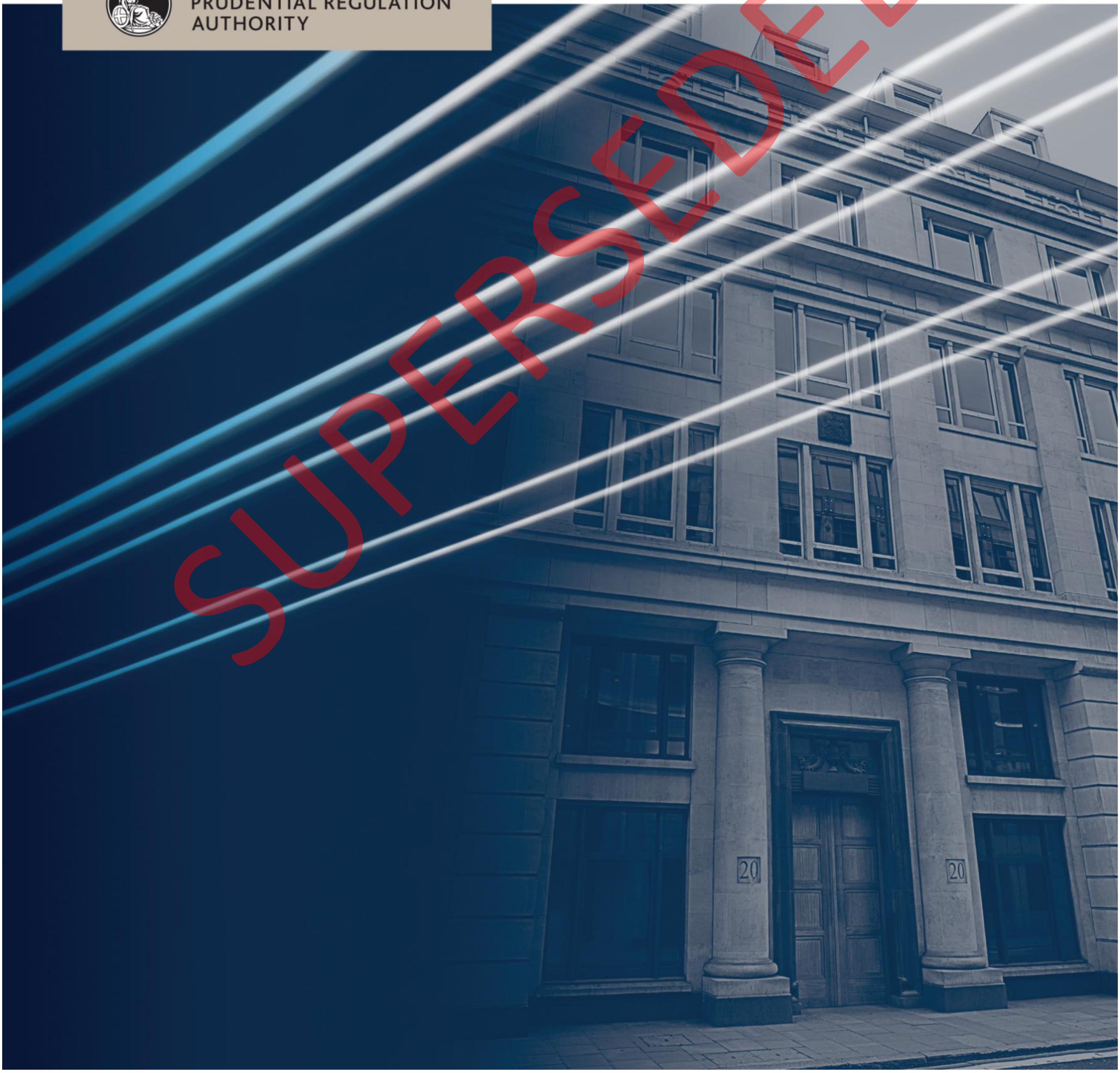
Supervisory Statement | SS45/15

The UK leverage ratio framework

November 2018

(Updating December 2015)

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

1 Introduction

This supervisory statement (SS) is aimed at Capital Requirements Regulation (CRR) firms in scope of the UK leverage ratio framework. The purpose of this SS is to set out the expectations of the Prudential Regulatory Authority (PRA) on leverage ratio buffers and the reporting and disclosure of an averaged leverage ratio, as well as to provide some clarification on the PRA rules. It should be read alongside the Leverage Ratio, 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.

2 Leverage Ratio Buffers

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.

2.3 The global systemically important institution (G-SII) and systemic risk buffer (SRB) additional leverage ratio buffer (ALRB) is firm specific. 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). If a firm does not hold an amount of CET1 capital that is equal to or greater than its ALRB, it will be required to notify the PRA immediately and prepare a capital plan and submit it to the PRA. Where a firm is subject to both a G-SII buffer and a SRB on the same basis of consolidation, the higher of the two buffers shall apply for the purpose of calculating the ALRB.

2.3A The PRA considers that ring-fenced body (RFB) group risk[1] may arise when an RFB is subject to the ALRB at the level of the RFB sub-group,[2] but the consolidated group is either not subject to the ALRB, or its consolidated ALRB rate is lower than the ALRB rate applicable to the RFB sub-group. The PRA expects firms to take this RFB group risk into account by holding additional capital (the 'Leverage Ratio Group Add-on') on a consolidated basis. This is to ensure there is sufficient capital within the consolidated group, and distributed appropriately across it, to address both global systemic risks and domestic systemic risks. Where the ALRB applicable on a sub-consolidated basis for the RFB sub-group is higher than the RFB sub-group's share[3] of the ALRB on a consolidated basis, the difference will generally be reflected in the Leverage Ratio Group Add-on, in order to take account of the associated RFB group risk at the consolidated group level.

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

1 Group risk, as defined in the PRA Rulebook (Internal Capital Adequacy Assessment 1.2), means the risk that the financial position of a firm may be adversely affected by its relationships (financial or non-financial) with other entities in the same group or by risk which may affect the financial position of the whole group, including reputational contagion.

2 An RFB sub-group is a subset of related group entities within a consolidated group, consisting of one or more RFBs and other legal entities, which is established when the PRA gives effect to Article 11(5) of the CRR.

3 The RFB sub-group's share of the consolidated group ALRB can be determined by multiplying that consolidated group ALRB by the proportion of the consolidated group's leverage ratio exposures that are attributable to the RFB sub-group. The consolidated group's leverage ratio exposures that are attributable to the RFB sub-group are calculated as the RFB sub-group's leverage ratio exposure (calculated on a sub-consolidated basis) minus leverage ratio exposures of the RFB subgroup to group entities that are not members of the RFB subgroup.

(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. 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 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, the PRA will have regard to the period of time the firm had to meet the increase in its Countercyclical Capital Buffer rate(s). The PRA expects any increase in the CCLB rate to follow the transitional periods set for the increase in the relevant CCB rate(s), which will generally become effective twelve months after an announcement. This approach would ensure consistency and complementarity between the CCB and CCLB.

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

3 Averaged leverage ratio calculation

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 rules require firms to calculate the exposure measure based on firms' daily on-balance sheet assets averaged over the quarter and monthly (at the last day of the month) off-balance sheet exposures averaged over the quarter, in accordance with Reporting Leverage Ratio 3.2. The capital measure and relevant deductions and adjustments should be calculated with the same frequency as the off-balance sheet exposures.

3.3 During the transitional period for daily averaged reporting, the PRA permits firms to calculate the exposure measure based on monthly (at the last day of the month) exposure 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 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 balance sheet assets, 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.

Annex SS45/15 updates

This annex details changes made to SS45/15 following its initial publication in December 2015.

2018

14 November 2018

This SS was updated following the publication of PS28/18 'UK leverage ratio: Applying the framework to systemic ring-fenced bodies and reflecting the systemic risk buffer'.[1] It has been updated to:

(i) amend paragraph 2.3 to reflect the SRB in the ALRB; and

(ii) insert paragraphs 2.3A and 2.3B to provide that where applicable, the PRA expects firms to hold capital on a group consolidated basis to address RFB group risk (the 'Leverage Ratio Group Add-on').

1 https://www.bankofengland.co.uk/prudential-regulation/publication/2018/uk-leverage-ratio-applying-the-framework-to-systemic-rfbs-and-reflecting-the-srb.