UK FINANCE

A response to the PRA's consultation

Capital Requirements Directive V

September 2020

Introduction

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

We are pleased to respond to PRA's Consultation Paper on its plans to introduce those areas of CRDV that must be implemented before the end of the transition period, but that do not require legislative changes. We look forward to responding after the summer to the PRA's expected CP on those aspects of the changes to its rules, supervisory statements and statements of policy that do require legislative change.

We very much support the broader proposed approach to the implementation of prudential regulation after the end of the transition period which is to provide the Prudential Regulation Authority with new or updated powers, enabling it to implement CRDV by updating its rulebook as needed and to respond flexibly and quickly to emerging regulatory initiatives at an international and where appropriate, regional level.

Pillar 2

Principles of proportionality

We support the inclusion by the PRA of additional criteria in addition to those relating to the frequency and intensity of the SREP process based on a firm's nature, scale and complexity, and look forward to working with the PRA as it considers how more proportionality could in the future be introduced to the current regulatory framework.

1. *What are your views on the proposed approach to setting the PRA Buffer for subsidiaries?*

We agree with the PRA's proposed approach that the group-level PRA Buffer assessment should be the starting point for setting a buffer on an individual basis, where the firm is a subsidiary of a UK

consolidation groups or RFB subgroups and that the individual PRA buffer will typically be set to zero. We agree too that only where there are particular factors present, described in paragraph 5.25F of the draft supervisory statement SS 31/15 included in Appendix 3, should a comprehensive individual assessment be carried out. We recognise that that the factors are identified are by way of example only but have not identified other factors that should be taken into account in determining if a comprehensive assessment should be undertaken.

We would welcome more granular clarification of its proposal under 2.24 that, where a firm has a very similar risk profile to its UK consolidation group, then it will set the PRA buffer on an individual basis by reference to the PRA buffer calculated for that group or sub-group. Could the PRA elaborate on how the exact threshold would be set for an entity to meet this condition?

Under the PRA's current approach to the implementation of the Systemic Risk Buffer (SRB) a Ring Fenced Bank (RFB) subgroup is required to hold a systemic risk buffer (SRB) at the sub group level only - this requirement is not applied to individual entities of the sub group. Under RFB Group Risk requirements, a PRA buffer needs to be held at the level of the UK consolidation group to reflect the SRB at the RFB sub-group (where the SRB is not by offset the G-SIB buffer)

As we read them the PRA's proposals, a UK consolidated group PRA buffer arising from an RFB sub-group SRB would be allocated down to individual subsidiaries both inside and outside of the RFB sub-group. This may effectively result in UK group subsidiaries in the RFB sub-group and outside the RFB sub-group on an individual basis having a PRA buffer originating from the SRB buffer - which would significantly extend the impact of an SRB.

We do not expect that this is an intended outcome from the PRA's proposals, as the consultation paper does not refer to PRA buffers which are applied at UK consolidation groups as a result of RFB group risk. Could the PRA clarify that the PRA Buffer applied to subsidiaries excludes the element of UK consolidation group's PRA buffer that results from RFB group risk.

It would be helpful too if the PRA would clarify that the PRA buffer will be applied only to UK entities within the group that exceeds 5% of the UK consolidation group as opposed to all subsidiaries under the UK consolidation group.

Leverage in Pillar 2

We think it is helpful that the PRA is not intending to set a Pillar 2R for leverage at this stage and are aware of the FPC-PRC's upcoming review of the Leverage Ratio, which we look forward to contributing to that in due course.

2. Are there other areas of supervisory reporting that might qualify as duplicative?

We welcome the removal of remove the duplicative profit or loss – forecast and concentration risk data requirements. Members raised the following additional reports that are duplicative in full or in part.

The *liquidity return C66* is duplicative to the PRA110 submission. As such it should be in the PRA' should C66 after the EU Exit Transition Period.

The *Treasury Asset Return* (TAR) provides the UK Deposit Takers team with granular information on a variety of treasury related exposures, however, the ALMM and COREP duplicate its content. As the ALMM and COREP templates are not expected to be entirely replaced, the need for information requested by TAR other by exception should be re-considered. All material aspects of the TAR are collected through ALMM and COREP. It needs to be noted that the origin of TAR was the PRA's justified concern over UK Deposit Takers' exposures to obligors and counterparties in the PIIGS countries. We trust that those concerns should be suitably addressed and are not applicable for most if not all firms subject to this form of reporting.

Mortgage data collected through the *Mortgage Lending & Administration Return* and the *Loan Book Data* template already significant overlap and duplication particularly in relation to non-performing loans. In addition, the forthcoming FINREP reporting on non-performing loans and provisions template will add to that duplication and overlap. Members request that the PRA considers how such data should be collated, in fact what use of FINREP reporting it will make and use the opportunity of the forthcoming reporting changes to streamline data collection.

In light of the ongoing COREP C08:02 reporting; and the additional C08:03 and C34:07 reports which go-live on 30 June 2021, can the PRA consider whether it will continue to require *FSA045* reporting?

Remuneration

2. *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?*

Our smaller members welcome the PRA's proposal to increase the total assets threshold to £15 billion in respect of payments in instruments, discretionary pension contributions and the minimum deferral of variable remuneration and its plans to adopt the same approach for branches of third country firms. But our members seek clarity on the PRA's intention with regard to the £15 billion threshold. Paragraphs 3.22 and 3.26 and the table in 3.32 proposes the assets threshold at €15 billion, whereas question suggest below £15 billion.

We recognise however that the application of CRDV does not allow the previous degree of differentiation by proportionality level which we had previously welcomed.

Proportionate application of remuneration requirements - application to individuals

We recognise that the changes to the thresholds for applying a proportionate approach for individuals reflect the requirements of CRD V and are therefore mandatory. However, these changes will bring more people into scope of deferral, retained shares, and the holding and retention periods for discretionary pension benefits; and we do not believe that this will substantially further the objectives of promoting effective risk management and discouraging excessive risk-taking (due to the low absolute value of variable pay used). We would therefore welcome a further review of these thresholds once the EU Exit Transition Period ends.

We note that in paragraph 3.30 of the main consultation document; and in the draft amendments to paragraphs 15.20 and 15.20 of the Remuneration Part of the PRA Rulebook, the PRA proposes to

apply a proportionate approach to clawback periods applied to MRTs. Whilst we recognise the drivers for the proposed changes and the positive intent in reducing clawback periods for some MRTs, these will be operationally very difficult to manage as we expect colleagues may move between MRT categories and earning more or less than £500,000 year on year. This will lead to different clawback periods being applied to different awards; and potentially there being different treatment of the up-front portion of awards from one year to the next. The current approach of applying 7-year clawback to all awards from the date of grant is simpler to manage and is easier for colleagues in scope of the remuneration rules to understand. Given that a standardised clawback period for all MRTs is not incompatible with the requirements of the EBA Guidelines on Sound Remuneration Policies, our preference would be to retain the current approach.

Further, we note that the clawback period of 5 years 6 months for the deferred portion of variable remuneration awarded to an MRT who is not a member of the management body or senior management of a significant firm, where the deferral period is 5 years or more, is not in line with the EBA Guidelines on Sound Remuneration Policies paragraph 272 which require the period during which malus or clawback can be applied to at least cover deferral and retention periods, and paragraph 267 with requires a retention period of at least one year. Therefore, for a deferral period of 5 years, the minimum clawback period would be 6 years. We would welcome clarification on this point.

Application of remuneration requirements to groups

We are supportive of the PRA maintaining its current approach (paragraph 3.24 of the consultation) where 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. However, in applying the rules at consolidated and sub-consolidated levels to all entities within a 'group', we wish to highlight a concern with the continuing reference to section 421 of FSMA (as set out in paragraph 3.5 of the consultation).

Our concern is that applying remuneration requirements based on the FSMA section 421 definition would include any entities in which a group has a participating interest, which can be as low as 20%. This is not a level at which a group can exercise control over the entity.

Groups understand the need for a good corporate governance framework across subsidiaries that adheres to any local legal and regulatory requirements. However, there is not the same ability to control entities in which a group only has a participating interest. It cannot mandate such entities to remunerate their employees in a way that is consistent with that group's deferral and clawback requirements, the bonus cap, rules relating to identification of MRTs, and application of a compliant remuneration policy to name some of the requirements.

By way of example, there are companies where multiple regulated firms may each have interests on or around 20%. If each such firm is subject to different regulatory requirements it will create practical difficulties in terms of how a single remuneration policy for such company can ensure the required level of compliance for each investor firm. Even where investor firms are subject to the same remuneration requirements, there can still be divergences between each firm's remuneration policies and application of the rules.

So, we would ask the PRA (and a similar request will be made in response to the FCA's consultation) to acknowledge the practical challenges in following the section 421 FSMA definition where groups hold a participating interest but not control. We would also welcome the opportunity to meet with the PRA in order to discuss potential solutions.

When transposing CRD V it would be appropriate for the PRA to clarify the definition of variable remuneration to ensure that remuneration and MDA rules do not prohibit certain recovery actions (e.g. treatment of severance payments) or jeopardise the ability of firms to execute an orderly resolution or wind-down (e.g. retention payments).

Additional feedback (not covered by consultation questions)

Minimum deferral period

We would welcome additional clarity on certain aspects of the revised rules on deferral as we perceive there to be gaps in the current drafting of paragraph 15.17 of the Remuneration Part of the PRA Rulebook. As the FCA has done previously, we would propose to the PRA to outline its proposals on deferral and clawback for the different staff categories (MRTs, PRA Risk Managers, Senior Managers) against the requirements for high earners and non-high earners. Our reading of the draft text suggests there is need for clarity given on the minimum deferral periods for:

- MRTs who performs a PRA senior management function, but who are not considered to be a higher paid MRT (i.e. who earns less than £500k total remuneration). There is some overlap with the population identified as members of the management body and senior management, but the two populations are not identical: and

- MRTs who meet the criteria in 3.1(1)(a) to (c) or whose professional activities meet the qualitative criteria set out in Article 6(1), 6(2) or 6(5) but who are not considered to be a higher paid MRT. We view that this category of staff would be categorised as PRA Risk Managers, but would appreciate clarification from the PRA on this interpretation.

Remuneration reporting requirements

Whilst no change is proposed to the reporting requirements; and therefore, no related question in the consultation, we would welcome a review of regulatory reporting in respect of remuneration. In particular, we would welcome clarity on whether Remuneration Benchmarking and High Earners Reports which we share with the PRA for onward transmission to the EBA will be required once the EU Exit Transition Period ends (Chapters 17 and 18 of the Remuneration Part of the PRA Rulebook). We would also support the PRA to review accordingly the reporting requirements under the RPS questionnaire and tables 1-7 to reflect the changes proposed to the Remuneration Part of the PRA Rulebook.

3. Do you have any views on the design and amount of currency thresholds following the end of the EU Exit Transition Period?

Setting a Sterling value for currency thresholds is a helpful amendment to provide consistency year on year by removing the impact of exchange rate fluctuations between Euros and Sterling. However, we would be grateful for clarification on the frequency with which the PRA will review these thresholds, especially in the event of a material and sustained change in the prevailing exchange rate.

Further, we note that the PRA has not provided a Sterling equivalent for €750,000. The FCA consultation uses a translated value of £658,000. It would be helpful for the PRA to include the same value that the FCA has used, and in any case for the two regulators to align on their remuneration rules to the furthest extent possible.

Intermediate parent undertakings (IPUs)

We welcome the PRA's statement that it intends to remove the rules requiring an IPU to be established after the end of the transition period, recognising that it already has firm-specific powers to require a UK IPU to be established.

Unfortunately, there is a period of (only) four days between the implementation date of CRDV and the end of the EU Exit Transition Period, where it seems, some firms may be required to establish and IPU. Whatever the cost of doing so - we suspect theses will not be *de minimis* - this requirement would divert resource from business critical activities although we do not believe many, if any, firms will be caught by this requirement.

We recommend that should a firm believes it may be caught by this fleetingly brief requirement to establish an IPU the PRA should engage with it in order to identify the least resource intensive way of doing so.

4. *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?*

We have not gathered any information from members in response to this question

Governance

We support the proposals that the PRA Rulebook and Supervisory Statement 28/15 be amended to introduce a number of additional governance requirements. We believe that our members are already complying with the spirit of these changes.

While we have no general concerns with regard to the loans to directors' proposals we would appreciate more clarity on the level of information the PRA would be looking for in terms of related party transaction disclosures(RPTs) and what is meant by the reference to RPTs being 'properly documented'. Is the expectation that directors would need to disclose any loans on a register similar to conflicts of interest?

Third-country branch reporting

Our members do not anticipate any issues in complying with the proposed additional regulatory reporting in relation to the branch's activities and will be able to do so well within the required seven-month window after the end of the relevant financial year. But some of our members will not be able

to meet the requirements of Regulatory Reporting 22.4(6) in relation to the provision of a group recovery plan produced for the relevant home resolution authority. A number of home state regulators do not yet require a group wide recovery plan, so it will be impossible for the UK branch to comply with this requirement. We would welcome a discussion on behalf of this only small number of members as to how this obligation could be met in a proportionate way.

Responsible Executive

✉ simon.hills@ukfinance.org.uk
☎ +44 (0) 7921 498 183