



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY

Consultation Paper | CP12/20

# Capital Requirements Directive V (CRD V)

July 2020



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Responses are requested by Wednesday 30 September 2020.

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## 1 Overview

1.1 This Consultation Paper (CP) sets out proposed changes to the Prudential Regulation Authority's (PRA's) rules, supervisory statements (SS), and statements of policy (SoP) in order to implement elements of the Capital Requirements Directive<sup>1</sup> (CRD V). This consultation is relevant to banks, building societies, and PRA-designated investment firms ('firms').

1.2 The PRA shall consult in autumn 2020 on draft rules to implement the remaining elements of CRD V not covered by this CP – in particular those requiring legislative change – and amendments to the Capital Requirements Regulation (CRR II) that apply from Monday 28 December 2020.<sup>2</sup>

### Background

1.3 In May 2019, the European Union (EU) published legislation to implement, within the EU, some of the remaining Basel III prudential reforms agreed by the Basel Committee on Banking Supervision (BCBS). This legislation amends the current CRD and CRR.

1.4 CRD V is required to be transposed by Monday 28 December 2020. Most of its requirements apply from Tuesday 29 December 2020. Certain aspects require legislative changes in order to implement them in the United Kingdom (UK). HM Treasury is consulting on its proposed approach<sup>3</sup> to transposing these aspects of CRD V.

1.5 The PRA proposes not to implement the requirements of CRD V that do not need to be complied with by firms until after the end of the EU Exit Transition Period, in particular some of the requirements for EU Intermediate Parent Undertakings (IPUs) and Pillar 2 requirements for the leverage ratio.<sup>4</sup>

### Objectives of CRD V

1.6 The financial crisis highlighted problems in banks' risk management and in the regulatory framework. In 2013, CRD IV and the CRR – the EU legislation that implemented Basel III – sought to address many of those problems, such as the quantity and quality of banks' capital and liquidity resources. CRD V introduces further measures, implementing Basel III's enhanced Pillar 2 approach to the management and control of interest rate risk in the banking book (IRRBB). It also introduces a number of EU-specific measures designed to further harmonise micro and macroprudential supervision and to introduce greater proportionality in prudential requirements.

1.7 CRD V seeks to achieve these objectives by:

- clarifying the application of supervisory requirements and guidance under Pillar 2;
- adjusting requirements applied to remuneration policies;
- requiring the establishment of IPUs; and
- updating the governance requirements applied to firms.

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<sup>1</sup> Directive (EU) 2019/878.

<sup>2</sup> Regulation (EU) 2019/876.

<sup>3</sup> <https://www.gov.uk/government/consultations/consultation-on-updating-the-uks-prudential-regime-before-the-end-of-the-transition-period>.

<sup>4</sup> This aligns with HMT Treasury's proposed approach in, 'Transposition of the Bank Recovery and Resolution Directive II: consultation', June 2020.

1.8 It also introduces the following measures that will be addressed in the PRA's autumn 2020 consultation:

- a new requirement for approval and supervision of holding companies;
- clarification of the capital stack;
- a revised definition of the maximum distributable amount (MDA);
- revisions to the capital buffers that may be applied; and
- the introduction of supervisory requirements to measure, monitor, and control interest rate risk in the banking book (IRRBB).

## Pillar 2

1.9 The current EU requirements under Pillar 2 of CRD IV allow different interpretations of the way that additional capital requirements may be applied. In addition to being used to address firm-specific risks, additional capital requirements under Pillar 2 may also be used to address systemic risk. Different interpretations of the composition of capital that must be used to meet requirements under Pillar 2 are also possible. CRD IV does not explicitly address supervisors' ability to communicate to firms their expectations that they hold capital that exceeds minimum requirements, Pillar 2 requirements, and the combined buffer.<sup>5</sup> There is also the potential for duplicative reporting to be required under Pillar 2, which could create an administrative burden for firms.

1.10 CRD V introduces greater specificity in Pillar 2 and the supervisory review and evaluation process (SREP) requirements to address each of these points.

1.11 The PRA's proposals for implementing the CRD V Pillar 2 requirements are set out in Chapter 2.

## Remuneration policies

1.12 CRD IV allows firms to apply remuneration principles in a way that is appropriate to their size, internal organisation, and the nature and scale of their activities. It does not specify conditions under which remuneration requirements for variable remuneration that is to be deferred, or paid in instruments, may not be applied on proportionality grounds to smaller firms or certain individuals. It also does not address the extent to which remuneration policies are gender neutral.

1.13 CRD V seeks to address these points by introducing a framework for not applying certain remuneration requirements on proportionality grounds, and new requirements on gender neutral remuneration. It also seeks to strengthen incentives by increasing the minimum period for the deferral of payment of variable remuneration.

1.14 The PRA's proposals for implementing the CRD V remuneration requirements are set out in Chapter 3.

## Intermediate Parent Undertakings (IPUs)

1.15 CRD IV does not require non-EU groups with significant activities in the EU to have a common EU IPU. CRD V seeks to enhance the resolution process by introducing a new requirement for such groups to have an EU IPU.

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<sup>5</sup> The 'combined buffer' comprises the capital conservation buffer and, where applicable, the countercyclical capital buffer, the systemic risk buffer, the global systemically important institutions buffer, and the other systemically important institutions buffer.

1.16 The PRA's proposals for implementing the CRD V IPU requirements are set out in Chapter 4.

### Governance

1.17 CRD IV's governance requirements do not address the monitoring of loans to related parties by supervisory oversight, and the supervisors' roles and responsibilities in the event of money laundering or terrorist financing, or an increased risk thereof, or the power for supervisors to remove board members where they are not fit and proper or do not possess the necessary skills. CRD V introduces new requirements to address these issues.

1.18 Parts of the revised governance regime are currently under consultation by HM Treasury, including the power for the PRA to remove members of the management body in certain circumstances. Therefore, draft rules included in this CP could be subject to change.

1.19 The PRA's proposals for implementing the CRD V governance requirements are set out in Chapter 5.

### Third-country branch reporting

1.20 CRD IV does not specify the information that branches of third-country firms should report to competent authorities. CRD V introduces new requirements to enhance the analogous reporting of third-country branches.

1.21 The PRA's proposals for implementing the CRD V third-country branch reporting requirements are set out in Chapter 6.

## Implementation

### Application of EU law during the EU Exit Transition Period

1.22 Much of CRD V applies on Tuesday 29 December 2020. In accordance with the European Union (Withdrawal Agreement) Act 2020, such provisions shall apply in the UK until 23:00 GMT on Thursday 31 December 2020.

### CRR II and CRD V

1.23 The CRR, as amended by CRR II, is the 'single rulebook' that gives effect to provisions relating to variable capital requirements for real estate exposures, and requires parent undertakings to be responsible for ensuring that consolidated prudential requirements are met. CRD V contains, in particular, provisions concerning remuneration, governance, supervisory powers, SREP, Pillar 2R and Pillar 2G, IRRBB, IPUs, holding company approval and supervision, and the modification of capital buffers and MDAs.

### CRD V

1.24 Unlike the CRR, CRD is not directly applicable and must be transposed into UK law. A brief explanation of the PRA's approach to the transposition of CRD V, and the text of the proposed draft rules, is included in this consultation.

### Powers

1.25 In implementing CRD provisions and relevant CRR discretions and derogations through PRA rules, the PRA acts as a 'competent authority' and will exercise its rule-making powers under the Financial Services and Markets Act 2000 (FSMA). In the exercise of 'supervisory powers', such as requiring firms to hold additional capital, the PRA may impose a requirement: (i) on a PRA firm under section 55M of FSMA; or (ii) on specified PRA firms as a general rule under section 137G of FSMA.

## European Banking Authority (EBA) technical standards, guidelines, and Q&As

1.26 CRD V provides for technical standards to be drafted by the EBA. Such standards are subject to adoption by the European Commission before they come into force as directly applicable regulations. The EBA is also mandated to draft guidelines in specified areas. If applicable prior to 23:00 GMT on Thursday 31 December 2020, these standards and guidelines may cause the PRA to consider whether it needs to adjust elements included in this consultation. Where particularly relevant, reference is made to the standards and guidelines in specific chapters of this CP. The EBA also applies a Q&A tool to facilitate a common understanding of provisions related to CRD V. The PRA notes that the Q&As have no binding force in EU law, and are not subject to 'comply or explain' requirements.

1.27 It has been necessary to consult on the amended Remuneration Part of the PRA Rulebook on the basis of the draft regulatory technical standards (RTS) published by the EBA on Thursday 18 June 2020.<sup>6</sup> If the RTS enacted as EU law substantively differs from that draft version, the PRA will re-consult for the purposes of its effect on the Remuneration Part.

## Coordination with other UK bodies

1.28 The PRA is consulting with the Financial Conduct Authority (FCA) on CRD V implementation where it affects FCA objectives.

1.29 Some provisions in CRD V must be implemented by HM Treasury or other UK bodies. For example, CRD V provisions on capital buffers and holding company approval and supervision will be transposed by HM Treasury. Furthermore, HM Treasury must designate which authorities will be responsible for the application of variable capital requirements for real estate under CRR II and for the Systemic Risk Buffer (SRB) and other systemically important institutions (O-SII) buffer under CRD V. HM Treasury is currently consulting on the changes to domestic legislation required by CRD V provisions that apply before the end of the EU Exit Transition Period.<sup>7</sup> The PRA will set out its proposed approach on these aspects in its autumn 2020 consultation.

## Application after the end of the EU Exit Transition Period

1.30 The proposals set out in this CP have been designed in the context of the UK's withdrawal from the European Union and entry into the EU Exit Transition Period, during which time the UK remains subject to European law. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework at the end of the EU Exit Transition Period, including those arising once any new arrangements with the European Union take effect. Except where otherwise stated, the proposals set out in this CP would continue to apply after the end of the EU Exit Transition Period.

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<sup>6</sup> See draft Remuneration Rule 1.3, 'Material Risk Takers Regulation' definition. The draft EBA RTS is available at: <https://eba.europa.eu/revised-regulatory-technical-standards-identified-staff-remuneration-purposes#pane-289>.

<sup>7</sup> <https://www.gov.uk/government/consultations/consultation-on-updating-the-uks-prudential-regime-before-the-end-of-the-transition-period>.

1.31 The PRA has assessed that the proposals would need to be amended under the EU (Withdrawal) Act 2018 (EUWA 2018).<sup>8</sup> A second version of the proposed rules which includes the relevant amendments under EUWA 2018, is set out in Appendix 2.

1.32 With the exception of draft SS2/17 'Remuneration', the draft Ss and Statements of Policy (SoPs) (Appendix 3) attached to this CP should be read in conjunction with SS1/19 'Non-binding PRA materials: The PRA's approach after the UK's withdrawal from the EU'.<sup>9</sup> In general, the PRA is not intending to make line-by-line amendments to non-binding materials that are applicable ahead of the UK's withdrawal from the EU. However, from the end of the EU Exit Transition Period, firms should read and interpret these materials in light of the UK's withdrawal from the EU, as well as the amendments that have been made to related legislation under EUWA 2018. This includes changes to the PRA Rulebook and Binding Technical Standards. In particular, firms should take into account the key changes that have been made to legislation as outlined in SS1/19.

1.33 The amendments to SS2/17 are due to apply to firms only after the end of the EU Exit Transition Period. Therefore, they reflect the fact that EU law will not be applicable at that point. All references in the revised SS2/17 to Regulations and Binding Technical Standards should be taken to be made to the onshored versions, which are the versions that will apply in UK law after the end of the EU Exit Transition Period and will include the relevant amendments under EUWA 2018.

1.34 After the end of the EU Exit Transition Period, EU Guidelines referred to in these proposals should be read in conjunction with the Bank Statement of Policy on EU Guidelines and Recommendations.<sup>10</sup>

## Responses and next steps

1.35 This consultation closes on Wednesday 30 September 2020. The PRA invites feedback on all the proposals set out in this consultation and also on the specific questions included in Chapters 2, 3 and 4. Please address any comments or enquiries to [CP12\\_20@bankofengland.co.uk](mailto:CP12_20@bankofengland.co.uk).

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<sup>8</sup> Please see PS5/19 'The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018' for further details: <https://www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018>.

<sup>9</sup> April 2019: <https://www.bankofengland.co.uk/prudential-regulation/publication/2019/non-binding-pra-materials-the-pra-approach-after-the-uks-withdrawal-from-the-eu-ss>.

<sup>10</sup> April 2019: <https://www.bankofengland.co.uk/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop>.



## 2 Pillar 2

### CRD Articles 97, 104, 104a, 104b, 104c, 113, and 141a

2.1 This chapter sets out the PRA's proposed implementation of changes to Pillar 2 provisions relating to firms' internal capital assessments, supervisory review of those assessments, and the additional capital requirements and guidance that may be applied.

2.2 Firms should have adequate capital and appropriate processes to address the risks that arise in their businesses. Pillar 2 serves to mitigate risks to a firm not covered, or not adequately covered, by Pillar 1 standards, thereby advancing the safety and soundness of firms in line with the PRA's statutory objectives.

2.3 The proposals in this chapter would amend:

- Statement of Policy 'The PRA's methodologies for setting Pillar 2 capital' (Pillar 2 SoP) (Appendix 3, Chapter 1); and
- SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)' (Appendix 3, Chapter 2).

### Proposals

#### Supervisory powers

2.4 CRD V requires that competent authorities have powers to address risks introduced or increased as a result of outsourced activities.<sup>11</sup> The PRA already has such powers under FSMA. The PRA assesses such risks under the SREP and may impose requirements under Pillar 2. The PRA does not consider that these provisions of CRD V require a change to its approach.

#### SREP

2.5 CRD V will require changes to the PRA's SREP documentation in relation to: (i) proportionality; and (ii) money laundering or terrorist financing (MLTF).<sup>12 13</sup>

#### *Proportionality*

2.6 CRD V introduces a new requirement for supervisors to define, apply, and disclose the criteria used to apply proportionality in the SREP process.

2.7 The PRA already applies proportionality to the SREP, as reflected in its policy documents. The PRA makes clear the ways in which proportionality is considered and applied in the SREP. To clarify its approach further, the PRA proposes to make amendments to the SREP chapter of SS31/15 to highlight the ways that proportionality is applied, as follows:

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<sup>11</sup> Article 104(1f) of CRD V.

<sup>12</sup> Article 97(4) of CRD V.

<sup>13</sup> Articles 91(1) and 97(6) of CRD V.

- The PRA applies the approach in the EBA SREP Guidelines on proportionality.<sup>14 15</sup>
- Smaller firms have fewer reporting requirements than larger firms under the Reporting Pillar 2 Part of the PRA Rulebook.<sup>16</sup>
- A proportionate approach is applied in setting the operational risk Pillar 2A add-on for non-Category 1 firms. The PRA assesses operational risk for these firms on the basis of data provided by the firm, the firm's own assessment of operational risk, and supervisory judgement.<sup>17</sup>
- The PRA provides more proportionate scenarios for smaller firms' own stress testing. For example, the PRA buffer applied to new banks takes account of their recent entry to the market.<sup>18</sup>

### *Money laundering or terrorist financing (MLTF)*

2.8 CRD V requires the PRA to notify and coordinate with the EBA and the FCA in the event that assessment under the SREP provides reasonable grounds to suspect MLTF is being committed at a firm, has been committed, or there is an increased risk thereof. It also requires the PRA to undertake a common assessment with the FCA.

2.9 The PRA proposes to amend SS31/15 to clarify how these MLTF requirements will be addressed in the SREP. Chapter 5 on Governance sets out the PRA's proposed approach to verifying the continuing fitness and propriety of members of a firm's management body where the PRA has reasonable grounds to suspect MLTF is being or has been committed or attempted at a firm, or there is an increased risk thereof in connection with that firm.

### *Tailored SREP methodologies*

2.10 CRD V gives supervisors discretion to tailor the application of SREP methodologies to institutions with a similar risk profile, such as similar business models or geographical location of exposures.<sup>19</sup> This would allow for the same SREP and Pillar 2A approach to be applied to a group of firms with similar risk profiles.

2.11 The PRA does not currently apply the tailored SREP methodologies considered by CRD V. The PRA does not consider changes to its approach to be necessary at this time.

### *Pillar 2A*

2.12 The PRA considers changes to its Pillar 2A approach not to be required by CRD V. The PRA's current approach to Pillar 2A aligns with CRD V's provisions on the setting of Pillar 2 requirements (Pillar 2R),<sup>20</sup> including on the quality of capital required to meet Pillar 2A.

### *Risks covered*

2.13 CRD V removes the CRD IV requirement for supervisors to assess systemic risk in determining the appropriate level of own funds for a firm under the SREP. This has the effect of meaning the PRA would be constrained in its ability to use Pillar 2 for macroprudential purposes. CRD V also permits

<sup>14</sup> EBA SREP Guidelines Section 2.4.

<sup>15</sup> Paragraph 32, 'The Prudential Regulation Authority's approach to banking supervision': <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/pr-a-approach-documents-2018>.

<sup>16</sup> Rule 2.3 of the Reporting Pillar 2 Part of the PRA Rulebook.

<sup>17</sup> See paragraphs 4.2–4.3 of the Pillar 2 SoP.

<sup>18</sup> CP9/20 'Non-systemic UK banks: The Prudential Regulation Authority's approach to new and growing banks', July 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/new-and-growing-banks>.

<sup>19</sup> Article 97(4a) of CRD V.

<sup>20</sup> Article 104a of CRD V.

the use of Pillar 2R to address the risks to which a firm is exposed resulting from its activities, including risks relating to the impact of economic and market developments.

2.14 As the PRA has not used Pillar 2A to address macroprudential risks under CRD IV, the PRA does not consider that changes to its current approach will be required to address these aspects of CRD V.

2.15 HM Treasury is consulting on the transposition of CRD V's systemic risk buffer (SRB) in the UK, in order to preserve macroprudential flexibility in light of CRD V's limitations on the use of Pillar 2 for macroprudential purposes.

### *Quality of capital for Pillar 2A*

2.16 CRD V requires the composition of capital used to meet Pillar 2R to be of a quality at least as high as that required to meet Pillar 1 requirements. That aligns with the PRA's current approach to Pillar 2A, which already requires that firms meet Pillar 2A with at least 56% Common Equity Tier 1 (CET1) capital, no more than 44% Additional Tier 1 (AT1) capital, and no more than 25% Tier 2 capital. CRD V also allows supervisors to require firms to meet Pillar 2 requirements with a higher proportion of CET1 or Tier 1 capital, where necessary and taking into account the circumstances of the firm.<sup>21</sup>

2.17 The PRA does not consider amendments to its Pillar 2A approach to be required to implement the CRD V provisions on the quality of capital for Pillar 2R. Accordingly, the PRA does not propose to make changes to this aspect of the PRA's current approach to Pillar 2A.

### **Pillar 2B – the PRA buffer**

2.18 The PRA considers that, except for paragraphs 2.19 to 2.25 below, the current PRA buffer already implements the CRD V requirement to apply Pillar 2G. The PRA buffer is an amount of capital that firms should maintain in addition to their total capital requirement (TCR) and the combined buffer. It absorbs losses that may arise under a severe stress scenario as well as addresses weaknesses such as in a firm's risk management, governance, stress testing processes, or data quality.

2.19 With the exception of its application to firms that are subsidiaries of UK consolidation groups or ring-fenced body (RFB) sub-groups, the PRA considers that compliance with CRD V would not require material changes to the PRA buffer. The PRA proposes to amend its rules to make more explicit the need for firms to have sufficient capital to absorb losses resulting from stress scenarios, in accordance with Article 104b of CRD V.

### **Applying the PRA buffer to subsidiaries of UK consolidation groups or RFB sub-groups**

2.20 The PRA proposes to implement the PRA buffer on an individual basis for firms that are part of a UK consolidation group, or part of an RFB sub-group ('subsidiaries'), in a similar way to the PRA approach to setting Pillar 2A capital requirements on an individual basis.<sup>22</sup> The approach depends on: (i) the transferability of group resources; (ii) the nature and extent of integration of the subsidiary; (iii) the likelihood of group support; and (iv) the significance of the entity and the risk profile of its business relative to the group. The PRA proposes to update the SREP chapter of SS31/15 and the PRA buffer section of the Pillar 2 SoP to give effect to these changes.

2.21 The PRA's proposed framework for applying the PRA buffer to subsidiaries would take the group-level PRA buffer assessment as a starting point. For these purposes, a subsidiary would be considered not to be material if it comprised less than 5% of the UK consolidation group risk -

<sup>21</sup> Article 104a(4) of CRD V.

<sup>22</sup> Paragraphs 5.14 and 5.15 of SS31/15.

weighted assets (RWAs), leverage exposures, and operating income. The PRA proposes to take the approach set out in paragraph 2.20 where it considers financial resources to be transferable between the group entities and judges the parent to be likely to support a failing subsidiary.

#### *Subsidiaries with a similar risk profile to their group or that are not material to the group*

2.22 The PRA proposes to set the PRA buffer for a subsidiary such that, when aggregated with the total capital requirement (TCR) and the combined buffer, the total capital it is expected to hold is the same as the internal capital the firm determines in its internal capital assessment to be sufficient. Internal capital must be sufficient to cover all the risks to which it is exposed and to absorb potential losses from stress scenarios. Where the sum of TCR and combined buffer exceeds the capital the firm has determined in its internal assessment, the PRA expects to set a PRA buffer of zero. The PRA proposes to take this approach where:

- on a UK consolidated basis, the PRA buffer plus combined buffers and TCR is the same as the internal capital considered internally to be sufficient; and
- on an individual basis, the PRA has not identified the subsidiary as being exposed to materially different risks to those of the group in a medium-term stress.

2.23 The PRA proposes to also take this approach where these conditions are not met, in cases where: (i) a subsidiary is not material in the context of its UK consolidation group or RFB sub-group; (ii) the PRA considers financial resources to be transferable between the group entities; and (iii) the PRA expects parental support would be likely to be provided to the subsidiary, if required. A subsidiary would be considered not to be material for these purposes if it comprises less than 5% of the UK consolidation group RWAs, leverage exposures and operating income.

#### *Subsidiaries with very similar risk profile to the group*

2.24 Where a firm has a very similar risk profile to its UK consolidation group or RFB sub-group, the PRA proposes to set the PRA buffer on an individual basis by reference to the PRA buffer calculated for that group or sub-group. For example, where a subsidiary comprises more than 80% of the UK consolidation group's RWAs, and the rest of the group undertakes similar activities as the subsidiary.

#### *Firms subject to a full PRA Buffer assessment process*

2.25 The PRA proposes to set the PRA buffer according to a comprehensive individual assessment if none of the above approaches is applicable, or if the PRA identifies any factor indicating a full assessment to be needed, such as:

- there are material impediments to the transferability of capital within the group;<sup>23</sup>
- the subsidiary is a specialist subsidiary containing a high concentration of a group's business that could lead to a negative outcome in a stress, but this concentration is offset at a group wide level;
- there are significant weaknesses in the risk management or governance of the subsidiary;
- the subsidiary has significant weaknesses that call into question the adequacy of its existing capital requirements; or

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<sup>23</sup> As defined in SS31/15 – Paragraphs 5.20 to 5.24.

- other material supervisory concerns lead the supervisor to consider the firm's internal capital not to be sufficient to cover the risks to which it is exposed.

### *Pillar 2 for Leverage*

2.26 CRD V requires the PRA to set a Pillar 2R for leverage where it considers that the risk of excessive leverage is not sufficiently addressed by CRR II's Pillar 1 leverage ratio.<sup>24</sup> As CRR II's Pillar 1 leverage ratio applies after the end of the EU Exit Transition Period, the PRA proposes not to implement the requirement for Pillar 2R for leverage.<sup>25</sup>

2.27 The PRA has a leverage ratio regime, as set out in the Leverage Part of the PRA Rulebook, and ensures that firms assess the risks of excessive leverage in the internal capital adequacy assessment process (ICAAP).<sup>26</sup> The Financial Policy Committee (FPC) and Prudential Regulation Committee (PRC) are reviewing the FPC-PRC leverage ratio framework in light of international standards. The PRA will consult on any proposed updates to that framework following FPC-PRC's review.

### *Duplicative reporting*

2.28 CRD V introduces a limitation on the supervisory discretion to require additional or more frequent reporting, prohibiting the collection of information that is duplicative.<sup>27</sup>

2.29 Accordingly, the PRA has performed a review of its data collections and identified elements of reporting templates PRA107 (Statement of profit or loss – forecast data)<sup>28</sup> and FSA079 (Concentration risk additional data requirements) that could qualify as duplicative reporting.<sup>29</sup>

2.30 The PRA proposes to amend existing PRA reporting to remove the duplicative reporting requirements identified.

2.31 The PRA proposes to offer firms that submit Funding Plans a modification by consent, to provide firms with the option to waive one of their two PRA107 submissions during the year, where this report would have the same reporting reference date as the Funding Plans. These Funding Plans are submitted under the EBA's 'Updated Guidelines on harmonised definitions and templates for funding plans of credit institutions'.<sup>30</sup> Firms benefitting from the modification would still make the other of their two PRA107 submissions each year. All other firms submitting PRA107 would still be required to submit PRA107 twice a year.

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<sup>24</sup> CRR Article 92(1)(d) and CRD V Article 104a(3).

<sup>25</sup> This applies the approach to transposition of measures that apply after the end of the EU Exit Transition Period on which HM Treasury is consulting in its Transposition of the Bank Recovery and Resolution Directive II.

<sup>26</sup> Risk of Excessive Leverage Chapter of the Internal Capital Adequacy Assessment Part of the PRA Rulebook.

<sup>27</sup> Duplicative data includes information that is the same or substantially the same as that which has otherwise been reported to the competent authority.

<sup>28</sup> Firms submit PRA107 on a semi-annual basis. The 'Updated Guidelines on harmonised definitions and templates for funding plans of credit institutions' (December 2019) introduce a new Forecast Profit/Loss template, which has substantially the same breakdown of line items to PRA107. Firms that are in scope of the Funding Plans submit the plan annually, potentially duplicating one of the PRA107 submissions. While PRA107 applies to all PRA-regulated firms, the Funding Plans reporting only applies to a small group of firms determined by the PRA on an annual basis. The PRA ensures that it collects the information from enough firms to cover 75% of the total assets in the UK banking system. Firms included in the data collection for Funding Plans could be considered, absent any action from the PRA, to be required to submit two forecasts of the Profit/Loss template at the same time.

<sup>29</sup> All PRA-regulated firms return the FSA079 report. This consists of three tables for single name concentration risk, sector concentration risk, and geographic (international) concentration risk. The geographic concentration risk table provides exposure at default (EAD) and RWA information for regions of the world, for all credit portfolios excluding mortgages under the standardised approach. Firms submit this report in line with their ICAAP submission dates. On a quarterly basis, firms also submit Common Reporting (COREP) for credit risk, including the C09.01 and C09.02 templates that provide geographical breakdowns of exposure, broken down by country of residence of the obligor. The FSA079 report could be considered duplicative because it could be produced to the same quality using information that is already reported on the COREP templates, by aggregating the countries into regions.

<sup>30</sup> <https://eba.europa.eu/regulation-and-policy/supervisory-reporting/updated-guidelines-on-harmonised-definitions-and-templates-for-funding-plans-of-credit-institutions>.

2.32 The PRA also proposes to remove the duplication from the FSA079 report by deleting the Geographic (international) concentration risk table.

### **Questions**

1. What are your views on the proposed approach to setting the PRA Buffer for subsidiaries?
2. Are there other areas of supervisory reporting that might qualify as duplicative?

### 3 Remuneration

#### CRD Articles 74, 75, 92, 94, and 109

3.1 This chapter sets out the PRA's proposed implementation of changes relating to remuneration.

3.2 CRD V's provisions on remuneration are intended to enhance firms' risk management and the risk-taking behaviour of individuals, and to introduce greater consistency in the approaches applied across firms. Sound remuneration policies and processes enhance the safety and soundness of firms, in line with the PRA's objectives.

3.3 The proposals in this chapter would amend:

- the Remuneration Part of the PRA Rulebook (Appendix 1, Chapter 7 and Appendix 2, Chapter 2); and
- SS2/17 'Remuneration' (Appendix 3, Chapter 3).

#### Proposals

##### Scope of application

3.4 The PRA's proposed implementation of CRD V's revised remuneration requirements applies to UK banks, building societies, and PRA-designated investment firms, in respect of individual material risk takers (MRTs) employed by subsidiaries within a firm's group that perform professional activities that have a direct, material impact on the risk profile or business of firms in the group.<sup>31</sup>

3.5 CRD V gives discretion to also apply the remuneration requirements on a consolidated basis to a broader range of subsidiaries and their staff,<sup>32</sup> which may include subsidiaries within a firm's corporate group that are subject to other sectoral remuneration requirements. The PRA proposes to use that discretion to maintain its current approach of applying remuneration rules at consolidated and sub-consolidated levels to all entities within a 'group', as defined in FSMA.<sup>33</sup> This would ensure that MRTs across a group are subject to CRD V remuneration requirements and have incentives that are appropriately aligned with prudent risk taking. The PRA proposes to amend Chapter 4 of the Remuneration Part of the PRA Rulebook in order to clarify this.

##### Identification of MRTs

3.6 CRD V updates the basis for identifying certain categories of MRTs, specifying certain categories of staff whose professional activities have a material impact on a firm's risk profile.<sup>34</sup>

3.7 The PRA proposes to update the Remuneration Part to implement CRD V's revised approach to identifying MRTs, including for MRTs in branches of third-country firms.<sup>35</sup>

<sup>31</sup> These subsidiaries include asset management companies and undertakings that perform investment services and activities listed in points (2), (3), (4), (6) and (7) of Section A of Annex I to Directive 2014/65/EU.

<sup>32</sup> CRD Article 109(6).

<sup>33</sup> Section 421.

<sup>34</sup> CRD Article 92(3) and Article 94(2).

<sup>35</sup> On June 18 2020, the EBA published an amended version of draft regulatory technical standards (RTS) covering the identification of MRTs. If those revised draft standards are adopted by the European Commission and are operative in EU law before the end of the EU Exit Transition Period, they will form part of the body of rules that is onshored in UK legislation under the European Union (Withdrawal) Act 2018. While the RTS applies directly to UK firms in scope of the Remuneration Part of the PRA Rulebook, it is also cross-referenced in rules that concern MRT identification requirements for third-country branches (Rule 3.2) and minimum deferral period (Rule 15.17). The PRA is consulting on the basis of the revised draft standards and, if these are adopted in a substantively different form, the PRA intends to re-consult as necessary.

### Minimum deferral period

3.8 CRD V increases the three to five year minimum deferral period for variable remuneration to four to five years for all MRTs, and to five years for members of management bodies and senior management of firms that are significant in terms of their size, internal organisation, and the nature, scope, and complexity of their activities.

3.9 The current PRA approach requires at least 40% of an MRT's variable remuneration to be deferred. It sets the minimum deferral period at three, five, or seven years, depending on an individual's role and seniority. For MRTs with variable remuneration above £500,000, and directors of significant firms, at least 60% of the amount must be deferred over three, five, or seven years depending on an individual's seniority.

3.10 To apply the revised CRD V requirement, the PRA proposes to lengthen the minimum deferral period for remuneration from three years to four years for MRTs that are not already subject to longer deferral periods under PRA rules.<sup>36</sup>

### Payment in instruments

3.11 The PRA proposes to modify its rules to permit listed firms to include share-linked instruments in the instruments that must make up at least 50% of variable remuneration.<sup>37</sup> This reflects CRD V's allowance of the use of share-linked instruments in such cases.

### Gender neutral remuneration

3.12 CRD V requires firms' remuneration policies to be gender neutral, for there to be data collection on remuneration, including on the gender pay gap, and for that information to be used to benchmark remuneration trends and practices.

3.13 HM Treasury is consulting on its proposed approach to transposing these requirements.<sup>38</sup> The PRA will determine what further changes, if any, are needed to its approach in light of HM Treasury's approach to transposition. The PRA would intend to consult on such changes in autumn 2020, if necessary.

### Relevant performance year

3.14 The PRA proposes that the changes to the Rulebook and SS2/17 proposed here would take effect on Tuesday 29 December 2020. The PRA considers CRD V to require firms to apply the amendments to the Remuneration Part to any remuneration awarded in relation to the first performance year starting after that date. For remuneration awarded on or after Tuesday 29 December 2020 in respect of earlier performance years, the PRA proposes that firms must comply with the rules as they applied immediately prior to the proposed modifications.

### Application of certain remuneration requirements to all firms and individuals

3.15 CRD V requires remuneration requirements to apply to all firms and individuals, irrespective of the size of the firm or level of remuneration of the individual including: the maximum ratio between variable and fixed remuneration; the prohibition on guaranteed variable remuneration; malus; clawback; and requirements covering buy-outs of variable remuneration.

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<sup>36</sup> Remuneration 15.17.

<sup>37</sup> Remuneration 15.15.

<sup>38</sup> <https://www.gov.uk/government/consultations/consultation-on-updating-the-uks-prudential-regime-before-the-end-of-the-transition-period>.



3.16 Under the current PRA approach to remuneration, a firm may comply with the Remuneration Part in a way that is appropriate to its size, internal organisation, and the nature, scope, and complexity of its activities, and may be permitted not to apply certain remuneration requirements.<sup>39</sup> SS2/17 currently clarifies that the PRA does not expect firms to apply certain requirements at individual level where an individual's variable remuneration is no more than 33% of their total remuneration and their total remuneration is no more than £500,000.

3.17 The PRA is also proposing to amend its current approach to apply the CRD V requirements covering the maximum ratio between variable and fixed remuneration, malus, clawback, and buy-outs to all firms. It also proposes to amend its approach to apply the same CRD V requirements, and the prohibition of guaranteed variable remuneration, to all MRTs.

3.18 The PRA proposes also to amend the regime for part-year MRTs in line with the CRD V restrictions on disapplication of rules at individual level.

### Proportionate application of remuneration requirements

3.19 CRD V introduces an explicit framework under which remuneration requirements for payment in instruments, minimum deferral of variable remuneration, and discretionary pension benefits are not applied to smaller, less complex firms on proportionality grounds.

3.20 The PRA has considered CRD V's proportionality regime for smaller, less complex firms based on the information available to it. The PRA proposes to amend its approach to proportionality, as set out in Remuneration 5.1 and the current version of SS2/17, to implement CRD V's revised approach.

### *Application at firm-level*

3.21 In line with CRD V, the PRA proposes that firms would not be required to comply with remuneration requirements for payment in instruments, minimum deferral of variable remuneration, and discretionary pension benefits where they:

- do not qualify as a 'large institution';<sup>40</sup> and
- have total assets of equal to or less than €5 billion averaged over the four-year period immediately preceding the current financial year.

3.22 The PRA proposes to exercise a CRD V discretion to permit certain smaller firms with total assets larger than €5 billion not to apply these remuneration requirements. This would maximise the alignment of the PRA's revised approach to proportionality with its current approach. Accordingly, the PRA proposes to exercise the discretion under CRD V to increase the total assets threshold to €15 billion for firms that meet the following criteria:

- they do not qualify as 'large institutions';
- they are subject to no obligations, or simplified obligations, for recovery and resolution planning purposes under the Bank Recovery and Resolution Directive;
- their on- and off-balance sheet trading book business is equal to or less than 5% of their total assets, and €50 million;

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<sup>39</sup> Remuneration 5.1.

<sup>40</sup> 'Large institution' is defined in CRR II Article (3)(1)(146).

- the total value of their derivatives positions held with trading intent does not exceed 2% of their total on- and off-balance sheet assets, and the total value of their overall derivatives positions does not exceed 5% of their total on- and off-balance sheet assets; and
- it is appropriate for the firm not to be required to comply, taking into account the nature, scope, and complexity of its activities, its internal organisation and, if applicable, the characteristics of the group to which it belongs.

3.23 For firms that are part of a group, the PRA also proposes potentially to use the discretion under CRD V to reduce the total assets threshold.<sup>41</sup> The PRA proposes to do this where a firm that qualifies for the non-application of certain remuneration requirements on an individual basis belongs to a group with at least one other firm that must apply the full remuneration requirements.

3.24 The effect of exercising this discretion would be to ensure through a PRA rule that all firms within a group continue to be subject to the same remuneration rules as those applicable to the highest proportionality level firm in the group, as is the case in paragraph 2.10 in the current version of SS2/17.

#### *Application to branches*

3.25 The PRA proposes to modify its approach to the proportionate application of remuneration requirements to branches of third-country firms operating in the UK to maintain an equivalent treatment to that applied to PRA-authorised firms.

3.26 Accordingly, the PRA proposes that branches of third-country firms operating in the UK would not be required to comply with remuneration requirements for payment in instruments, minimum deferral of variable remuneration, and discretionary pension benefits where the total assets of the branch are equal to or less than €5 billion averaged over the four-year period immediately preceding the relevant financial year, or they meet the following criteria:

- branch total assets are equal to or less than €15 billion averaged over the four-year period immediately preceding the current financial year;
- the on- and off-balance sheet trading book business of the branch is equal to or less than 5% of their total assets, and €50 million;
- the total value of the derivatives positions of the branch held with trading intent does not exceed 2% of their total on- and off-balance sheet assets, and the total value of their overall derivatives positions do not exceed 5% of their total on- and off-balance sheet assets; and
- it is appropriate for the third-country CRR firm with the PRA's proposed rules specified above, taking into account the nature, scope, and complexity of the activities and internal organisation of its branch operation in the UK and, if applicable, the characteristics of the group to which it belongs.

3.27 The PRA considers that the other CRD V proportionality criteria applicable to UK firms, such as those relating to simplified recovery and resolution planning or the systemic importance of a firm in its home state, are not relevant to the situation of a branch of a third-country firm operating in the UK. In addition, the PRA considers their application is not necessary to ensure the treatment of branches of third-country firms is not more favourable than that applied to other firms or branches.

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<sup>41</sup> CRD Article 94(4)(b).

### *Application to individuals*

3.28 The PRA proposes to amend its approach to the proportionate application of remuneration requirements to individuals in line with CRD V. The PRA proposes to clarify that remuneration requirements for payment in instruments, minimum deferral of variable remuneration, and discretionary pension benefits do not apply to individuals with annual variable remuneration equal to or less than €50,000 and which represents no more than one-third of total remuneration. Under the current PRA approach, an MRT is not expected to be subject to certain remuneration requirements if their variable remuneration is equal to or less than 33% of total remuneration and their total remuneration is equal to or less than £500,000.

3.29 For MRTs whose variable remuneration is no more than a third of total remuneration and their total remuneration is no more than £500,000, the PRA proposes to apply deferral and clawback periods in line with CRD requirements to the extent they are applicable. For such MRTs, when deferral may not be disapplied on proportionality grounds, the PRA proposes generally to set the deferral period at four years. For an MRT that is a member of the management body and/or senior management<sup>42</sup> of firms that are significant in terms of their size, internal organisation, and the nature, scope, and complexity of their activities, the PRA proposes to set the deferral period at five years.

3.30 The proposed clawback period for such MRTs will differ for immediately paid variable remuneration and deferred variable remuneration, as well as the position of the MRT. Clawback will be exercisable within a year from the payment of variable remuneration, unless the variable remuneration is deferred in which case it will be exercisable within five years five years and six months, or six years depending on the MRT's role in their institution.

### *Euro denominated thresholds*

3.31 CRD's proportionality thresholds for firms and individuals are denominated in euro. The PRA proposes to transpose those thresholds into PRA rules.

3.32 The PRA proposes to set these thresholds in sterling once the EU Exit Transition Period ends. To inform its view of the appropriate sterling thresholds, the PRA has used the average of daily GBP/EUR spot exchange rates over a 12-month period prior to 10 July 2020: £1 = €1.14, rounded to the nearest integer. The PRA's proposals are outlined in the table below.

Threshold	Individual variable remuneration Rule 15.1(3)	Individual total remuneration Rule 3.1(1)(c)	Total assets Rule 1.3, SS2/17 Table B	Total assets Rule 1.3, <sup>43</sup> SS2/17 Table B
CRDV (EUR)	€50,000	€500,000	€5 billion	€15 billion
Proposed (GBP)	£44,000	£440,000	£4 billion	£13 billion

<sup>42</sup> Together they encompass what CRD defines as the 'management body'.

<sup>43</sup> This cross reference is focused solely on the definition of 'small CRR firm' and 'small third-country CRR firm'.

## Questions

3. What further information can firms with assets below £15 billion provide on the cost and benefits of the PRA's proposals? More broadly, do you agree with the PRA that the approach consulted upon is proportionate?
4. Do you have any views on the design and amount of currency thresholds following the end of the EU Exit Transition Period?

## 4 Intermediate parent undertakings (IPUs)

### CRD Article 21b

4.1 This chapter sets out the PRA's proposed implementation of CRD V's IPU requirements.

4.2 The IPU requirements are intended to simplify and strengthen the resolution process of non-EU groups with significant activities in the EU.

4.3 The proposals in this chapter would make amendments to:

- The Groups Part of the PRA Rulebook (Appendix 1, Chapters 2 and 3); and
- SS15/13 'Groups' (Appendix 3, Chapters 5 and 6).

### Proposals

#### IPU requirements

4.4 The PRA proposes not to implement the IPU requirement for third-country groups operating through two or more firms that had total EU assets of €40 billion or more on Thursday 27 June 2019. These requirements do not need to be complied with by firms until after the end of the EU Exit Transition Period.<sup>44</sup>

4.5 The PRA proposes to make rules implementing the CRD V requirement for a third-country group to have an IPU if it operates through two or more EU firms, has total EU assets of €40 billion or more, but had total assets that were less than €40 billion on Thursday 27 June 2019. For any third-country groups in this category, the IPU requirement applies from Tuesday 29 December 2020.

#### Dual IPUs

4.6 CRD V allows supervisors to permit relevant groups to establish two IPUs where a single IPU would either:

- be incompatible with mandatory structural separation requirements imposed in the group's home jurisdiction; or
- make resolvability less efficient than having two IPUs, following an assessment by the competent resolution authority of the EU IPU.

4.7 The PRA proposes that groups that meet either condition consider applying for a waiver from the proposed PRA rule requiring a single IPU. Where the statutory conditions are satisfied and the PRA granted such a waiver, it would ensure that non-EU groups that are subject to mandatory structural separation requirements do not have to restructure under a single IPU.

4.8 The PRA proposes to update SS15/13 to indicate the type of information that might be provided by groups subject to mandatory structural separation when applying for a waiver. The PRA would use that information to assess under FSMA s138A(4) whether an application meets the requirement

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<sup>44</sup> This applies the approach to transposition of measures that apply after the end of the EU Exit Transition Period on which HM Treasury is consulting in its Transposition of the Bank Recovery and Resolution Directive II.

for a single IPU to be incompatible with mandatory structural separation requirements applied to the group.<sup>45</sup>

### **Approach after the end of the EU Exit Transition Period**

4.9 When the EU Exit Transition Period ends, the PRA proposes to remove the rules requiring an IPU to be established. The PRA is responsible for supervising the PRA-regulated activities of third-country groups in the UK, including any relevant banking subsidiaries, PRA-designated investment firms, and related branches. The PRA is able to monitor effectively the prudential risks arising from those operations without a requirement to establish an IPU. Where warranted, the PRA has firm-specific powers to require a UK IPU to be established.

### **Question**

5. For non-EU groups subject to the PRA's proposed rule on IPUs that do not already have an IPU, what would be the cost of establishing an IPU?

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<sup>45</sup> Namely that the rule is unduly burdensome or does not meet its objective, and that granting the waiver will not adversely affect advancement of the PRA's objectives.

## 5 Governance

### CRD Articles 85, 88(1), 91(1), 91(7), 91(8), and 97(6)

5.1 This chapter sets out the PRA's proposals to implement CRD V requirements on governance.

5.2 The CRD V provisions on governance are intended to help ensure that firms and their management organise and control their affairs responsibly and effectively. Sound governance practices and procedures enhance the safety and soundness of firms, in line with the PRA's objectives.

5.3 The proposals in this chapter would make amendments to:

- the General Organisational Requirements (GOR) Part of the PRA Rulebook (Appendix 1, Chapter 1);
- the Internal Capital Adequacy Assessment (ICAA) Part of the PRA Rulebook (Appendix 1, Chapter 4);
- the Related Party Transactions Risk (RPTR) Part of the PRA Rulebook (Appendix 1, Chapter 6); and
- SS28/15 'Strengthening individual accountability in banking' (Appendix 3, Chapter 4).

### Proposals

#### Operational risk from outsourcing

5.4 The PRA proposes to amend Chapter 10 of the ICAA Part to implement the CRD V requirement for firms to implement policies and processes to evaluate and manage exposures to operational risk arising from outsourcing.

5.5 The PRA expects the proposed amendments would also need to be reflected in any final version of Table 1 in the draft SS on 'Outsourcing and third-party risk management' included in CP30/19.<sup>46</sup>

#### Loans to board members

5.6 The PRA proposes to implement the CRD V requirement for data on loans to members of the management body and their related parties to be properly documented and made available to the supervisor on request.

5.7 The new requirements would apply in addition to the current requirements in the RPTR Part of the PRA Rulebook. The PRA is proposing to amend the definition of 'related parties' in the RPTR Part to include the parties set out in CRD V.

5.8 The PRA acknowledges this could involve additional cost to firms should they be required to report data on individual loans, or other transactions, to the PRA. However, the PRA proposes to request any additional data on a proportionate basis, and not to apply a new, ongoing reporting requirement for all firms. The ability to request such data, in addition to the data already set out in the RPTR Part, would enhance the PRA's ability to monitor risks from loans to related parties or conflicts of interest that arise.

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<sup>46</sup> December 2019: <https://www.bankofengland.co.uk/prudential-regulation/publication/2019/outsourcing-and-third-party-risk-management>.

## Verification of fitness and propriety

5.9 CRD V requires supervisors to verify that members of a firm's management body continue to meet CRD requirements for fitness and propriety where supervisors have reasonable grounds to suspect that:

- money laundering or terrorist financing (MLTF) is being or has been committed or attempted; or
- there is an increased risk of MLTF.

5.10 The PRA considers that its existing framework for assessing fitness and propriety aligns with the CRD V requirements. In particular, the existing obligations for firms to assess the fitness and propriety of individuals, and the criteria against which the assessment is carried out, would already include an attempted or committed MLTF incident at a firm, or an increased risk thereof, and would warrant a firm verifying the fitness and propriety of one or more individuals.<sup>47</sup> To enhance its clarity, the PRA proposes to amend SS28/15 to make the PRA's approach explicit in the circumstances envisaged by CRD V.

### *Increased risk*

5.11 The PRA intends to take a proportionate approach to assessing whether there is an 'increased risk' that MLTF activity may occur. Whether an incident or increased risk would require such an assessment would likely depend on the individual circumstances of each case.

### Independence of mind

5.12 CRD V clarifies that individuals' membership of the management body of a company or entity that is affiliated to a PRA-authorized firm does not prevent such individuals from acting with independence of mind as a member of the management body of the PRA-authorized firm. The PRA proposes to amend the GOR Part of the PRA Rulebook accordingly. The PRA expects that this will enhance the proportionality of its governance framework by clarifying its requirements.

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<sup>47</sup> For PRA regulated firms, FSMA s60A and s63E set requirements that firms must be satisfied about an individual's fitness and propriety and specifically that the person has appropriate qualifications and training, competence, and personal characteristics needed to perform their function effectively and in accordance with any relevant requirements, and to enable sound and prudent management of the firm. This is replicated in Fitness and Propriety 2.6 of the PRA Rulebook.



## 6 Third-country branch reporting

### CRD Article 47(1a)

6.1 CRD V introduces new, annual reporting requirements for third-country branches of credit institutions.<sup>48</sup> These changes formalise the requirement for third-country branches to report data, some of which the PRA already collects.

6.2 The proposals in this chapter would make amendments to:

- the Regulatory Reporting Part of the PRA Rulebook (Appendix 1, Chapter 5 and Appendix 2, Chapter 1);
- SS34/15 ‘Guidelines for completing regulatory reports’ (Appendix 3, Chapter 7);
- SS4/16 ‘Internal governance of third country branches’ (Appendix 3, Chapter 8); and
- S1/17 ‘Supervising international banks: the PRA’s approach to branch supervision – liquidity reporting’ (Appendix 3, Chapter 9).

### Proposals

6.3 The PRA proposes updating the branch reporting rules in the Regulatory Reporting Part of the PRA Rulebook to implement CRD V requirements where the PRA does not currently have equivalent reporting rules, to include:

- information on the liquid assets available to the branch, in particular the availability of liquid assets in Member State currencies;
- the own funds that are at the disposal of the branch;
- the deposit protection arrangements available to depositors in the branch;
- the risk management arrangements;
- the governance arrangements, including key function holders for the activities of the branch; and
- recovery plans covering the branch.

6.4 The PRA considers that Regulatory Reporting 22.2 is currently equivalent to ‘the total assets corresponding to the activities of the branch authorised in that Member State’ and ‘any other

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<sup>48</sup> These cover:

(a) the total assets corresponding to the activities of the branch authorised in that Member State;  
 (b) information on the liquid assets available to the branch, in particular availability of liquid assets in Member State currencies;  
 (c) the own funds that are at the disposal of the branch;  
 (d) the deposit protection arrangements available to depositors in the branch;  
 (e) the risk management arrangements;  
 (f) the governance arrangements, including key function holders for the activities of the branch;  
 (g) the recovery plans covering the branch; and  
 (h) any other information considered by the competent authority necessary to enable comprehensive monitoring of the activities of the branch.

information considered by the competent authority necessary to enable comprehensive monitoring of the activities of the branch' requirements in CRD V.

6.5 The PRA proposes that firms submit the information annually and within seven months from the end of the financial year either through existing data requests within the relevant submission year or by email to their supervisory contact.

6.6 The PRA considers that its proposals would result in minimal new obligations or operational impacts on firms from implementing the CRD V requirements. The PRA considers that firms would be able to comply with these proposals by submitting to the PRA the information through, or related to, existing data requests within the relevant submission year. Any additional information would be submitted by e-mail to a firm's supervisory contact annually within seven months from the end of the financial year. The PRA considers that firms would already have available internal information where new reporting is required.

6.7 The PRA also proposes to amend the relevant supervisory statements (SS34/15, SS4/16, and SS1/17) to set out its expectations on how firms should comply with the requirements and to provide additional, detailed explanation.

## 7 The PRA's statutory obligations

7.1 In carrying out its policy making functions, the PRA is required to comply with several legal obligations. Before making any rules, the Financial Services and Markets Act 2000 (FSMA)<sup>49</sup> requires the PRA to publish a draft of the proposed rules accompanied by:

- a cost benefit analysis;
- an explanation of the PRA's reasons for considering that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective<sup>50</sup> and secondary competition objective;<sup>51</sup>
- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles;<sup>52</sup> and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.<sup>53</sup>

7.2 The Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury.<sup>54</sup>

7.3 The PRA is also required by the Equality Act 2010<sup>55</sup> to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services, and functions.

### Cost benefit analysis

7.4 This section sets out the analysis of the costs and benefits of introducing those elements of CRD V for which proposals are set out in this consultation paper.

7.5 CRD V is part of the EU's risk reduction package used to implement, in the EU, reforms agreed at an international level following the 2007–2008 financial crisis. As such, the costs and benefits of CRD V need to be considered in the context of all measures addressing financial stability. Moreover, a number of these measures are intended to ensure that the benefits of EU measures already introduced will be realised. The PRA estimated that the net benefits of all prudential measures in response to the financial crisis at the time of the CRD IV package,<sup>56</sup> which implemented Basel III reforms with the EU in 2015, would be approximately £8.25 billion per annum.<sup>57</sup>

7.6 The expected impacts on firms arising from the PRA's proposals are outlined below. Table 1 sets out the expected impacts on firms for each policy area by benefit, cost, and no incremental change. Given the significant net benefits expected of the CRD IV measures in place, the PRA expects the measures introduced in CRD V to continue to have net benefits for the UK financial system and the economy.

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<sup>49</sup> Section 138J of FSMA.

<sup>50</sup> Section 2B of FSMA.

<sup>51</sup> Section 2H(1) of FSMA.

<sup>52</sup> Sections 2H(2) and 3B of FSMA.

<sup>53</sup> Section 138K of FSMA.

<sup>54</sup> Section 30B of the Bank of England Act 1998.

<sup>55</sup> Section 149.

<sup>56</sup> CP5/13, 'Strengthening Capital Standards: Implementing CRD IV': <https://www.bankofengland.co.uk/prudential-regulation/publication/2013/strengthening-capital-standards-implementing-crd-4>.

<sup>57</sup> Annualised net present value of the chain-volume measure (2012) of GDP.

**Table 1: Impact to firms by policy areas**

Impact to firms		Policy Areas
Benefits		Pillar 2 (duplicative reporting) and Remuneration (share-linked instruments)
Cost	Material	Remuneration and IPUs
	Not material	Third-country branch reporting, Pillar 2 (PRA buffer) and Governance (loans to board members)
No incremental change	No substantial change in approach	SREP, Tailored methodology, and Pillar 2A, MLTF, and Governance

## Benefits

7.7 The PRA expects additional benefits from these proposals from two policy areas in particular, in addition to helping realise the net benefits expected from all measures promoting financial stability:

- Pillar 2 – Duplicative reporting:<sup>58</sup> this measure seeks to eliminate requests for additional or more frequent information from firms in cases where this would be duplicative, and hence reduce costs to firms. Although a one-off cost may be incurred to remove overlapping requirements in their reporting systems, the PRA expects that it is exceeded by the ongoing benefit from a relieved reporting burden.
- Remuneration:<sup>59</sup> the PRA expects additional benefits from remuneration requirements to arise from the lower risk of bank failure and the associated costs. Research by Kleymonova and Tuna (2018)<sup>60</sup> shows that the overall impact of remuneration requirements introduced in the UK in 2010/11 was to reduce the contribution of large UK firms and comparable US banks to systemic risk. The availability of using share-linked instruments of listed firms in the CRD V requirement for remuneration can also decrease costs by providing firms with a more efficient way to align their payments to employees with the market value of firms. Firms can reduce one-off and ongoing costs for linking the change of the equity price compared to other payment methods (eg by cash). The PRA also considers that lengthening the minimum deferral period from three to four years to all MRTs (certain MRTs are already subject to a minimum five or seven year deferral) will help realise the overall benefits of remuneration requirements to a fuller extent, as it better reflects the length of the business cycle and the time it takes for risks to materialise. Post-war estimates for the UK would suggest the length of the average business cycle is around five to seven years, depending on how it is estimated (Hills et al., 2010). The PRA proposes to set the CRD V remuneration thresholds in sterling amounts following the end of the EU Exit Transition Period. The PRA expects this to reduce the uncertainty for firms and individuals regarding the scope of application of remuneration rules that could arise as a result of exchange rate

<sup>58</sup> Article 104 of CRD V.

<sup>59</sup> Article 94 of CRD V.

<sup>60</sup> Kleymonova, A. and Tuna, A. (2020) 'Regulation of Compensation and Systemic Risk: Evidence from the UK'. Chicago Booth Research Paper No. 16-07: <http://dx.doi.org/10.2139/ssrn.2755621>.

fluctuations. The PRA currently expects that increasing coverage of the remuneration requirements will further reduce the contribution of UK banks to systemic risk, although the size of the benefit is highly uncertain and the PRA does not consider it is reasonably practicable to provide a monetary estimate of the likely benefit.

## Costs

7.8 The measures of CRD V contained in this CP fall into three categories according to the materiality of expected cost to firms: (i) material costs; (ii) non-material costs; and (iii) no incremental costs.

### Material costs

- **Remuneration:** The PRA expects the remuneration requirements to generate costs for firms, driven by increasing the scope of individuals and firms affected by the regulations. Bringing new individuals within the scope of the requirements will increase annual compliance costs for firms. There are currently 30 firms in scope of the remuneration requirements, with an additional 10 firms likely to be brought into scope with the changes under CRD V. The PRA estimates that annual compliance costs could rise by up to 10%, which would lead to additional expenses of £35,000 to £131,000 (€40,000 to €150,000) per affected firm. The expansion of the scope of application to firms is likely to see newly regulated firms incur additional costs in setting up and managing their systems.<sup>61</sup> The EBA estimated that one-off costs ranging from £875,000 to £4.4 million (€1 million to €5 million) and annual ongoing costs ranging from £350,000 to £1.3 million (€400,000 to €1.5 million) are required for a large firm to comply with the new remuneration requirements. For small, non-complex firms, the one-off and ongoing costs range from £87,000 to £440,000 (€100,000 to €500,000) and from £44,000 to £175,000 (€50,000 to €200,000) per annum, respectively. The PRA has considered the costs of longer minimum deferral periods to the affected MRTs and does not expect their income flows to be materially affected so as to outweigh the associated prudential benefits.
- **IPUs:** Certain third-country groups operating through two or more EU firms with total assets of €40 billion, as per the total assets threshold in CRD V after Friday 28 June 2019, will have to have an EU IPU by end of 2020.<sup>62</sup> Third-country groups for which the requirements are applicable on Tuesday 29 December 2020, that do not already have an EU IPU, could incur significant costs to establish and maintain one.

### Non-material costs

- **Pillar 2 – P2G:** CRD V requires P2G to be applied at all levels of consolidation, rather than at group level as currently applied under the PRA's Pillar 2B assessment. The PRA will take a risk-based and proportionate approach to setting the PRA buffer for subsidiaries within a group.<sup>63</sup> However, the PRA considers that some firms may incur small additional costs related to the information submitted as part of the ICAAP.
- **Loans to board members (Governance):** The PRA does not expect the changes relating to loans to board members and their related parties to incur material additional costs for firms. While the PRA is proposing to amend the definition of 'related parties', there is an overlap between the requirements in RPTR Part of the PRA Rulebook and the new CRD V requirements such that firms should already have mechanisms to record and report data

<sup>61</sup> Article 74, 75, 92, 94, and 109 of CRD V.

<sup>62</sup> Article 21b of CRD V.

on transactions with related parties to the PRA. The PRA does not therefore expect firms to need to make material changes in order to comply with the new CRD V requirements.

- Third-country branch reporting: To comply with requirements for third-country branch reporting,<sup>64</sup> branches from non-EU countries in the UK will have to submit existing recovery plans to the PRA. The PRA expects that there will be only a marginal increase in reporting this information to the PRA.

### No incremental change

7.9 The policy areas in this CP that do not incur any incremental costs to firms fall into two cases. Firstly, where the existing PRA's approach does not need to be changed since it has already satisfied CRD V requirements. Secondly, where the analysis of costs to firms cannot be employed as the design of the policy is not yet finalised.

### No substantial change in approach

- Pillar 2 – SREP, Tailored methodology, and Pillar 2A: The CRD V requirement for proportionality in SREP<sup>65</sup> requires only clarification of the existing rule without substantial changes in the obligation of firms. The PRA considers that the existing framework does not include tailored methodologies<sup>66</sup> and that material changes to its approach to Pillar 2A approach are not required.<sup>67</sup>
- MLTF: The PRA considers that the existing framework to assess the risk from MLTF through SREP aligns with the CRD V requirements.<sup>68</sup> Minor clarification of the PRA's existing approach is planned to implement CRD V.
- Governance (excluding loans to board members): The PRA does not expect requirements for governance<sup>69</sup> to incur additional costs to firms, as the existing framework already satisfies the requirements. Although minor revisions to the current rules are required, these amendments do not affect the current obligations of firms.

### Compatibility with the PRA's objectives

7.10 The PRA considers that the proposals in this CP advance its general objective to promote the safety and soundness of PRA-authorized firms. The PRA's proposals intend to ensure that firms have adequate capital to support all the relevant risks in their business, through Pillar 2, and to ensure sound governance and remuneration practices and procedures.

7.11 When discharging its general functions in a way that advances its objectives, the PRA has, as a secondary objective, a duty, as far as reasonably possible, to act in a way that facilitates effective competition in markets for services provided by PRA-regulated firms carrying on regulated activities. The PRA considers that costs arising from its proposals will be commensurate with the size, scale, and complexity of firms, and has targeted its proposals at any risks of which firms may not currently take sufficient account. In this case, the requirements may facilitate effective competition by removing an implicit subsidy from those firms taking advantage of these risks. Nevertheless, the PRA does not expect this effect on competition to be material.

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<sup>64</sup> Article 104 of CRD V.

<sup>65</sup> Article 97(4) of CRD V.

<sup>66</sup> Article 97(4a) of CRD V.

<sup>67</sup> Article 104a(4) of CRD V.

<sup>68</sup> Article 91(1) and 97(6) of CRD V.

<sup>69</sup> Article 88(1) and 91(8) of CRD V.

## Regulatory principles

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

- (i) that the PRA's resources are used in the most efficient and economical way.
  - The proposed policies would support the PRA in supervising firms in an efficient and effective way. For example, the PRA proposes to only subject firms to a full PRA buffer assessment in specific circumstances or where the PRA identifies factors indicating a full assessment is needed. Similarly, the PRA's proposed MLTF requirements would focus its supervision on an attempted or committed MLTF incident at a firm, or an increased risk thereof.
- (ii) that a burden imposed on a PRA-authorized person should be proportionate to the benefits expected to result from that burden.
  - Overall, the PRA considers that the cost for firms of implementing and meeting the requirements on an ongoing basis will be proportionate to firms' size and complexity. The PRA proposes to exercise discretions to allow requirements not to be applied to a broader range of smaller and less complex firms where appropriate, for example in CRD V's remuneration framework. The PRA also intends to increase the proportionality of its current framework where specified in CRD V, for example through clarification of what constitutes the 'independence of mind' of members of a firm's management body; and
- (iii) that the PRA should exercise its functions transparently.
  - In this CP, the PRA consults on clarifying how its approach aligns with CRD V requirements and sets out these proposed clarifications in Ss. This is particularly relevant where CRD V has further specified these requirements, such as the application of proportionality in the SREP process, and clarification of what constitutes independence of mind for members of management bodies.

## Impact on mutuals

7.13 The PRA considers that the impact of the proposed rule changes and expectations on mutuals would not differ from the impact on other firms.

## HM Treasury recommendation letter

7.14 HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.<sup>70</sup> The PRA has considered these aspects in relation to the proposals and considers competition and competitiveness to be of particular relevance. The PRA has considered competition in its proposed proportionate implementation of the CRD V requirements, which focuses on ensuring the burden placed on firms is commensurate with any risks the PRA has identified to its objectives. The PRA has considered competitiveness, in particular, in its proposals relating to requirements with regard to third-country groups and branches. This includes its proposed exercise of the discretion to permit

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<sup>70</sup> Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at <https://www.bankofengland.co.uk/about/people/prudential-regulation-committee>.

groups to establish two IPU, where IPU are required under CRD V during the EU Exit Transition Period, and its proposed removal of the IPU requirement at the end of the EU Exit Transition Period.

### **Equality and diversity**

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



## Appendices

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Appendix 1: Draft Rules instruments available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2020/cp1220app1.pdf>

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Appendix 2: Draft Rules EU Exit instruments available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2020/cp1220app2.pdf>

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Appendix 3: Draft Statements of Policy and Supervisory Statements available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2020/cp1220app3.pdf>