

2 Draft amendments to Supervisory Statement ‘The UK leverage ratio framework’

In this appendix, new text is underlined and deleted text is struck through. Footnote references will be updated when the final policy is published.

Introduction

1.1 This supervisory statement (SS) ~~is aimed at~~ applies to Capital Requirements Regulation (CRR) firms (hereafter, ‘firms’) and CRR consolidation entities on an individual, consolidated, and where relevant, sub-consolidated basis ~~in scope of the UK leverage ratio framework~~. The purpose of this SS is to give guidance on the UK leverage ratio capital requirements and buffers for firms in scope of the leverage ratio capital requirement, and to set out ~~the expectations of the Prudential Regulatory Authority’s (PRA) expectation as to how other firms will manage their risk of excessive leverage. ~~on~~ leverage ratio buffers and~~ It also provides guidance on the methodology for additional reporting and disclosure of an averaged leverage ratio for firms in scope of the leverage ratio capital requirement, as well as to provide some clarification on the PRA rules. It should be read alongside the Leverage Ratio – Capital Requirements and Buffers, Leverage Ratio (CRR), Disclosure (CRR), Reporting (CRR) and Internal Capital Adequacy Assessment Reporting Leverage Ratio and Public Disclosure Parts of the PRA Rulebook. ~~This statement complements the PRA’s rules with regard to a UK leverage ratio framework.~~

1.A Overview – the UK leverage ratio capital requirement

1.A.1 Until Saturday 31 December 2022, the Leverage Ratio – Capital Requirements and Buffers Part applies to the following firms:

- i. All banks and building societies with retail deposits in excess of £50 billion when calculated on an individual basis.
- ii. CRR consolidation entities of groups containing banks or building societies meeting the threshold referred to in (i) on the basis of their consolidated situation.
- iii. A ring-fenced body that has been required by the PRA to comply with the CRR on an RFB sub-consolidated basis and that is a member of a group containing an entity referred to in (i) or (ii) above.

applies on an individual basis to any firm in scope which is not part of a consolidation group, on a consolidated basis to CRR consolidation entities and on an RFB sub-consolidated basis to ring-fenced bodies.

1.A.2 From Sunday 1 January 2023, the Leverage Ratio – Capital Requirements and Buffers Part applies to the following firms on the following bases:

- i. All firms with retail deposits equal to or greater than £50 billion or foreign assets equal to or greater than £10 billion, when calculated on an individual basis are in scope.⁴ Such firms must comply with the Part on an individual basis (subject to section 4 below),

⁴ For this purpose, foreign assets means financial assets for which the counterparty is resident in a country or territory outside the UK, as reported in LV40, line 0050.

unless they are otherwise subject to the Part on the basis of their own consolidated situation because they are either: CRR consolidation entities referred to in (ii); or a ring fenced body identified in (iii) that is the ultimate parent within its RFB sub-group.

- ii. CRR consolidation entities meeting either threshold referred to in (i) above on the basis of their consolidated situations are in scope. They must comply with the Part on a consolidated basis.⁵
- iii. Ring-fenced bodies that have been required by the PRA to comply with the CRR on an RFB sub-consolidated basis and whose RFB sub-group meets either threshold referred to in (i) above on an RFB sub-consolidated basis are in scope. They must comply with the requirement on the same RFB sub-consolidated basis that they are required to comply with the CRR.

1.A.3 The minimum leverage ratio capital requirement, which must be met at all times, is 3.25% of the leverage exposure measure (LEM) defined in the Leverage Ratio (CRR) Part of the PRA Rulebook. The LEM excludes assets constituting claims on central banks, where they are matched by deposits, denominated in the same currency and of identical or longer maturity. Mirroring the risk-weighted capital framework, three quarters of this requirement must be met with Common Equity Tier 1 (CET1) capital instruments. The requirement must otherwise be met with Tier 1 capital, but additional Tier 1 capital must have a conversion trigger in relation to a firm's risk-weighted CET1 ratio of at least 7% in order to count towards the leverage ratio minimum. CRR transitional measures affecting Tier 1 capital apply to the definition of Tier 1 for the purposes of the leverage ratio, including the IFRS 9 transitional the PRA encouraged firms to use as part of the covid-19 response,⁶ and the continued eligibility of certain AT1 instruments.⁷

1.A.4 Firms in scope of the leverage ratio minimum capital requirement are subject to buffers in addition to this minimum. These buffers must be met with CET1 resources and are set out in more detail in section 2.

1.A.5 Firms that are not in scope of the leverage ratio requirement are nevertheless expected to manage their leverage risk so that their leverage ratio – to be calculated based on the same rules as the in-scope firms - does not ordinarily fall below 3.25%. This PRA expectation is further described in section 5.

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Leverage ratio buffers

2.A There are two buffers in the leverage ratio framework, and an add-on. The buffers are:

- i. the countercyclical leverage ratio buffer (CCLB); and
- ii. the additional leverage ratio buffer (ALRB) to reflect systemic importance.

2.B The CCLB and ALRB are intended to make the leverage ratio framework equally resilient relative to the risk-weighted framework (i) over the cycle and (ii) for systemic and non-systemic firms. As a result, they are scaled at 35% of their risk-weighted equivalents with the CCLB rate percentage rounded to the nearest 10 basis points.

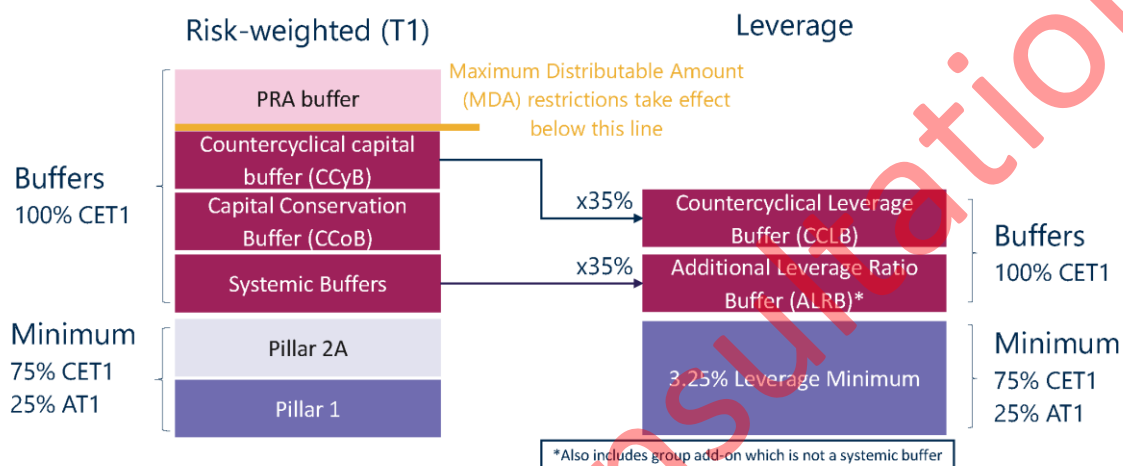
⁵ Where necessary for this purpose, references in this SS to firm, should be read as including a CRR consolidation entity.

⁶ Article 473a of the CRR

⁷ Article 494b of the CRR

2.C The leverage ratio buffers must be met with CET1 resources. The PRA requires firms not to double count CET1 towards the CCLB, the ALRB, and the minimum capital requirement. If a firm does not hold an amount of CET1 capital that is equal to or greater than the sum of its ALRB, CCLB and the CET1 component of its minimum requirement, it will be required to notify the PRA in accordance with Leverage Ratio – Capital Requirements and Buffers 5.1 and prepare a capital plan and submit it to the PRA, including the information required in Leverage Ratio – Capital Requirements and Buffers 6.2.

Figure 1 The Tier 1 Risk Weighted and Leverage Capital Stacks



2.1 Firms that do not hold an amount of Common Equity Tier 1 (CET1) equal to or greater than their applicable leverage ratio buffers will not face automatic restrictions on their distributions.

2.2 Where a firm does not hold an amount of CET1 capital that is equal to or greater than its countercyclical leverage ratio buffer (CCLB), it must notify the PRA immediately in accordance with Leverage Ratio 5.1 and prepare a capital plan and submit it to the PRA, including the information required in Leverage Ratio 6.2. [Deleted]

2.3 The global systemically important institution (G-SII) and other systemically important institutions (O-SII) buffers – parts of the additional leverage ratio buffer (ALRB) is firm specific, and scaled relative to systemic buffers. Where applicable to a firm, the ALRB and related reporting and disclosure requirements will be set by the PRA using its powers under section 55M of the Financial Services and Markets Act (2000), and will incorporate the ALRB Model Requirements.⁸ Where a firm is subject to both a G-SII buffer and an O-SII buffer on the same basis of consolidation, the higher of the two buffers shall apply for the purpose of calculating the ALRB.

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2.3B The PRA will notify the firm of the amount of any Leverage Ratio Group Add-on it is expected to hold in addition to its minimum leverage ratio requirement, CCLB and ALRB (where applicable). Firms will be expected to meet the Leverage Ratio Group Add-on with CET1 capital that shall be in addition to any CET1 capital maintained to meet the minimum leverage ratio, CCLB and ALRB.

⁸ Current version available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/vreq-additional-leverage-buffers-model-requirements>.

Consistent with Fundamental Rule 7, a firm should notify the PRA ~~as early as possible~~ if a firm's capital has fallen or is expected to fall below the level necessary to meet the Leverage Ratio Group Add-on.

2.4 ~~Where a firm is using its buffers,~~ The PRA will assess a firm's capital plan to determine whether, if implemented, it would be reasonably likely to secure that the amount of the firm's CET1 will be equal to or greater than the firm's leverage ratio buffers within a period which the PRA considers appropriate. When exercising its judgement on what constitutes a reasonable time to rebuild buffers drawn down in stress, the PRA will take into account the drivers of the firm's shortfall, including in the context of current and forecasted macroeconomic and financial conditions.

2.5 In determining the appropriate period for a firm to satisfy its CCLB ~~when that has been raised,~~ the PRA will have regard to the period of time the firm has ~~to~~ meet the associated increase in its Countercyclical Capital Buffer (CCyB) rate(s). The PRA expects any increase in the CCLB rate to follow the transitional periods set for the increase in the relevant CCyB rate(s), which will generally become effective twelve months after an announcement. This approach would ensure consistency and complementarity between the CCyB and CCLB.

2.6 When calculating its CCLB, a firm is expected to take into account any decrease in relevant CCyB rate(s) immediately.

Averaged leverage ratio calculation

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3.A All firms are required to report and disclose their leverage ratios as per the Reporting (CRR) and Disclosure (CRR) Parts of the PRA Rulebook (see section 6 below). The guidance in this section relates to the additional requirements for reporting and disclosure of averaged leverage metrics that apply only to firms in scope of the leverage ratio minimum requirement.

3.1 The PRA expects firms not to engage in short-term balance sheet management activities with a view to boosting their leverage ratio temporarily at any point in time.

3.2 For the purpose of calculating an averaged leverage ratio over a reporting quarter, the PRA rules⁹ require firms to calculate the exposure measure based on:

- daily firms' daily on-balance sheet assets and securities financing transactions (SFT) exposures averaged over the quarter; and
- end-of-month exposures averaged over the quarter for monthly (at the last day of the month) the remaining off-balance sheet items exposures averaged over the quarter, in accordance with Reporting Leverage Ratio 3.2.

The capital measure and relevant deductions and adjustments should be calculated based on end-of-month averages, with the same frequency as the off-balance sheet exposures.

3.3 During a transitional period for daily averaging averaged reporting of SFT exposures up to Sunday 1 January 2023, the PRA permits firms to calculate the exposure measure based on:¹⁰

- daily on-balance sheet assets averaged over the quarter; and

⁹ As per the second subparagraph of Article 430(2A) and Article 451(4) of the CRR.

¹⁰ As defined in the third subparagraph of Article 430(2A) and Article 451(5) of the CRR, applicable until Sunday 1 January 2023.

- ~~end-of-month monthly (at the last day of the month) off-balance sheet exposures, including off-balance sheet SFT exposures, measures averaged over a quarter, for both on and off-balance sheet exposures, in accordance with Reporting Leverage Ratio 4.2.~~

The capital measure and relevant deductions and adjustments should be calculated ~~based on end-of-month averages. in the same way.~~ The same methodology should apply to the computation of the averaged leverage ratio disclosed during the transitional period for disclosures.

3.4 The PRA recognises that there might be difficulties in valuing certain accounting assets at the end of each day and therefore intends to adopt a pragmatic approach to the implementation of the averaging requirement. The PRA considers that ‘best estimates’ are acceptable so long as they are measured consistently and prudently. For the purpose of daily valuation of on-balance sheet assets and SFT exposures, firms should apply methodologies and a valuation basis that are consistent with those used for quarter-end reporting. The PRA expects firms to have appropriate governance and procedures to ensure the accuracy and representativeness of the averaged leverage ratio and its components which are reported and disclosed. Firms should provide an explanation of the assumptions used in their calculations.

Sub-consolidation as an alternative to application on the individual basis

- 4 4.1 For firms that are subject to the leverage ratio capital requirement on an individual basis, the PRA will consider on a case-by-case basis replacing that requirement with a sub-consolidated requirement where a firm has subsidiaries that can be consolidated. In such cases, a firm may apply to the PRA for a permission under section 144G of FSMA that (i) dis-applies the requirements on an individual basis; and (ii) provides for the requirements to apply on a sub-consolidated basis in relation to the firm, with such modifications as may be specified in that permission. The PRA will consider the following conditions to assess whether to grant the application:
- the entities within the proposed sub-consolidation must be subsidiaries (as defined in the CRR) of the firm that is the ultimate parent of the sub-consolidation group. For example, this condition would be fulfilled when the firm at the top of the sub-consolidation group holds the majority of voting rights in the subsidiary undertaking, or is a member of the undertaking and has the right to appoint or remove a majority of the members of the management body of the subsidiary, or otherwise exercises dominant influence over the subsidiary undertaking, or it and the subsidiary undertaking are managed on an unified basis. The same conditions need to apply to all subsidiaries at each level of the sub-consolidation group;
 - evidence that leverage ratio risks and capital can effectively be managed and reported at sub-consolidated level: risk evaluation, measurement, and control procedures of the parent undertaking should cover the subsidiary, and the firm should be able to calculate the leverage ratio requirement and buffers (including a sub-consolidated CCyB) at sub-consolidated level;
 - evidence that effective governance is in place for the sub-group: the governance structure clearly allocates responsibilities for risk and capital decisions at sub-consolidated level for the firms included in the sub-consolidation;
 - effective supervisory cooperation, including information exchange, in the countries where the subsidiaries are located, and transparent regulation / adherence to Basel standards. This would allow the inclusion of US and EU subsidiaries, for example.

4.2 The PRA would specify the scope of the sub-consolidation group in the permission and may also withdraw this permission when the conditions are not fulfilled anymore.

Supervisory expectation on risk of excessive leverage for firms not subject to a minimum requirement

5.1 The PRA expects firms not in scope of the leverage ratio minimum capital requirement and buffers should manage their leverage risk so that their leverage ratio, as calculated in accordance with the Leverage Ratio (CRR) Part of the Rulebook, does not ordinarily fall below 3.25%.

5.2 The PRA expects firms not in scope of the leverage ratio requirement to meet the expectation with 75% CET1, ie the highest quality of capital.

5.3 The PRA expects that for a firm not in scope of the leverage ratio minimum capital requirement and buffers, the leverage ratio will not fall below 3.25% in the normal course of business or as part of its base business plan. The PRA acknowledges, however, that for such firms there may be occasions, such as in a systemic stress, or immediately following an idiosyncratic stress, where firms may not meet this expectation. Failure to meet the expectation does not create a presumption that a firm is breaching Chapter 11 of the ICAA Part or not meeting Threshold Conditions. The PRA would not expect the leverage ratio expectation to be met immediately following resolution. In line with ICAA 11.3, firms should take a forward-looking view of leverage risk in order to withstand stress events.

5.4 The PRA expects that firms should notify their supervisors as soon as practical if they do not meet or expect not to meet the PRA's expectation. There will be no automatic consequences; but a firm which does not meet the expectation can expect enhanced supervisory attention, and should prepare a credible plan to reduce excessive leverage. If the PRA is satisfied with the rationale presented for not meeting the expectation, the PRA will allow a firm to manage its excessive leverage by restoring compliance with the expectation over a reasonable period of time. In exercising its judgement on what constitutes a reasonable time to manage excessive leverage and other potential supervisory action, the PRA will take into account the firm's leverage ratio, the firms' rationale for not meeting the expectation, the expected period over which the firm would not meet the expectation, the drivers of the excessive leverage, the context of the excessive leverage (whether firm-specific or systemic) and macroeconomic and financial conditions. If the PRA is not satisfied with the firm's plan to reduce excessive leverage or with the firm's reasons for not meeting the expectation it may consider using its powers under section 55M of FSMA to resolve the issue, including by requiring the firm to raise sufficient capital to meet the expectation within an appropriate timeframe.

Reporting and disclosure

Reporting

6.1 All firms are required to report their leverage ratios as per the Reporting (CRR) Part of the PRA Rulebook. Firms subject to the leverage ratio minimum capital requirement are subject to additional reporting requirements, at the same level of application as the minimum capital requirement applies, including the calculation of the leverage ratio on an averaged basis, the countercyclical leverage ratio buffer and, where applicable, the additional leverage ratio buffer, and capital surpluses/shortfalls to the requirement.

6.2 The leverage reporting templates are set out in the following table.

Table 1 – Description of leverage reporting templates

Template	Content
<u>LV47</u>	<u>Reporting on the calculation of the leverage ratio, including the calculation of the leverage ratio on an average basis for firms in scope of the UK’s leverage ratio requirement.</u>
<u>LV40</u>	<u>Reporting on an alternative treatment of the exposure measure.</u>
<u>LV41</u>	<u>Reporting on an additional breakdown of on- and off-balance sheet exposures in accordance with the risk weight.¹¹</u>
<u>LV43</u>	<u>Reporting on an alternative breakdown of leverage exposure measure components.</u>
<u>LV44</u>	<u>Reporting on general information.</u>

6.3 The PRA requires firms to report all leverage templates on a quarterly basis, with a remittance of 42 calendar days, in line with the proposed timelines for quarterly reporting of non-leverage information¹². Reporting and remittance dates for each quarter of the year are outlined in the table below. Note that where the remittance day is a public holiday or falls on a Saturday or Sunday, the data shall be submitted on the following working day.

Table 2 – Reporting and remittance dates for leverage reporting templates

Quarter	Reporting date	Remittance date
<u>1</u>	<u>31 March</u>	<u>12 May</u>
<u>2</u>	<u>30 June</u>	<u>11 August</u>
<u>3</u>	<u>30 September</u>	<u>11 November</u>
<u>4</u>	<u>31 December</u>	<u>11 February</u>

Disclosure

6.4 All firms are required to disclose their leverage ratios as per the Disclosure (CRR) Parts of the PRA Rulebook. Firms subject to the leverage ratio minimum capital requirement are subject to additional disclosure requirements, at the same level of application as the minimum capital requirement applies, in relation to averaging and the countercyclical leverage ratio buffer and, where applicable, the additional leverage ratio buffer.

6.5 The PRA requires firms to disclose leverage ratio templates with the frequency outlined in the following table:

Table 3 – Frequencies for leverage ratio disclosures

Template	Frequency large institutions (listed)	Frequency large institutions (not listed)	Frequency other institutions (listed)
<u>UK LR1 - LRSum: Summary reconciliation of accounting assets</u>	<u>Semi-annual</u>	<u>Annual</u>	<u>Annual</u>

¹¹ This template is based on COREP template C41. Although the EBA is removing this template as part of the Taxonomy 3.0 changes, the PRA proposes to retain this template. The data helps in monitoring the risk composition of leverage ratio exposures, supports the PRA’s supervisory activities, and provides useful information for future reviews of the leverage ratio framework.

¹² Article 2 of Chapter 5 of the Reporting (CRR) Part.

<u>and leverage ratio exposures</u>			
<u>UK LR2 - LRCom: Leverage ratio common disclosure</u>	<u>Annual (for rows 28 to UK-34); Semi-annual (for rows up to row 28)⁽¹⁾</u>	<u>Annual⁽²⁾</u>	<u>Annual⁽³⁾</u>
<u>UK LR3 - LRSpl: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)</u>	<u>Semi-annual</u>	<u>Annual</u>	<u>Annual</u>
<u>UK LRA: Free format text boxes for disclosure on qualitative items</u>	<u>Annual</u>	<u>Annual</u>	<u>Annual</u>
<u>UK KM1 – Key metrics template; rows 13 to 14e</u>	<u>Quarterly⁽⁴⁾</u>	<u>Semi-annual⁽⁵⁾</u>	<u>Semi-annual⁽⁶⁾</u>

Footnotes:(1),(2),(3)

Institutions that are in scope of the leverage ratio minimum requirement shall disclose values in UKL2 – LRCom;UK-24b, UKL2 – LRCom;25, UKL2 – LRCom;UK-25a, UKL2 – LRCom;UK-25c, UKL2 – LRCom;27, UKL2 – LRCom;UK-27b, UKL2 – LRCom;UK-33 and UKL2 – LRCom;UK-34 with a quarterly frequency.

Institutions that are in scope of the leverage ratio minimum requirement shall disclose values in rows 13 to 14e of template UK KM1 with a quarterly frequency.

Draft for consultation