensitivity to interest rate changes as the underlying cash flows.

4.5 The sensitivities should be assessed with reference to independent movement in sample rates across the yield curve, with at least one sensitivity point in each of the maturity bands and appropriate

to produce accurate valuation changes based on the assumed interest rate changes as set out in Table 2 in Article 339 of the CRR.

4.6 The sophistication of all pricing models used should:

- be proportionate to the complexity and risk of the instruments and the nature of the business.
- be based on appropriate assumptions that have been assessed and challenged by suitably qualified parties independent of the development process.
- have been independently tested, including validation of the mathematics, assumptions, and software implementation.
- have been developed or approved independently of the trading desk.

4.7 The frequency of independent testing of the accuracy of the pricing model and guidelines for the use of unobservable inputs, where relevant, should be documented. The responsibilities of the various areas involved in the calculation should be clearly defined and documented.

4.8 Risk management functions should be aware of weaknesses in the model used to calculate sensitivities to interest rate changes, and where weaknesses are identified a prudent amount of additional capital should be held against the relevant exposures.

4.9 Firms should confirm that sensitivities to interest rate changes can be recalculated promptly following significant movements in inputs used to calculate sensitivities. IT systems used to calculate sensitivities to interest rate changes should be sufficient to ensure that sensitivity positions can be calculated accurately and reliably.

5 Calculation of the overall net foreign exchange position

5.1 Firms intending to exclude from the calculation of net open currency positions any positions which are taken in order to hedge against the adverse effect of the exchange rate on its ratios in accordance with Article 92(1) are expected to demonstrate that they meet the requirements for grant of the relevant permission by providing the PRA with confirmation that they meet the minimum standards set out in paragraphs 5.3-5.9 below. Firms should read CRR Article 352 before applying for this permission.

5.2 If a firm has a permission under any of these articles but ceases to be able to provide assurance with regard to a particular position which is currently within its permissions, a capital add-on may be applied and a rectification plan agreed. If a firm is unable to comply with the rectification plan within the mandated time-frame, further supervisory measures may be taken. This may include variation of permissions so that it is no longer allowed to exclude those hedging positions from the calculation of net open currency positions for which it does not meet the minimum standards.

Minimum standards

5.3 Firms should confirm that the structural foreign exchange (FX) positions are deliberately taken in order to protect capital adequacy ratios against adverse movements in FX rates and are of a non-trading or structural nature.

5.4 Firms should confirm that mismatches resulting in an open position are avoided as far as possible and that positions are accounted for so that capital ratios are protected.

5.5 Firms should confirm that they consider and avoid any residual risks arising from structural FX positions as far as possible.

5.6 Firms should confirm that policies and procedures are clearly articulated and are made available to the board and to regulators on an annual basis. The structural FX hedging strategy should be clearly articulated to investors and included in Pillar 3 disclosures.

5.7 Firms should confirm that books containing structural FX positions are segregated from other trading activities.

5.8 Firms should confirm that traders' remuneration structures do not in any way incentivise structural FX positions becoming a profit centre.

5.9 Oversight of structural FX positions should be carried out by the appropriate committees of the boards of both the foreign entity and the group on at least a quarterly basis.

6 Netting a convertible with its underlying instrument

6.1 For the purposes of CRR Article 327(2), the netting of a convertible bond and an offsetting position in the instrument underlying it is permitted. The convertible bond should be:

• treated as a position in the equity into which it converts; and

• the firm's equity own funds requirement should be adjusted by making:

(i) an addition equal to the current value of any loss which the firm would make if it did convert to equity; or

(ii) a deduction equal to the current value of any profit which the firm would make if it did convert to equity (subject to a maximum deduction equal to the own funds requirements on the notional position underlying the convertible).

7 Offsetting derivative instruments

7.1 CRR Article 331(2) states conditions that should be met before firms not using interest rate pre-processing models can fully offset interest rate risk on derivative instruments. One of the conditions is that the reference rate (for floating rate positions) or coupon (for fixed rate positions) should be 'closely matched'. The PRA would normally consider a difference of less than 15 basis points as indicative of the reference rate or coupon being 'closely matched' for the purposes of this rule.

8 Exclusion of overshootings when determining multiplication factor addends

8.1 The PRA's starting assumption will be that all overshootings should be taken into account for the purpose of the calculation of addends. If a firm believes that an overshooting should not count for that purpose, then it should seek a variation of its VaR model permission in order to exclude that particular overshooting. The PRA will then decide whether to agree to such a variation.

8.2 One example of when a firm's overshooting might properly be disregarded is when it has arisen as a result of a risk that is not captured in its VaR model, but against which capital resources are already held.

9 Derivation of notional positions for standardised approaches

Futures and forwards on a basket or index of debt securities

9.1 These should be converted into forwards on single debt securities as follows:

(1) futures or forwards on a single currency basket or index of debt securities should be treated as either:

(a) a series of forwards, one for each of the constituent debt securities in the basket or index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant debt security in the basket; or

(b) a single forward on a notional debt security; and

(2) futures or forwards on multiple currency baskets or indices of debt securities should be treated as either:

(a) a series of forwards (using the method described in 1(a)); or

(b) a series of forwards, each one on a notional debt security to represent one of the currencies in the basket or index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant currency in the basket.

9.2 Notional debt securities derived through this treatment should be assigned a specific risk position risk adjustment and a general market risk position risk adjustment equal to the highest that would apply to the debt securities in the basket or index.

9.3 The debt security with the highest specific risk position risk adjustment within the basket might not be the same as the one with the highest general market risk position risk adjustment. A firm should select the highest percentages even where they relate to different debt securities in the basket or index, and regardless of the proportion of those debt securities in the basket or index.

Bonds where the coupons and principal are paid in different currencies

9.4 Where a debt security pays coupons in one currency, but will be redeemed in a different currency, it should be treated as:

(i) a debt security denominated in the coupon's currency; and

(ii) a foreign currency forward to capture the fact that the debt security's principal will be repaid in a different currency from that in which it pays coupons, specifically:

(a) a notional forward sale of the coupon currency and purchase of the redemption currency, in the case of a long position in the debt security; or

(b) a notional forward purchase of the coupon currency and sale of the redemption currency, in the case of a short position in the debt security.

Interest rate risk on other futures, forwards and swaps

9.5 Other futures, forwards, and swaps where a treatment is not specified in Article 328 should be treated as positions in zero specific risk securities, each of which:

(i) has a zero coupon;

(ii) has a maturity equal to that of the relevant contract; and

(iii) is long or short according to the following table:

Instrument	Notional positions		
Foreign currency forward or future	A long position denominated in the currency purchased	and	A short position denominated in the currency sold.
Gold forward	A long position if the forward or future involves an actual (or notional) sale of gold	or	A short position if the forward or future involves an actual (or notional) purchase of gold.
Equity forward	A long position if the contract involves an actual(or notional) sale of the underlying equity	or	A short position if the contract or future involves an actual (or notional) purchase of the underlying equity.

Deferred start interest rate swaps or foreign currency swaps

9.6 Interest rate swaps or foreign currency swaps with a deferred start should be treated as the two notional positions (one long, one short). The paying leg should be treated as a short position in a zero specific risk security with a coupon equal to the fixed rate of the swap. The receiving leg should be treated as a long position in a zero specific risk security, which also has a coupon equal to the fixed rate of the swap.

9.7 The maturities of the notional positions are shown in the following table:

	Paying leg	Receiving leg
Receiving fixed and paying floating	The maturity equals the start date of the swap.	The maturity equals the maturity of the swap.
Paying fixed and receiving floating	The maturity equals the maturity of the swap.	The maturity equals the start date of the swap.

Swaps where only one leg is an interest rate leg

9.8 For the purposes of interest rate risk, a firm should treat a swap (such as an equity swap) with only one interest rate leg as a notional position in a zero specific risk security:

(a) with a coupon equal to that on the interest rate leg;

(b) with a maturity equal to the date that the interest rate will be reset; and

(c) which is a long position if the firm is receiving interest payments and short if making interest payments.

Foreign exchange forwards, futures and CFDs

9.9 A firm should treat a foreign currency forward, future, or Contracts for Difference (CFDs) as two notional currency positions as follows:

(a) a long notional position in the currency which the firm has contracted to buy; and

(b) a short notional position in the currency which the firm has contracted to sell.

9.10 The notional positions should have a value equal to either:

(a) the contracted amount of each currency to be exchanged in the case of a forward, future, or CFD held in the non-trading book; or

(b) the present value of the amount of each currency to be exchanged in the case of a forward, future, or CFD held in the trading book.

Foreign currency swaps

9.11 A firm should treat a foreign currency swap as:

(a) a long notional position in the currency in which the firm has contracted to receive interest and principal; and

(b) a short notional position in the currency in which the firm has contracted to pay interest and principal.

9.12 The notional positions should have a value equal to either:

(a) the nominal amount of each currency underlying the swap if it is held in the non-trading book; or

(b) the present value amount of all cash flows in the relevant currency in the case of a swap held in the trading book.

Futures, forwards, and CFDs on a single commodity

9.13 Where a forward, future or CFD settles according to:

(1) the difference between the price set on trade date and that prevailing at contract expiry, then the notional position should:

(a) equal the total quantity underlying the contract; and

(b) have a maturity equal to the expiry date of the contract; and

(i) the difference between the price set on trade date and the average of prices prevailing over a certain period up to contract expiry, then a notional position should be derived for each of the reference dates used in the averaging period to calculate the average price, which:

(a) equals a fractional share of the total quantity underlying the contract; and

(b) has a maturity equal to the relevant reference date.

Buying or selling a single commodity at an average of spot prices prevailing in the future

9.14 Commitments to buy or sell at the average spot price of the commodity prevailing over some period between trade date and maturity should be treated as a combination of:

(1) a position equal to the full amount underlying the contract with a maturity equal to the maturity date of the contract, which should be:

(a) long, where the firm will buy at the average price; or

(b) short, where the firm will sell at the average price; and

(2) a series of notional positions, one for each of the reference dates where the contract price remains unfixed, each of which should:

(a) be long if the position under (1) is short, or short if the position under (1) is long;

(b) equal to a fractional share of the total quantity underlying the contract; and

(c) have a maturity date of the relevant reference date.

10 Qualifying debt instruments

10.1 CRR Article 336(4)(a) states that positions listed on a stock exchange in a third country, where the exchange is recognised by the competent authorities, qualify for the specific risk own funds requirements in the second row of the table in CRR Article 336.

10.2 For the purposes of this rule, the PRA recognise the following stock exchanges in third countries:

• Australian Securities Exchange Limited.

• Bermuda Stock Exchange.

• Bolsa Mexicana de Valores.

• Bourse de Montreal Inc.

• Channel Islands Stock Exchange.

• Chicago Board of Trade.

• Chicago Board Options Exchange.

• Chicago Board of Trade (CBOT).

• Chicago Stock Exchange.

• Dubai Financial Market.

• EUREX (Zurich).

• Euronext Amsterdam Commodities Market.

• Hong Kong Exchanges and Clearing Limited.

• ICE Futures US, Inc.

• Indonesia Stock Exchange.

• Johannesburg Stock Exchange.

• Kansas City Board of Trade.

• Korea Exchange.

• Kuala Lumpur Stock Exchange.

• Minneapolis Grain Exchange.

• NASDAQ OMX PHLX

• National Association of Securities Dealers Automated Quotations (NASDAQ).

• National Stock Exchange India.

• New York Stock Exchange.

• New York Mercantile Exchange Inc (NYMEX Inc.).

• New Zealand Exchange.

• NYSE Liffe US.

• NYSE MKT.

• Osaka Securities Exchange.

• Shanghai Stock Exchange.

• Singapore Exchange.

• SIX Swiss Exchange AG.

• South African Futures Exchange.

• Stock Exchange of Mumbai.

• Stock Exchange of Thailand.

• Taiwan Stock Exchange.

• The Chicago Mercantile Exchange (CME).

• Tokyo Financial Exchange.

• Tokyo Stock Exchange.

• Toronto Stock Exchange.

11 Expectations relating to internal models

11.1 CRR Article 363 states that permission for an institution to use internal models to calculate capital is subject to competent authorities verifying compliance with:

• the general requirements;

• requirements particular to specific risk modelling; and

• requirements for an internal model for incremental default and migration risk.

11.2 The standards that the PRA expects to be met to consider that an institution is compliant with these requirements are set out below.

High-level standards

11.3 A firm should be able to demonstrate that it meets the risk management standards set out in CRR Article 368 on a legal entity and business line basis where appropriate. This is particularly important for a subsidiary undertaking in a group subject to matrix management, where the business lines cut across legal entity boundaries.

Categories of position

11.4 A VaR model permission will generally set out the broad classes of position within each risk category within its scope.

It may also specify how individual products within one of those broad classes may be brought into or taken out of scope of the VaR model permission. These broad classes of permission are as follows:

(1) Linear products, which comprise securities with linear pay-offs (such as bonds and equities), and derivative products which have linear pay-offs in the underlying risk factor (such as interest rate swaps, FRAs, and total return swaps).

(2) European, American and Bermudan put and call options (including caps, floors, and swaptions) and investments with these features.

(3) Asian options, digital options, single barrier options, double barrier options, look back options, forward starting options, compound options and investments with these features.

(4) All other option based products (such as basket options, quantos, outperformance options, timing options, and correlation-based products) and investments with these features.

Data standards

11.5 The PRA expects a firm to ensure that the data series used by its VaR model is reliable. Where a reliable data series is not available, proxies or any other reasonable value-at-risk measurement may be used when the firm can demonstrate that the requirements of CRR Article 367(2)(e) are met.

A firm should be able to demonstrate that the technique is appropriate and does not materially understate the modelled risks.

11.6 Data may be deemed insufficient if, for example, it contains missing data points, or data points which contain stale data. With regard to less-liquid risk factors or positions, the PRA expects the firm make a conservative assessment of those risks, using a combination of prudent valuation techniques and alternative VaR estimation techniques to ensure there is a sufficient cushion against risk over the close out period, which takes account of the illiquidity of the risk factor or position.

11.7 A firm is expected to update data sets to ensure standards of reliability are maintained in accordance with the frequency set out in its VaR model permission, or more frequently if volatility in market prices or rates necessitates more frequent updating. This is in order to ensure a prudent calculation of the VaR measure.

Aggregating VaR measures

11.8 In determining whether it is appropriate for an institution to use empirical correlations within risk categories and across risk categories within a model, the PRA expects certain features to be observed in assessing whether such an approach is sound and implemented with integrity. In general, the PRA expects a firm to determine the aggregate VaR measure by adding the relevant VaR measure for each category, unless the firm's permission provides for a different method of aggregating VaR measures which is empirically sound.

11.9 The PRA does not expect a firm to use the square root of the sum of the squares approach when aggregating measures across risk categories or within risk categories unless the assumption of zero correlation between these categories is empirically justified. If correlations between risk categories are not empirically justified, the VaR measures for each category should simply be added in order to determine its aggregate VaR measure. However, to the extent that a firm's VaR model permission provides for a different way of aggregating VaR measures:

(1) that method applies instead; and

(2) if the correlations between risk categories used for that purpose cease to be empirically justified then the firm must notify the appropriate regulator at once.

Testing prior to model validation

11.10 A firm is expected to provide evidence of its ability to comply with the requirements for a VaR model permission.

In general, it will be required to demonstrate this by having a backtesting programme in place and should provide three months of backtesting history.

11.11 A period of initial monitoring or live testing is required before a VaR model can be recognised. This will be agreed on a firm by firm basis.

11.12 In assessing the firm's VaR model and risk management, the results of internal model validation procedures used by the firm to assess the VaR model will be taken into account.

Backtesting

11.13 For clarity, the backtesting requirements of CRR Article 366 should be implemented as follows:

• If the day on which a loss is made is day n, the value-at-risk measure for that day will be calculated on day n-1, or overnight between day n-1 and day n. Profit and loss figures are produced on day n+1, and backtesting also takes place on day n+1. The firm's supervisor should be notified of any overshootings by close of business on day n+2.

• Any overshooting initially counts for the purpose of the calculation of the plus factor even if subsequently the PRA agrees to exclude it. Thus, where the firm experiences an overshooting and already has four or more overshootings for the previous 250 business days, changes to the multiplication factor arising from changes to the plus factor become effective at day n+3.

11.14 A longer time period generally improves the power of backtesting. However a longer time period may not be desirable if the VaR model or market conditions have changed to the extent that historical data is no longer relevant.

11.15 The PRA will review, as part of a firm's VaR model permission application, the processes and documentation relating to the derivation of profit and loss used for backtesting. A firm's documentation should clearly set out the basis for cleaning profit and loss. To the extent that certain profit and loss elements are not updated every day (for example certain reserve calculations) the documentation should clearly set out how such elements are included in the profit and loss series.

Planned changes to the VaR model

11.16 In accordance with CRR Article 363(3), the PRA expects a firm to provide and discuss with the PRA details of any significant planned changes to the VaR model before those changes are implemented. These details must include detailed information about the nature of the change, including an estimate of the impact on VaR numbers and the incremental risk charge.

Bias from overlapping intervals for ten-day VaR and sVaR

11.17 The use of overlapping intervals of ten-day holding periods for the purposes of CRR Article 365 introduces an autocorrelation into the data that would not exist should truly independent ten-day periods be used. This may give rise to an underestimation of the volatility and the VaR at the 99% confidence level. To obtain clarity on the materiality of the bias, a firm should measure the bias arising from the use of overlapping intervals for ten-day VaR and sVaR when compared to using independent intervals. A report on the analysis, including a proposal for a multiplier on VaR and sVaR to adjust for the bias, should be submitted to the PRA for review and approval.

12 Stressed VaR calculation

12.1 CRR Article 365 requires firms that use an internal model for calculating their own funds requirement to calculate at least weekly a 'stressed value-at-risk' (sVaR) of their current portfolio. When the PRA considers a firm's application to use a sVaR internal model, the PRA would expect the following features to be present prior to permission being granted as indicative that the conditions for granting permission have been met.

Quantile estimator

12.2 The firm should calculate the sVaR measure to be greater than or equal to the average of the second and third worst loss in a twelve-month time series comprising of 250 observations.

The PRA expects as a minimum that a corresponding linear weighting scheme should be applied if the firm use a larger number of observations.

Meaning of 'period of significant financial stress relevant to the institution's portfolio'

12.3 The firm should ensure that the sVaR period chosen is equivalent to the period that would maximise VaR given the firm's portfolio. There is an expectation that a stressed period should be identified at each legal entity level at which capital is reported. Therefore, group-level sVaR measures should be based on a period that maximises the group-level VaR, whereas entity-level sVaR should be based on a period that maximises VaR for that entity.

Antithetic data

12.4 The PRA expects firms to consider whether the use of antithetic data in the calculation of the sVaR measure is appropriate to the firm's portfolio. A justification for using or not using antithetic data should be provided to the PRA.

Absolute and relative shifts

12.5 The PRA expects firms to explain the rationale for the choice of absolute or relative shifts for both VaR and sVaR methodologies. In particular, statistical processes driving the risk factor changes need to be evidenced for both VaR and sVaR.

12.6 The following information is expected to be submitted quarterly:

• analysis to support the equivalence of the firm's current approach to a VaR-maximising approach on an ongoing basis;

• the rationale behind the selection of key major risk factors used to find the period of significant financial stress;

• summary of ongoing internal monitoring of stressed period selection with respect to current portfolio;

• analysis to support capital equivalence of upscaled one-day VaR and sVaR measures to corresponding full ten-day VaR and sVaR measures;

• graphed history of sVaR/VaR ratio;

• analysis to demonstrate accuracy of partial revaluation approaches specifically for sVaR purposes (for firms using revaluation ladders or spot/vol-matrices). This should include a review of the ladders/matrices or spot/vol-matrices, ensuring that they are extended to include wider shocks to risk factors that incur in stress scenarios; and

• minutes of Risk Committee meeting or other form of evidence to reflect governance and senior management oversight of stressed VaR methodology.

13 Requirement to have an internal IRC model

13.1 CRR Article 372 requires firms that use an internal model for calculating own funds requirements for specific risk of traded debt instruments to also have an internal incremental default and migration risk (IRC) model in place. This model should capture the default and migration risk of its trading book positions that are incremental to the risks captured by its VaR model.

13.2 When the PRA considers a firm's application to use an IRC internal model, the PRA expects that the following matters would be included as demonstrating compliance with the standards set in CRR Article 372.

Basis risks for migration

13.3 The PRA expects the IRC model to capitalise pre-default basis risk. In this respect, the model should reflect that in periods of stress the basis could widen substantially. Firms should disclose to the PRA their material basis risks that are incremental to those already captured in existing market risk capital measures (VaR-based and others). This must take actual close-out periods during periods of illiquidity into account.

Price/spread change model

13.4 The price/spread change model used to capture the profit and loss impact of migration should calibrate spread changes to long-term averages of differences between spreads for relevant ratings. These should either be conditioned on actual rating events, or using the entire history of spreads regardless of migration. Point-in-time estimates are not considered acceptable, unless they can be shown to be as conservative as using long-term averages.

Dependence of the recovery rate on the economic cycle

13.5 To achieve a soundness standard comparable to those under the IRB approach, LGD estimates should reflect the economic cycle. The PRA therefore expects firms to incorporate dependence of the recovery rate on the economic cycle into the IRC model. Should the firm use a conservative parameterisation to comply with the IRB standard of the use of downturn estimates, evidence of this will be required to be submitted in quarterly reporting to the PRA, bearing in mind that for trading

portfolios, which contain long and short positions, downturn estimates would not in all cases be a conservative choice.

14 Annual SIF attestation of market risk internal models

14.1 The PRA expects an appropriate individual in a Significant Influence Function (SIF) role to provide to the PRA on an annual basis written attestation that:

(i) the firm's internal approaches for which it has received a permission comply with the requirements in Part 3 Title IV of the CRR, and any applicable PRA market risk supervisory statements; and

(ii) where a model has been found not to be compliant, a credible plan for a return to compliance is in place and being completed.

14.2 Firms should agree the appropriate SIF for providing this attestation with the PRA, noting that the PRA would not expect to agree more than 2 SIFs to cover all the firm's market risk internal models as described in Part 3 Title IV of the CRR.

Appendix 4

SS 12/13

1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD

IV applies. This statement:

• clarifies the Prudential Regulation Authority's (PRA's) expectations as to the inclusion of securities financing transactions in the calculation of the credit valuation adjustment capital charge;

• clarifies the identification of qualifying central counterparties;

• sets out the factors which the PRA expects such firms to take into account when applying for certain permissions related to the counterparty credit risk regulatory framework; and

• sets out the PRA's approach to post approval changes to counterparty credit risk advanced model approaches.

4.5 This statement should be considered in addition to the requirements in CRR Articles 162 and 382; the Counterparty Credit Risk rules of the PRA Rulebook and the high-level expectations outlined in *The PRA's Approach to Banking Supervision*.[20]

2 Factors which the PRA expects firms to take into account when applying to certain permissions related to the counterparty credit risk regulatory framework

Use of 'Internal CVA model' for the calculation of the maturity factor 'M'

2.1 This section sets out the PRA's expectations for granting a firm permission to use its own one-sided credit valuation adjustment internal models (an 'Internal CVA model') for the purpose of estimating the Maturity factor 'M', as proposed under CRR Article 162(2), paragraph (h).

2.2 The Maturity factor 'M' is intended to increase own funds requirements to reflect higher risks associated with medium and long-term over the counter (OTC) derivative portfolios where the exposure profile of contracts extends beyond one year. The adjustment is only applicable to firms using the Internal Model Method (IMM) for the calculation of exposure values.

2.3 Subject to permission being granted by the PRA, as the relevant competent authority, firms may replace the formula for the Maturity factor 'M', as set out in CRR Article 162(2), paragraph (g), with the 'effective credit duration' derived from the firm's Internal CVA model.

2.4 Internal CVA models are complex by nature and modelling practices vary significantly across the industry. The PRA considers the creation of an acceptable model resulting in an appropriate credit duration to be challenging. Accordingly, the PRA expects firms to demonstrate a strong case for permission to be granted.

2.5 A firm that wishes to make an application under CRR Article 162(2), paragraph (h) should provide a satisfactory justification for the use of an internal CVA model for estimating the maturity factor 'M'. The PRA does not consider the reduction of the own funds requirements for counterparty credit risk to be a reasonable justification. The PRA will also require highly conservative modelling assumptions within a firm's Internal CVA model for the purpose of CRR Article 162(2), paragraph (h).

2.6 To apply for the CRR Article 162(2), paragraph (h) permission, firms should contact the PRA.

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[20] www.bankofengland.co.uk/pra/Pages/supervision/approach/default.aspx.

Permission to set the maturity factor 'M' to 1 for the Counterparty Credit Risk default charge

2.7 This section sets out the PRA's expectations for granting a permission to firms with the permission to use the Internal Model Method (IMM) and the permission to use an internal Value-at-Risk (VaR) model for specific risk associated with traded debt instruments to set to 1 the Maturity factor 'M' defined in CRR Article 162.

2.8 CRR Article 162(2), paragraph (i) allows a firm using the IMM to set the Maturity factor 'M' to 1 provided the firm's internal VaR model for specific risk associated with traded debt instruments reflects the effect of rating migration. This is subject to the PRA's permission.

2.9 Internal VaR models for specific risk associated with traded debt instruments are not designed to capture the effects of rating migrations. The risk captured by these models is based on a ten-day time horizon which does not appropriately reflect the dynamics of rating migrations, which occur on an irregular and infrequent basis. This deficiency was one of the main reasons for the introduction of a separate risk measure for the capture of both default and migration risk, based on a one-year time horizon (the 'IRC' model, CRR Article 372).

Since the challenges of appropriately capturing credit rating migrations in an internal VaR model are significant, the PRA expects firms to demonstrate a strong case for the granting of the permission set out in CRR Article 162(2), paragraph (i).

2.10 A firm that wishes to make an application under CRR Article 162(2), paragraph (i) should provide a satisfactory justification for the use of its internal VaR to capture the risks associated with rating migration. The reduction of the own funds requirements for counterparty credit risk is not considered by the PRA to be a reasonable justification. The PRA expects highly conservative modelling assumptions for the capture of rating migrations within a firm's internal VaR model for the purpose of satisfying the requirements of CRR Article 162(2), paragraph (i).

2.11 To apply for the permission proposed under CRR 162(2), paragraph (i), firms should contact the PRA.

3 Inclusion of securities financing transactions in the scope of the CVA capital charge

3.1 This section sets out the PRA's determination of when risk exposures arising from securities financing transactions (SFTs) should be deemed material and be included in the scope of the own funds requirements for credit valuation adjustment (CVA) in accordance with CRR Article 382(2).

3.2 SFTs are not defined in the regulation. The PRA considers that, for these purposes, SFTs should include:

• repurchase transactions; and

• securities or commodities lending or borrowing transactions.

3.3 SFTs generally need not be included within the scope of a firm's CVA charge since they are typically accounted for based on their substance as secured lending arrangements. However, firms can be exposed to CVA risk as a result of SFT transactions. For example, the transfer of an asset and its forward sale (which underpin the legal form of the SFT) would be recognised as a derivative in the event of a subsequent deterioration in the creditworthiness of the counterparty to the SFT. The PRA considers that this CVA risk may be material where the following three conditions are met:

• the SFT's counterparty has demonstrated a recent deterioration of its creditworthiness;

• a severe deterioration of the SFT's counterparty's creditworthiness would lead to a previous transfer being accounted for as a sale and therefore the recognition of a derivative that would be included in the scope of the CVA charge; and

• the SFT transactions do not benefit from adequate credit risk mitigation. An example would be where the SFTs are not included in a master netting agreement that has the effect of reducing exposure to credit risk.

3.4 Where these conditions are met, firms must include SFT transactions in the scope of own funds requirements for CVA risk. The PRA may review firms' methodology for determining the inclusion of these SFT transactions in the scope of own funds requirements for CVA risks.

4 Calculating own fund requirements for exposures to Central counterparties: identifying qualifying central counterparties

4.1 During the transitional period determined by the European Commission, the following will be qualifying central counterparties (QCCPs):

- all CCPs listed on the Bank of England's register of Recognised Clearing Houses (RCHs); and
- those third country CCPs that currently provide clearing services to UK credit institutions, or their subsidiaries.

4.2 The Bank of England's register of RCHs is available on the following link:

www.bankofengland.co.uk/financialstability/Pages/fmis/supervised_sys/rch.aspx.

4.3 The transitional period will expire on the date announced by the European Commission.

4.4 A list of authorised CCPs and information on recognised CCPs can be found on the European Securities and Markets Authority website: http://www.esma.europa.eu/page/Central-Counterparties. Authorised or recognised CCPs on the register will be considered to be QCCPs.

4.5 The PRA expects firms to notify the PRA if notification has been received that a CCP no longer reports its hypothetical capital (Kccp). The PRA will consider the reasons why the CCP has stopped calculating Kccp and issue a notice considering whether the reasons are valid, allowing firms to apply the treatment set out in Article 310 of the CRR.

5 Annual SIF attestation of counterparty credit risk internal models

5.1 The PRA expects an appropriate individual in a Significant Influence Function role to provide to the PRA on an annual basis written attestation that:

• the firm's internal approaches for which it has received a permission comply with the requirements in Part 3 Title II of the CRR, and any applicable PRA counterparty credit risk supervisory statements; and

• where a model has been found not to be compliant, a credible plan for a return to compliance is in place and being completed.

5.2 Firms should agree the appropriate SIF for providing this attestation with the PRA, noting that the PRA would not expect to agree more than two SIFs to cover all the firm's counterparty credit risk internal models as described in Part Three Title II of the CRR.

6 Counterparty credit risk advanced model approaches: process for post approval changes

6.1 This section describes the PRA's approach for post-approval changes to Counterparty Credit Risk Internal Model Method (IMM) as defined in Section 6 of Title II, Chapter 6 of the CRR and Internal Models approach for Master netting agreements ('Repo VaR') as defined in Article 221 of the CRR, including extensions of the scope of approval, and roll out of portfolios according to the roll-out plan; it suggests the documentation the PRA would seek to support the proposed change and provides an overview of the PRA's response to these advised changes.

6.2 The framework for post-approval model changes outlined here forms one integral element of the wider regime for calculating counterparty credit risk using advanced methods but does not encompass the entirety of the regime. To run this regime effectively, the PRA will deal with firm-driven actions (such as model changes) and also undertake other work (such as reviews and thematic work).

6.3 The PRA regard the post-approval regime as critical to maintaining confidence in the high standards which firms have been set during their initial CRR permission applications. An effective post-approval framework, which is the objective of the proposals in this paper, will provide this

assurance while firms' models are adjusted over time, without imposing a disproportionate burden on firms and on the PRA.

6.4 The PRA will ask for prior information only for the most material changes (defined in paragraph 10) to their IMM or Repo VaR model, as described in paragraph 13. The PRA envisage that this will typically result in only a few pre-notifications on average per year per firm, even from the largest firms. For details about the changes, the PRA will rely to the extent it can on information generated internally by the firms. This should foster a pragmatic, 'no surprises', and proportionate regime.

6.5 Other changes need be reported in summary form only and after implementation. The arrangements allow for firms to agree *de minimis* thresholds below which no report needs to be made at all.

6.6 The PRA will review in due course, with input from the industry, how the process is operating.

Defining materiality

6.7 Firms must notify the PRA of significant changes to IMM or Repo VaR models prior to these changes being implemented for capital purposes. The permission will offer some broad guidelines around factors which constitute significant change: these will be published in due course. The starting point is the assumption that firms will proactively advise supervisors of significant events or issues affecting the operation of the advanced model with the onus on the firm to judge what is significant.

6.8 The PRA's approach to assessing the significance of issues will be based on the materiality of changes, which in turn will be governed by the substance of the change as relevant to the firm rather than measurement against a predefined set of parameters. Once notified, the firm supervisor will evaluate the proposed change on a case by case basis. It is expected that both the firm and its respective supervisor will in the course of time reach a common understanding of the type of change that warrants consultation and approval.

6.9 Changes to a firm's model can be categorised as low or high impact depending on the level of materiality. This spectrum at one end denotes simple, minor changes which do not warrant prior consultation with the PRA. The other end is characterised by significant, high-impact changes which will need to be reported in advance and require PRA approval.

These boundaries will encompass a middle range of changes that will be reported but which may or may not warrant PRA review.

Examples of change

6.10 Changes may involve several aspects of the advanced model framework. The following are examples of changes the PRA deems to be significant and therefore requiring prior approval by the PRA (please note that this is not an exhaustive list):

(a) Development of new models to cover products currently not in the scope of the permission, eg equity derivatives, interest rate derivatives.

(b) A model change resulting in a change in Counterparty Credit Risk (CCR) capital requirements for the UK consolidation group greater than 5% in both directions (that is, either increase or decrease of capital) or a change in gross EAD (for clarity the EAD should be calculated gross of netting, margin and collateral) of 5% in both directions.

While the PRA would be open to suggestions from firms as to their preferred level for this threshold, or the basis on which it is calculated, the final parameter would need to be agreed between the firm and the PRA. As a benchmark the PRA intend that a change in CCR capital requirements of 5% should be considered significant or a change in gross EAD of 5% should be considered significant.

(c) A model previously deemed immaterial becomes material if it will calculate EAD greater than 5% of gross EAD or contribute more than 5% of CCR related capital requirement.

(d) Changes to the calculation system. This could include:

(i) Structural changes to the system used to generate exposure profiles.

(ii) Re-development/optimisation of existing routines which could lead to significant changes in the output of the model.

6.11 The following are examples of changes the PRA deem to be less significant and therefore require post-notification to the PRA (please note that this is not an exhaustive list):

(e) Extension of current models to new product types (product types currently not in the scope of the permission) eg swaps, caps, swaptions, etc.

(f) Changes to currently approved models. This may be related to:

(i) Introduction of new risk factors (eg introduction of a new market risk factor in the simulation engine such as new currencies, new interest rate curves. It is not expected that this will cover increases in the granularity of particular risk factor curves).

(ii) Changes to the evolution process of existing risk factors.

(iii) Calibration methodology.

(iv) Changes to the pricing functions used.

(g) Changes to the models due to changes in the composition of the portfolios and products traded (eg changes due to merger and/or acquisitions).

(h) A significant change to the outputs of the model resulting from a series of changes that in isolation may not be significant but cumulatively have a significant effect.

6.12 Firms may agree more detailed materiality thresholds with the PRA, if they wish.

Parallel running and the experience requirement

6.13 Depending on the materiality of changes, the requirements with regards to parallel running as defined under Article 289(2) of the CRR may change. The PRA does not intend to apply any formal requirement for parallel running to changes of IMM and Repo VaR systems. The PRA would, however, expect firms themselves to include parallel running to the extent they deem necessary as part of their normal general project management disciplines when introducing new or enhanced risk management tools.

6.14 It is expected that firms will demonstrate that the model is appropriate through backtesting. Firms are expected to backtest the advanced model and the relevant components that input into the calculation of EAD using historical data movements in market risk factors considering a number of distinct time horizons out to at least one year. The backtesting should cover a range of observation periods representing a wide range of market conditions.

Change of governance process

6.15 This section describes the process firms will be required to follow when pre-notifying or post-notifying a model change.

Pre-notifying a change

• **Step 1**. The firm should advise the PRA about future proposed changes as far in advance as possible. In addition to this, during IMM reviews the firm will be expected to advise the PRA of its current thinking on future changes, across the group. The firm should expect that a decision by the PRA regarding pre-approval of a change can take up to six months.

• **Step 2**. The firm should submit a short description of the change.

• **Step 3**. The firm should conduct a self-assessment of the change against the relevant CRR rules, noting any areas of non-compliance with details of how and when these gaps will be closed and set out which CRR rules are not considered relevant.

• **Step 4**. If the change is recognized to be significant as per paragraph 10 prepare and submit the material set out in Appendix B.

• **Step 5**. Send the material from Steps 2, 3 and 4 to the PRA.

The material needs to be sent sufficiently far in advance of the proposed change to allow time to review it prior to implementation. If the PRA chooses to review the change, it may ask for additional information and if necessary meetings or on-site visits. The PRA is content for firms to provide internal documentation for this purpose provided this addresses clearly and sufficiently the process requirements set out above.

Post-notifying a change

6.16 Where the change belongs to category (e), (f), (g), (h) in paragraph 10 the firm can notify the PRA after it has occurred.

The firm will need to provide the following:

(a) a short description of the change, including the date on which the change was implemented;

(b) confirmation that the change has been reviewed through the firm's internal governance processes; and

(c) confirmation that a self-assessment of the change against the CRR rules has been completed and has not identified any areas of non-compliance.

6.17 After the post-notification, the PRA might request additional information, including internal documentation consistent with the relevant parts of Appendix C.

6.18 The PRA is also prepared to respond constructively to proposals from firms on a cumulative de minimis figure for immaterial models, changes to which will not require post-notification. The PRA envisage this total figure being in the region of a 5% increase or decrease in the CCR related capital requirement or EAD of the model for the UK consolidation group. Accordingly, a firm may nominate a number of models, each of which account for no more than a 5% change in the CCR related capital requirement or EAD and which in total account for no more than a 5% change in CCR related capital or EAD, for which neither pre-notification nor post-notification is ordinarily necessary.

Fees

6.19 There will be some circumstances where a fee will be applied — for example, when a firm is extensively changing the scope of its model approval or following a merger or acquisition that impacts the materiality of business in scope of an advanced approach permission.

Self-assessment

6.20 The self-assessment process described in paragraph 13, Step 3 needs only be an assessment against CRR rules that are relevant to the change in question. While it is the firm's responsibility to decide on the method of conducting the self-assessment, the PRA expects the self-assessment to be sufficiently rigorous to allow the firm to identify areas of non-compliance. In the case where areas of non-compliance have been identified the PRA expects firms to provide a detailed process for becoming compliant in the areas identified.

6.21 It is important to highlight that a high-level 'gap analysis' or a process that places reliance on the firm's governance process or on the firm's developmental process to deliver a compliant approach is unlikely to form an adequate self-assessment.

PRA response

6.22 To pre-notified changes: Following pre-notification, the PRA will make a prompt initial assessment of the material and determine whether a full review is needed or not. If a full review is not judged necessary, then the firm may make the change as planned. If a full review is judged necessary, then the firm will be informed, any on-site review work executed and a decision reached. In very limited circumstances, to be agreed on a case by case basis, the PRA may be prepared to allow firms to implement the proposed change in the interim, subject to an additional element of conservatism being applied.

6.23 Decision options for pre-notified changes are: 'approve', 'approve with hard ongoing conditions' and 'reject'. Firms will be given the opportunity to address issues prior to a formal decision being issued.

6.24 To post-notified changes: The PRA may take no action, or may select a change or portfolio for subsequent review as part of the review process.

6.25 Our relationship with other EEA regulators will be governed by Articles 115, 116 and, if necessary, by Articles 112 and 113 of the CRD as well as by the associated technical standards. The PRA will maintain a reciprocal agreement between EEA regulators to keep each other informed of significant changes as advised by the respective local sites.

Involvement with other non-EEA regulators will be achieved via continued collaboration.

6.26 Updating the Direction: In the spirit of accuracy and transparency, any revisions to the permission decision should be reflected in the permission document and published as a subsequent

version of the original. Generally, changes to the scope will warrant a change to the permission and require formal action. However, not every model change will warrant an update, even if it is a significant change. Following review of a significant change, there may follow a recommendation to add conditions.

Pillar 2

6.27 Depending on the magnitude of the effect on the firm's capital position, the change may also trigger a review of the firm's capital position under Pillar 2, possibly requiring submission of a fresh ICAAP.

6.28 The firm should not rely on the PRA to ensure that a notified change is compliant and should not assume that the lack of an immediate response to a submission positively indicates that the change is compliant: responsibility for compliance rests with the firm.

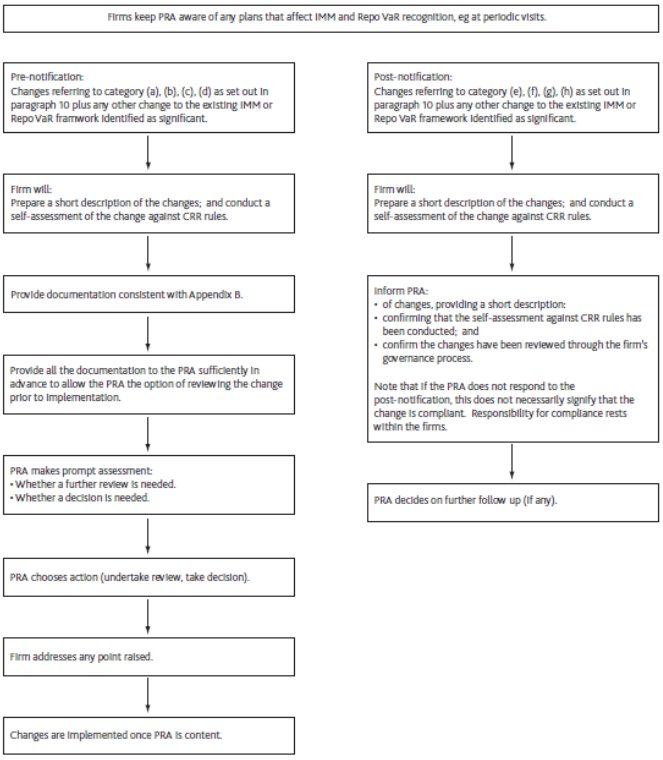
Summary

6.29 The PRA observe that the assessment of significant changes cannot be a mechanistic approach given the individual characteristics of each firm. The PRA recognises that there will be a process of learning and refinement on both sides in terms of reaching an understanding of what is considered to be significant.

6.30 A diagram covering the key steps is attached as Appendix A.

Appendix A

IMM and Repo VaR Post-Approval Model Changes Process



Appendix B

Documentation required for material changes

As detailed under paragraph 14 (step 4) if the changes to the IMM or Repo VaR model are recognised to be material, further documentation will be required for review from the PRA. The following list represents a minimum requirement which needs to be met when applying for material changes. The PRA may ask for further information and/or documentation on a case by case basis. This section is divided in two main categories:

• Changes to models.

• Changes to the counterparty risk system.

Changes to models (new model being introduced or changes to existing models)

The following is the minimum information that should be provided for changes to models.

• CRR self-assessment. This should include an assessment against any requirement relevant to the changes made and sign-off from a Significant Influence Function attesting that the model is fit for purpose and meets regulatory requirements.

• Distribution of risk for an appropriate parallel run period for the transactions covered by the model changes according to the following categories (each table should include number of trades, Positive MtM, EAD, PFE, regulatory capital using the old model, regulatory capital using the new model):

(i) Product (if more than one) for number of trades; positive MtM; and exposure and capital measures calculated gross of netting;

(ii) Counterparty Credit Rating (ie Probability of Default rating);

(iii) Industry;

(iv) Country/Geographic region.

• Independent validation report relevant to the changes to models.

• Backtesting results for an appropriate parallel run period.

• Sign off minutes for model approval from the relevant committees.

The following information should be provided if documentation previously submitted has changed as a result of the changes to models.

• Technical documentation outlining the methodology used to model and calibrate risk factors. This documentation should also include the methodology used to estimate the relationship between risk factors, eg correlation.

• Technical documentation for the methodology used to price the product(s) modelled.

• Technical documentation for the modelling of collateral if modelled jointly with exposures.

• Technical documentation outlining the implementation of netting/margining rules for the new model.

• Updated policy for:

(i) Backtesting

(ii) Stress Testing

(iii) Wrong Way Risk

(iv) Collateral management

(v) Validation policy

Changes to the counterparty risk system

If changes to the system occur in conjunction with material changes to models the latter would require a separate submission of documents as outlined in the section ‘Changes to models (new model being introduced or changes to existing models)’. The following is the minimum information that should be provided for changes to the counterparty risk system.

• CRR self-assessment. This should include an assessment against any requirement relevant to the changes made and sign-off from a Significant Influence Function attesting that the model is fit for purpose and meets regulatory requirements.

• Distribution of risk: distribution of risk, over an appropriate parallel run period, for the transactions covered by changes according to the following categories (each table should include number of trades, positive MtM, EAD, PFE, regulatory capital prior to and after changes being applied):

(i) Product (if more than one) for number of trades; positive MtM; and exposure and capital measures calculated gross of netting;

(ii) Counterparty Credit Rating (ie Probability of Default rating);

(iii) Industry;

(iv) Country/Geographic Region.

• Operational requirements (in the form of internal documentation or policies as relevant):

(i) Description of the Control Unit in charge of design of model (including organizational chart);

(ii) Description of the Control Unit in charge of implementation into production system (including organisational chart);

(iii) Description of the Control Unit in charge of initial and ongoing validation of Counterparty Risk Exposure Model (including organizational chart);

(iv) Data integrity assessment and policy around data quality;

(v) Sample reports of the output of the model (as used and seen by model users);

(vi) Impact on trading limits (ie change in credit policy with regards to allocation/management of credit limits).

• Backtesting analysis and results for an appropriate parallel running period.

The following information should be provided if documentation previously submitted has changed as a result of the changes to the counterparty risk system.

• Updated policy for:

(i) Stress Testing

(ii) Wrong Way Risk

(iii) Backtesting

(iv) Collateral

(v) Validation (covering both initial and ongoing validation).

Appendix 5

PRA RULEBOOK: CRR FIRMS NON-CRR FIRMS: INDIVIDUAL ACCOUNTABILITY INSTRUMENT (NO 4) 2015

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 63F (Issuing of certificates);
(2) section 137G (The PRA's general rules); and
(3) 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 Non-CRR Firms: Individual Accountability Instrument (No 4) 2015

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

Commencement

E. This instrument comes into force on [DATE].

Citation

F. This instrument may be cited as the PRA Rulebook: CRR Firms Non-CRR Firms: Individual Accountability Instrument (No 4) 2015.

By order of the Board of the Prudential Regulation Authority

[DATE]

Annex A

Amendments to the Certification Part

This Annex amends the Certification Part as published in the Near Final Rules in Appendix 2 of PS20/15. In this Annex, new text is underlined and deleted text is struck through.

Part

CERTIFICATION

Chapter content

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to every *firm* that is:

(1) a *CRR firm*;
(2) a *credit union;* or
(3) a *third country CRR firm* in relation to the activities of its establishment in the *UK*.

. . .

1.2 In this Part, the following definitions shall apply:

…

significant risk taker

means

(1) ~~any~~ an *employee* of a *CRR firm* ~~who meets any of the criteria set out~~ whose professional activities have a material impact on the *firm's* risk profile, including any *employee* who is deemed to have a material impact on the *firm's* risk profile in accordance with criteria set out in Articles 3 to 5 of the *Material Risk Takers Regulation*; or

…

(3) ~~subject to Remuneration 3.2 to 3.3,~~ an~~y~~ *employee* of a *third country CRR firm*[21] who would ~~have met any of the criteria set out in Articles 3 to 5 of the *Material Risk Takers Regulation*~~ fall within (1) if it had applied in relation to him or her, unless the *firm* has deemed the *employee* not be a material risk taker under Remuneration 3.2.

…

[21] Please note that the extra-territorial effect of this provision is limited (as a result of 1.1(3)) to those staff who implement or conduct the UK regulated activities of the non-EEA firm's UK branch.

Appendix 6

PRA RULEBOOK: CRR FIRMS: DEFINITION OF CAPITAL AMENDMENT INSTRUMENT 2015

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"):

(6) section 137G (the PRA's general rules); and
(7) 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 Definition of Capital Amendment Instrument 2015

D. The PRA makes the rules in Annex A, Annex B and Annex C to this instrument.

Commencement

E. This instrument comes into force on [DATE].

Citation

F. This instrument may be cited as the PRA Rulebook: CRR Firms: Definition of Capital Amendment Instrument 2015.

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

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

Part

DEFINITION OF CAPITAL

…

7 NOTIFICATION REGIME

7.1 A *firm* must ~~shall~~ notify the *PRA* in writing of its intention, or the intention of another member of its *group* that is not a *firm* but is included in the supervision on a consolidated basis of the *firm*, to issue a capital instrument that it considers~~believes~~ will qualify under the *CRR* as an *own funds instrument* at least ~~thirty days~~one month before the intended date of issue~~.~~ 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 practicable in those circumstances. ~~This rule does not apply to the capital instruments described in 7.3 below.~~

7.2 When giving notice under 7.1, the *firm* must ~~shall provide~~:

(1) ~~details of the amount and type of *own funds* the *firm* is seeking to raise through the intended issue and whether the capital instruments are intended to be issued to external investors or to other members of its *group*~~complete and submit the form referred to in 7.5(1) (Pre-Issuance Notification (PIN) Form);

(2) provide a copy of the draft terms and conditions of the capital instrument~~term sheet and details of any features of the capital instrument which are novel, unusual or different from a capital instrument of a similar nature previously issued by the *firm* or widely available in the market~~;

~~(3) confirmation from a member of the *firm's senior management* responsible for authorising the intended issue or, in the case of an issue by another *group* member, for the issue's inclusion in the *firm*'s consolidated *own funds*, that the capital instrument meets the conditions for qualification as an own funds instrument; and~~

~~(4)~~(3) subject to 7.3, provide a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification as the relevant type of *own funds instrument*~~.~~; and

(4) where it considers that the capital instrument in 7.1 will qualify as an *Additional Tier 1 instrument*, provide a properly reasoned opinion by its auditors as to that capital instrument's treatment under the *applicable accounting framework*.

~~7.3 The *firm* does not have to give notice under 7.1 if the capital instrument is:~~

~~(1) an ordinary share with voting rights and no new or unusual features; or~~

~~(2) a debt instrument issued under a debt securities programme under which the *firm* or *group* member has previously issued and the *firm* has notified the *PRA* in accordance with this Chapter prior to a previous issuance under the programme.~~

~~7.4 A *firm* shall notify the *PRA* in writing no later than the date of issue of its intention, or the intention of another member of its *group* that is not a *firm* but is included in the supervision on a consolidated basis of the *firm*, to issue a capital instrument described in 7.3.~~

~~7.5 When giving notice under 7.4, the *firm* shall provide:~~

~~(1) confirmation that the terms of the capital instrument have not changed since the previous issue by the *firm* of that type of capital instrument; and~~

~~(2) the items described in 7.2(1) and (3).~~

7.3 Where a *firm* considers that the capital instrument in 7.1 will qualify as a *Common Equity Tier 1 instrument*, 7.2(3) does not apply. In this case the *firm* must complete and submit the form referred to in 7.5(2) (CET1 Compliance Template).

7.4 The *firm* shall notify the *PRA* in writing of any change to the intended date of issue, amount 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 7.1 ~~or 7.4~~.

7.5 (1) The Pre-Issuance Notification (PIN) Form can be found here.

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

Annex B

This Annex sets out the form referred to in 7.5 (1) of the Definition of Capital Part of the PRA Rulebook.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

PRA **- Pre Issuance Notification (PIN) Form for *CRR Firms***

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

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

1. Name and, where applicable, *Firm* Reference Number (FRN) of the issuer:	
2. Reason(s) for the issuance of the capital instrument:	
3. Notification of amendment to an existing capital instrument? [Yes/No]	
4. 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):	
5. At what level is the regulatory capital proposed to be included (individual/(sub-)consolidated or a combination):	
6. 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 identify the investor and describe how the purchase of the capital instrument will be funded:	
7. Proposed tier of capital (*Common Equity Tier 1 capital*, *Additional Tier 1 capital* or *Tier 2 capital*):	
8. If the proposed tier of capital is *Additional Tier 1 capital*, please state its treatment under the applicable accounting framework: (Please attach (in accordance with 7.2(4) of Definition of Capital) a properly reasoned opinion by your auditor):	
9. Proposed date of issue or amendment:	
10. Proposed currency and amount (or approximation) to be issued:	

11. Is the capital instrument compliant with the relevant provisions of the *CRR* and Commission Delegated Regulation (EU) 241/2014 and any other relevant binding technical standard? (Please attach (in accordance with 7.2(3) of Definition of Capital) a properly reasoned independent legal opinion from an appropriately qualified individual)	

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 Tier 1 capital* or *Tier 2 capital*, 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 capital* or *Tier 2 capital* (in accordance with 7.2(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 7.3 of Definition of Capital); and
- For any item intended for inclusion within *Additional Tier 1 capital*, a properly reasoned opinion by your auditor (in accordance with 7.2(4) of Definition of Capital).

Declaration by a member of the *senior management*:

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. 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.

Annex C

This Annex sets out the form referred to in 7.5 (2) of the Definition of Capital Part of the PRA Rulebook.

CRR provision[1]	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[2]: (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,				

[1] Applicable (A); not applicable (NA)
[2] Please specify the type of institution. If institutions within (v), please provide additional information according to that number

CRR provision[1]	Terms & conditions	Articles of association	National Regulation	Comments + reference to document(s)
where applicable, 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[1]:				

[1] 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

CRR provision[1]	Terms & conditions	Articles of association	National Regulation	Comments + reference to document(s)
(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, 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				

CRR provision[1]	Terms & conditions	Articles of association	National Regulation	Comments + reference to document(s)
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;[1]				
(j) the instruments rank below all other claims in the event of insolvency or liquidation of the institution;				
(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;				

[1] 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

CRR provision[1]	Terms & conditions	Articles of association	National Regulation	Comments + reference to document(s)
(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; (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.				
Article 29				
1. Capital instruments issued by mutuals, cooperative societies, savings institutions and similar institutions shall qualify as CET1 instruments only if the conditions laid down in Article 28 with modifications resulting from the application of this Article are met.				
2. The following conditions shall be met as regards redemption of the capital instruments:				
(a) except where prohibited under applicable national law, the institution shall be able to refuse the redemption of the instruments;				
(b) where the refusal by the institution of the redemption of instruments is prohibited under applicable national law, the provisions governing the instruments shall give the institution the ability to limit their redemption;				
(c) refusal to redeem the instruments, or the limitation of the redemption of the instruments				

CRR provision[1]	Terms & conditions	Articles of association	National Regulation	Comments + reference to document(s)
where applicable, may not constitute an event of default of the institution.				
3. The capital instruments may include a cap or restriction on the maximum level of distributions only where that cap or restriction is set out under applicable national law or the statute of the institution.				
4. Where the capital instruments provide the owner with rights to the reserves of the institution in the event of insolvency or liquidation that are limited to the nominal value of the instruments, such a limitation shall apply to the same degree to the holders of all other CET1 instruments issued by that institution.				
The condition laid down in the first subparagraph is without prejudice to the possibility for a mutual, cooperative society, savings institution or a similar institution to recognise within CET1 instruments that do not afford voting rights to the holder and that meet all the following conditions:				
(a) the claim of the holders of the non-voting instruments in the insolvency or liquidation of the institution is proportionate to the share of the total CET1 instruments that those non-voting instruments represent;				
(b) the instruments otherwise qualify as CET1 instruments.				
5. Where the capital instruments entitle their owners to a claim on the assets of the institution in the event of its insolvency or liquidation that is fixed or subject to a cap, such a limitation shall apply to the same degree to all holders of all CET1 instruments issued by the institution.				

Appendix 7

PRA RULEBOOK: SOLVENCY II FIRMS: OWN FUNDS (NOTIFICATION OF ISSUANCE – AMENDMENTS) INSTRUMENT 2015

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"):

(8) section 137G (the PRA's general rules); and
(9) 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 with the Financial Conduct Authority), 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: Solvency II Firms: Own Funds (Notification of Issuance – Amendments) Instrument 2015

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

Commencement

E. This instrument comes into force on [DATE].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Own Funds (Notification of Issuance – Amendments) Instrument 2015.

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex

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

Part

OWN FUNDS

…

5 NOTIFICATION OF ISSUANCE OF OWN FUNDS ITEMS

5.1 ~~5.2 to 5.6 do~~ This Chapter does not apply in respect of the following:

(1) any item which a *firm* intends to include within its *basic own funds* that is not covered by the lists of *own funds* items set out in the *Solvency II Regulations*, but which may be included in its *basic own funds* only if the *firm* has received the *PRA's* approval; and

(2) any item which a *firm* intends to include within its *ancillary own funds*.

5.2

(1) ~~A~~ Subject to 5.1 and 5.4, a *firm* must notify the *PRA* in writing of its intention to issue an item which it intends to include within its *basic own funds* at least one *month* before the intended date of issue, unless there are exceptional circumstances which make it impracticable to give such a period of notice~~, in which event.~~ In such circumstances, the *firm* must give the *PRA* as much notice as is practicable ~~in those circumstances~~ and explain to the *PRA* why the circumstances are considered exceptional.

(2) When giving notice, a *firm* must:

(a) provide details of the amount of *basic own funds* the *firm* is seeking to raise through the intended issue and whether the item is intended to be issued to external investors or within its *group*;

(b) identify the classification of *basic own funds* the item is intended to fall within;

~~(c) include confirmation from the *governing body* of the *firm* that the item complies with the rules applicable to items of *basic own funds* included in the classification of the item identified in (b); and~~

(~~d~~c) provide a copy of the ~~term sheet and details of any features of the item it intends to include within its basic own funds which are novel, unusual or different from an item of basic own funds of a similar nature previously issued by the firm or widely available in the market or not~~

~~specifically contemplated by the Solvency II Firms Sector of the PRA Rulebook or the Solvency II Regulations.~~ draft terms and conditions;

(d) provide a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the item complies with the rules applicable to items of *basic own funds* included in the classification of the item identified in (b);

(e) for any item referred to in Article 82(3) of the *Solvency II Regulations*, provide a properly reasoned independent accounting opinion from an appropriately qualified individual as to the item's treatment in the *firm's* financial statements;

(f) include confirmation from the *governing body* of the *firm* that the item complies with the rules applicable to items of *basic own funds* included in the classification of the item identified in (b); and

(g) state whether the item is encumbered or whether there are any connected transactions and, if so, provide details.

5.3 ~~A *firm* must provide a further written notification to the *PRA* including all the information required in 5.2(2) as soon as it proposes any change to the intended date of issue, amount of issue, type of investors, classification of a particular tier of *basic own funds* or any other feature of the item intended to be included as *basic own funds* to that previously notified to the *PRA*.~~ If after an initial notification under 5.2, but prior to an item's issuance, a *firm* proposes to change the information previously submitted, it must provide a further written notification of that change without delay.

~~5.4 If a *firm* proposes to establish a debt securities program for the issue of an item for inclusion within its *basic own funds*, it must:~~

~~(1) notify the *PRA* of the establishment of the program; and~~

~~(2) provide the information required by 5.2(2)~~

~~at least one *month* before the first proposed drawdown. The *PRA* must be notified of any changes in accordance with 5.3.~~

5.~~5~~4 ~~The items of basic own funds to which~~ 5.2 does not apply ~~are~~ to:

(1) ordinary *shares* which:

(a) meet the classification criteria for ordinary *share* capital in *Tier 1 own funds*; and

(b) are the same as ordinary *shares* previously issued by the *firm*; and

~~(2) debt instruments issued from a debt securities program, provided that program was notified to the *PRA* prior to its first drawdown, in accordance with 5.4; and~~

(~~3~~2) any item which is not materially different in terms of its characteristics and eligibility for inclusion in a particular tier of *basic own funds* to items previously issued by the *firm* and included in *basic own funds*.

5.~~6~~5 A *firm* must notify the *PRA* in writing, no later than the date of issue, of its intention to issue an item listed in 5.~~5~~4 which it intends to include within its *basic own funds*. When giving notice, a *firm* must:

(1) provide the information set out ~~at 5.2(2)(a), (b) and (c)~~ in 5.2 other than 5.2(2)(c) (draft terms and conditions), 5.2(2)(d) (legal opinion) and 5.2(2)(e) (accounting opinion); and

(2) confirm that the terms of the item have not changed since the previous issue by the *firm* of that type of item of *basic own funds*.

5.6 A *firm* shall notify the *PRA* in writing of its intention to amend or otherwise vary the terms of any item included within its *basic own funds* at least one *month* before the intended date of such amendment or other variation.

Appendix 8

PRA RULEBOOK: SOLVENCY II FIRMS: GROUP SUPERVISION (NOTIFICATION OF ISSUANCE – AMENDMENTS) INSTRUMENT 2015

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"):

(10)section 137G (the PRA's general rules); and
(11)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 with the Financial Conduct Authority), 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: Solvency II Firms: Group Supervision (Notification of Issuance – Amendments) Instrument 2015

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

Commencement

E. This instrument comes into force on [DATE].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Group Supervision (Notification of Issuance – Amendments) Instrument 2015.

By order of the Board of the Prudential Regulation Authority
[Date]

Annex

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

Part

GROUP SUPERVISION

…

6 GROUP SOLVENCY: NOTIFICATION OF ISSUANCE OF OWN FUNDS ITEMS BY GROUP MEMBER

6.1

(1) This ~~section~~ Chapter applies to a *firm* if another member of its *group* intends to issue an item for inclusion within the *basic own funds* forming the *own funds eligible for the group SCR* of the *firm's group*.

(2) This Chapter does not apply in respect of the following:

(a) any item which a *firm* intends to include within the *basic own funds* forming the *own funds eligible for the group SCR* of the *firm's group* that is not covered by the lists of *own funds* items set out in the *Solvency II Regulations*, but which may be included in the *basic own funds* forming the *own funds eligible for the group SCR* only if the *firm* has received the PRA's approval; and

(b) any item which a *firm* intends to include within the *ancillary own funds* forming the *own funds eligible for the group SCR* of the *firm's group*.

6.2

(1) Subject to 6.1(2) and 6.4, a ~~A~~ *firm* must notify the *PRA* in writing of the intention of another member of its *group* which is not a *firm* to issue an item which it intends to include within the *basic own funds* forming the *own funds eligible for the group SCR*, as soon as it becomes aware of the intention of the issuing *undertaking*.

(2) When giving notice, a *firm* must:

(a) provide details of the amount of *basic own funds* to be raised through the intended issue and whether the item is intended to be issued to external investors or within its *group*;

(b) identify the classification of *basic own funds* the item is intended to fall within;

~~(3) include confirmation from the governing body of the firm that the item complies with the rules applicable to items of basic own funds included in the classification of the item identified in (2); and~~

(4~~c~~) provide a copy of the ~~term sheet and details of any features of the item it intends to include within the basic own funds forming the own funds eligible for the group SCR which are novel, unusual or different from an item of own funds of a similar nature previously issued by the firm or widely available in the market or not specifically contemplated by the Solvency II Firms Sector of the PRA Rulebook or the Solvency II Regulations.~~ draft terms and conditions;

(d) describe the proposed item's contribution to *own funds eligible for the group SCR*;

(e) describe the *group's* membership and structure, including the relationship between the *firm* and the *group* member issuing the proposed item;

(f) provide a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the item complies with the rules applicable to items of *basic own funds* included in the classification of the item identified in (b);

(g) for any item referred to in Article 82(3) of the *Solvency II Regulations*, provide a properly reasoned independent accounting opinion from an appropriately qualified individual as to the item's treatment in the financial statements of the *group* member issuing the proposed item and of the *group*;

(h) include confirmation from the *governing body* of the *firm* that the item complies with the rules applicable to items of *basic own funds* included in the classification of the item identified in (b); and

(i) state whether the item is encumbered or whether there are any connected transactions and, if so, provide details.

6.3 ~~A *firm* must provide a further written notification to the *PRA* including all the information required in 6.2 as soon as it proposes any change to the intended date of issue, amount of issue, type of investors, classification of a particular tier of *basic own funds* or any other feature of the item intended to be included as basic own funds to that previously notified to the *PRA*.~~ If after an initial notification under 6.2, but prior to an item's issuance, a *firm* proposes to change the information previously submitted, it must provide a further written notification of that change without delay.

~~6.4 If an *undertaking* proposes to establish a debt securities program for the issue of an item which the *firm* intends to include within the *basic own funds* forming the *own funds eligible for the group SCR*, the *firm* must:~~

~~(1) notify the *PRA* of the establishment of the program; and~~

~~(2) provide the information required by 6.2~~

~~as soon it becomes aware of the proposed establishment. The *PRA* must be notified of any changes in accordance with 6.3.~~

6.~~5~~4 ~~The items of *basic own funds* to which~~ 6.2 does not apply ~~are~~ to:

(1) ordinary *shares* issued by an *undertaking* in the *group* which ~~are~~:

(a) ~~classified as *Tier 1 own funds* or *Tier 2 basic own funds*~~ meet the classification criteria for ordinary *share* capital in *Tier 1 own funds*; and

(b) are the same as ordinary *shares* previously issued by that *undertaking*; and

~~(2) debt instruments issued from a debt securities program established by an *undertaking* in the *group*, provided that program was notified to the *PRA* prior to its first drawdown in accordance with 6.4; and~~

(~~3~~2) any item which is not materially different in terms of its characteristics and eligibility for inclusion in a particular tier of *basic own funds* to items previously issued by the *undertaking* in the *group* and included in the *basic own funds* forming the *own funds eligible for the group SCR*.

6.~~6~~5 A *firm* must notify the *PRA* in writing, no later than the date of issue, of the intention of the *undertaking* in the *group* to issue an item listed in 6.~~5~~4 which it intends to include within the *basic own funds* forming the *own funds eligible for the group SCR*. When giving notice, a *firm* must:

(1) provide the information set out ~~at 6.2(1) to (3)~~ in 6.2(2) other than 6.2(2)(c) (draft terms and conditions), 6.2(2)(f) (legal opinion) and 6.2(2)(g) (accounting opinion); and

(2) confirm that the terms of the item have not changed since the previous issue of that type of item of *basic own funds* by that *undertaking*.

6.6 A *firm* must notify the *PRA* in writing of the intention of an *undertaking* in the *group* to amend or otherwise vary the terms of any item of *own funds eligible for the group SCR* as soon as it becomes aware of the intention of the issuing *undertaking* to amend or otherwise vary the terms of the item.

Appendix 9

PRA RULEBOOK: NON-SOLVENCY II FIRMS: INSURANCE COMPANIES – CAPITAL RESOURCES (NOTIFICATION OF ISSUANCE – AMENDMENTS) INSTRUMENT 2015

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"):

(12)section 137G (the PRA's general rules); and
(13)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 with the Financial Conduct Authority), 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: Non-Solvency II Firms: Insurance Companies – Capital Resources (Notification of Issuance – Amendments) Instrument 2015

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

Commencement

E. This instrument comes into force on 1 January 2016.

Citation

F. This instrument may be cited as the PRA Rulebook: Non-Solvency II Firms: Insurance Companies – Capital Resources (Notification of Issuance – Amendments) Instrument 2015.

By order of the Board of the Prudential Regulation Authority
[Date]

Annex

In this Annex, the text is all new and is not underlined.

Part

INSURANCE COMPANIES – CAPITAL RESOURCES

…

3 NOTIFICATION OF ISSUANCE OF CAPITAL INSTRUMENTS

3.1 Subject to 3.4, a *firm* must notify the *PRA* in writing of its intention to issue a *capital instrument* which it intends to include within its *capital resources* at least one *month* before the intended date of issue unless there are exceptional circumstances which make it impracticable to give such a period of notice. In such circumstances, the *firm* must give as much notice as is practicable and explain to the PRA why the circumstances are considered exceptional.

3.2 When giving notice, a *firm* must:

(1) provide details of the amount of capital the *firm* is seeking to raise through the intended issue and whether the *capital instrument* is intended to be issued to external investors or within its *group*;

(2) identify the stage of the *capital resources table* the *capital instrument* is intended to fall within;

(3) provide a copy of the draft terms and conditions;

(4) provide a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the *capital instrument* complies with the *rules* applicable to instruments included in the stage of the *capital resources table* identified in (2);

(5) include confirmation from the *governing body* of the *firm* that the *capital instrument* complies with the *rules* applicable to instruments included in the stage of the *capital resources table* identified in (2); and

(6) state whether the *capital instrument* will be encumbered or whether there are any connected transactions and, if so, provide details.

3.3 If after an initial notification under 3.1, but prior to a *capital instrument's* issuance, a *firm* proposes to change the information previously submitted, it must provide a further written notification of that change without delay.

3.4 3.1 does not apply to:

(1) ordinary *shares* which:

(a) are the most deeply subordinated *capital instrument* issued by the *firm*;

(b) meet the criteria set out in 5.1; and

(c) are the same as ordinary *shares* previously issued by the *firm*; and

(2) *capital instruments* which are not materially different in terms of their characteristics and eligibility for inclusion in a particular stage of the *capital resources table* to *capital instruments* previously issued by the *firm*.

3.5 A *firm* must notify the *PRA* in writing, no later than the date of issue, of its intention to issue a *capital instrument* listed in 3.4(1) or (2) which it intends to include within its *capital resources*. When giving notice, a *firm* must:

(1) provide the information set out in 3.2 other than 3.2(3) (draft terms and conditions) and 3.2(4) (legal opinion); and

(2) confirm that the terms of the *capital instrument* have not changed since the previous issue by the *firm* of that type of *capital instrument*.

3.6 A *firm* shall notify the *PRA* in writing of its intention to amend or otherwise vary the terms of any *capital instrument* included within its *capital resources* at least one *month* before the intended date of such amendment or other variation.

Appendix 10

Pre Issuance Notification (PIN) Form for Insurance Firms

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Prudential Regulation Authority (PRA) - Pre Issuance Notification (PIN) Form for Insurance Firms

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

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

1. *Name and, where applicable, Firm Reference Number (FRN) of the issuer:*	
2. *Reason(s) for the issuance of the capital instrument:*	
3. *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.):*	
4. *Where is the regulatory capital intended to be counted (solo PRA-regulated firm level, group level, or both)?*	
5. *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 identify the investor and describe how the purchase of the capital instrument will be funded:*	
6. *Intended tier of capital (firms subject to Solvency II) or stage of the capital resources table (non-Directive firms)*	
7. *For firms subject to Solvency II, for any item referred to in Article 82(3) of the Solvency II Regulations, provide a properly reasoned independent accounting opinion from an appropriately qualified individual as to the item's treatment in the financial statements of the firm, group member or the group (as appropriate)*	
8. *Proposed date of issue or amendment:*	
9. *Proposed currency and amount (or approximation):*	
10. *Compliance* *a. For Solvency II firms, are the proposed terms compliant with Articles 71, 73 or 77 of the Solvency II Regulations (Please provide a properly reasoned independent legal opinion from an appropriately qualified individual.)*	

b. For non-directive firms, are the proposed terms compliant with the PRA's rules on capital resources? (Please provide a properly reasoned independent legal opinion from an appropriately qualified individual.) *c. For Solvency II firms, please describe the basis for the choice of coupon structure, and any other provision that might suggest an economic incentive for redemption.*[1]	
11. *Are any payments due under the proposed item the subject of a guarantee or similar arrangement or any other form of encumbrance or connected transaction?(Yes/No)* *If the item is encumbered or subject to any connected transactions, please provide all relevant details.*	

Please include the following:

- A completed PIN form for Insurance Firms;
- A copy of the draft terms and conditions of the intended capital instrument;
- A group structure chart
- For any item other than ordinary shares, a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification in the intended tier or stage of capital; and
- For any item intended for inclusion within RT1 capital (for Solvency II firms), a properly reasoned independent accounting opinion from an appropriately qualified individual identifying the instrument's treatment as a financial liability or equity instrument.

Declaration by Governing Body:

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 intended tier or stage of capital resources.

Signed (on behalf of the governing body)

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.

[1] Applicable to firms subject to Solvency II only.