A response to CP 20/17

Changes to the PRA's large exposures framework

by UK Finance

January 2018

Introduction

UK Finance, which was formed on 1 July 2017 to represent the finance and banking industry operating in the UK, represents around 300 firms providing credit, banking, markets and payment-related services. The new organisation brings together most of the activities previously carried out by the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and The UK Cards Association.

We are pleased to be able to respond to the PRA's consultation paper CP 20/17[1] and review the key elements of our response below.

No change in approach

The industry takes comfort from the PRA's clarification that it is not aiming to tighten requirements. If the CP can be viewed as confirming current practice and seeking to increase the consistency of waivers, rather than articulating a change in risk appetite, we would support this approach.

MREL

We support the exemption of internal minimum own funds and eligible liabilities (MREL) from the Large Exposures (LE) framework, fully agreeing that this framework should focus on business-as-usual intragroup exposures. The proposal to exempt exposures that meet the Bank of England's MREL requirements as well as the Capital Requirement Regulations (CRR) therefore represents a welcome confirmation of the PRA's expectations regarding non-own funds elements of internal MREL. Thank you.

Intragroup permissions

We note that the proposals include a requirement that group entities should have the same risk evaluation, measurement and control procedures as the firm. This is a direct transposition of the CRR Article 113 (6) (c). We are reassured that paragraph Appendix 1: 2.5A – *Draft amendments to Supervisory Statement 16/13* – provides further factors that the PRA will consider in assessing whether the CRR condition has been met and welcome the recognition therein that 'same' does not mean 'identical'. An approach where the systems are reliable, consistent and integrated, and supported by regular communication of all sources of risk, will allow for necessary differences in risk management systems to be accommodated. These may be dictated by the possibly different business models of consolidated group members. At the same time,

[1] http://www.bankofengland.co.uk/pra/Documents/publications/cp/2017/cp2017.pdf

in order to meet senior management requirements at a legal entity level, we suggest that "same" should be widely implemented. We would appreciate further dialogue with the PRA on this point if we have misunderstood the intention of Appendix 1: 2.5A.

Non-core LE group permissions

It is our opinion that CRR Article 400 (2) does not apply CRR Article 113 (6) requirements to Non-core LE group (NCLEG) permissions and that therefore the proposed requirements to apply it are super-equivalent. Of course, we appreciate the ability to apply for NCLEG permissions but believe the process should be less mechanistic and based more on regulatory dialogue and the application of supervisory judgement.

Material legal or practical impediments to transfers

Our understanding is that the overriding intention of the CP is to ensure that the PRA receives a consistent set of documents from firms seeking to establish a core UK group, not to establish a potentially onerous attestation process.

We note that paragraph Appendix 1: 2.11 proposes that an attestation should be provided by the parent undertaking and the relevant group entities that there are '*no practical or legal impediments to the transfer of funds or repayment of liabilities'*. This represents a super-equivalent requirement relative to the CRR. The CRR text uses the phrase: "*no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities from the counterparty to the institution".* We believe the attestation should be aligned with the language in the CRR. Specifically, the phrases *"current or foreseen"* and "*material"* should be re-introduced.

There is currently a requirement, at Appendix 1: 2.8, that where a counterparty is not a firm it, should provide a legally binding guarantee to provide extra capital to ensure that the firm remains compliant with CRR and any other capital or concentration requirements. We consider that this serves the same purpose as the attestation and suggest the PRA should consider its removal.

Appendix 1 (3) of CP 20/17 extends CRR Art 113 (6) criteria for the core UK group (CUG) to the NCLEG, consistent with the current framework.

In the case of NCLEGs we suggest the focus of attestations should be on impediments to the transferability of debt and other intragroup exposures as they fall due. This is because of potential host-country supervisory restrictions on capital distributions. Membership of a NCLEG does not bring with it the regulatory relief available to CUG members in relation to total exemption from LE limits - which are treated as zero risk weighted – and exemption for leverage ratio purposes. The attestation by NCLEG should therefore focus on the transferability of funds and repayment of liabilities, not restrictions on capital distributions or other transfer of capital resources.

In our view, attestations of the adjusted form noted above are sufficient. We do not believe it is appropriate that NCLEG subsidiaries should be required to commit to legally binding agreements (Appendix 1: 2.8) on eligible capital (for example a capital maintenance agreement) or produce formal attestation (Appendix 1: 2.11) about the lack of practical or legal impediment on transfer of funds. It would be helpful if the PRA could confirm that this is not its expectation, particularly given the text in CP 19/17[2]. The implications of formalising cross-border legal arrangements, particularly for overseas regulated entities, would be significant. The host regulator would probably require that the counterparty they supervise should hold extra capital against the possible eventuality that it could be required, in turn, to supply extra capital to ensure the firm's continued compliance with own funds requirements. The cost of this would be prohibitive. It would also be inconsistent with current practice and therefore represent a material change.

[2] http://www.bankofengland.co.uk/pra/Documents/publications/cp/2017/cp1917.pdf

Clarification items

There are some areas where we would appreciate further clarification. These are:

- What would be the examples, for instance such as dividend restrictions, of practical or legal impediments to transfer of funds or repayment of liabilities between the group entities and the firm?
- What would be the PRA expectations for firms in demonstrating how to evidence 'strongly incentivised to support each other' in paragraph 2.5?
- In Appendix 2: 2.3.1 (1)(b) and (c), it is not clear which CUG firm's eligible capital should be the base of the 25%.
- It would be useful, given the complexity and potential for different interpretations across firms, if the PRA could provide worked examples of calculations for the NCLEG exemptions at the individual level and at the UK consolidated group level for firms with and without a CUG permission.
- It would be helpful if the PRA could suggest to the FCA that it apply a consistent approach to that proposed by the PRA.
- CP20/17 and its companion CP 19/17 require (at Appendix 1: 3.31 - *Draft amendments to Supervisory Statement 31/15*) management to address possible scenarios in the ICCAP in which inflows and outflows may be significantly reduced. We would appreciate further discussion on this point.
- In relation to the PRA's suggestion, in the cost benefit analysis at paragraph 4.5 of CP 20/17, that firms could use eligible credit risk mitigation with minimal costs to the firm, we note that this may not be as simple under CRR2. The draft CRR2 risk reduction package currently proposes wording that adds guaranteed exposures to the guarantor's capital requirements, even if the guarantees do not meet eligibility requirements. We would like to discuss this point further.

We have not reviewed the cost benefit analysis, other than noted immediately above, the compatibility statement or the statement on Government economic policy.

We hope you find UK Finance's response helpful and would be happy to discuss any of the points raised in further detail.

Simon Hills

✉ simon.hills@ukfinance.org.uk

☎ 020 3934 1105