UK FINANCE

A response to HM Treasury's consultation

Updating the UK's Prudential Regime before the end of the Transition Period

August 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 HM Treasury's Consultation Paper on its plans to introduce legislation to implement those areas of CRDV that must be implemented before the end of the transition period.

We very much support the broader proposed approach to implementation which is to provide the Prudential Regulation Authority with new or updated powers, which will enable it to implement CRDV by updating its rulebook as needed.

As there are other trade associations focusing solely on the representing Investment Firms UK Finance has taken the decision not to respond to Chapter 2 of the Consultation. But we note that we support HM Treasury's proposals not to apply CRRII/CRDV to FCA-regulated investment firms but instead apply a tailored version of the Investment Firms Regulation and Directive, via the Investment Firms Prudential Regime, to reflect the specificities of the UK market or UK firms. This will reduce complexity and the possible duplication or overlapping of regulatory requirements for Investment Firms.

Macro-prudential tools

Do you have any comments on the introduction of an Other Systemically Important Institutions buffer to replace the powers the PRA currently hold under the Systemic Risk Buffer?

We recognise the need to now introduce the O-SII buffer given the change in focus of the SRB introduced by CRDV which will no longer allow the PRA to use it to address the higher risks posed

by systemically important firms. We welcome HMT's confirmation that the O-SII buffer will be introduced in a way that mirrors the current application of the SRB for this purpose. But it would be helpful were the authorities to confirm that a UK ring-fenced bank, would not first have to be designated as an O-SII, by the EBA, before the O-SII buffers could be applied

Whilst the introduction of the O-SII buffer should be a change in name only, this is not clear from the details provided in the consultation. More importantly the Financial Policy Committee's (FPC) and HMT should coordinate to ensure that no further requirements are introduced as a result of this change.

The FPC's framework for the systemic risk buffer uses total assets as a proxy of systemic importance. Total assets are based on ring-fenced bank sub-groups and building societies in scope of the SRB with higher SRB buffer rates applicable as total assets increase through defined buckets. But the scoring and criteria methodology that the PRA currently uses to identify O-SIIs is based on the requirements of the CRD taking into consideration the EBA Guidelines on O-SIIs assessment - that is the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs).]

UK Finance is concerned that the O-SII scoring methodology could replace the simpler proxy based on total assets to inform the buffer rates applicable to SRB subgroups. This will remain uncertain until the FPC publish its 'high-level framework' on the calibration of the O-SII buffer requirements.

Banks currently subject to SRB would welcome an explicit confirmation that the level of buffer requirements will remain unchanged and that the current proxy based on total assets will be kept to inform the calibration of the O-SII buffer. The scoring methodology used under the O-SII framework would not provide additional benefits compared to the current total assets proxy and would add more complexities which should be avoided. The FPC framework for the systemic risk buffer should be rebranded to cater for the calibration of the O-SII buffer which is more adaptable by banks for capital planning and forecasting.

Also our members would not wish to see higher reporting burdens imposed on a ring-fenced bank as a result of having O-SII buffers applied. But we fear there will be higher reporting burdens because of the application of EBA Guidelines on Disclosures. were a firm to be formally designated as an O-SII, rather than just being subject to the O-SII buffer.

Paragraph 27 (page 14) requires O-SII disclosure a number of parameters each quarter which non-O-SIIs are required to disclose only annually, as follows:

> *27. Institutions required to comply with the obligations specified in Part Eight of the CRR and identified as G-SIIs or as O-SIIs or within the scope of application of the EBA Guidelines 2016/11 should pay particular attention to the possible need to provide more frequently than annually:*
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> *a) Information on own funds as referred to in paragraph 25(a), with a quarterly frequency;*
>
> *b) Information on leverage ratio as referred to in paragraph 25(c), with a quarterly frequency;*
>
> *c) The full set of information required by the Commission Implementing Regulation (EU) No 1423/2013 and the Commission Implementing Regulation (EU) No 2016/200, on a semi-annual basis;*

d) Other information listed in the guidance in the EBA Guidelines 2016/11, with the applicable frequency, and particularly:

i. Information in Article 438 points (c) to (f), as specified in templates EU OV1, EU CR8, EU CCR7, and EU MR2-B;

ii. Information on risk exposures, as specified in templates EU CR5, EU CR6 and EU MR2-A.

e) Information on other items prone to rapid changes.

Even if it is limited to the elements identified in paragraph d) sub parts i) and ii), (which relate to risk weighted exposure amounts, own funds and certain other and risk exposures) these are additional requirements compared to those currently applying to SRB institutions.

This seems to be an unnecessary additional burden and we look forward to discussing with the PRA how this additional burden could be eliminated in due course

Do you have any comments on the PRA being given a power over the CRDV Systemic Risk Buffer to replace its power to implement Sectoral Capital Requirements under Pillar 2 capital requirements?

We recognise that, although it has not previously done so, the PRA requires the power to set Sectoral Capital Requirements via the SRB as such macro-prudential risks will no longer be able to be met by Pillar 2 add-ons. But we note that the quality of capital (all CET1 rather than 56.25% CETI) held against such sectoral risks would be higher than would currently be the case were SCRs to be deployed and/or the amount of capital required could increase adversely impacting maximum distributable amount thresholds.

Holding companies

Do you have any comments on the powers the government intends to give to the PRA to enable them to supervise holding companies?

Our overarching expectation is that where a HoldCo is required to be established it should be only be subject to minimal regulatory requirement if it is already being supervised on a sub-consolidated basis.

CRD V article 21a (1) limits the approval process to (EU) Parent Financial Holding Companies, whilst other financial holding companies not subject to the requirements of the CRR or CRD are out of scope. This is a relevant point which members feel is missing from the consultation. Intermediate holding companies within the Group not subject to prudential requirements under the relevant legislation should not be subject to the approval process.

Bringing these entities in scope would not provide additional benefits to the authorities on prudential supervision with the additional burden of Groups to fulfil those requirements together with higher costs.

CRD V Article 21a paragraph 4 provides a more explicit exemption from the approval process for holding companies which exists solely to acquire holdings in subsidiaries, does not engage in the management of those subsidiaries and where a subsidiary is designated as being responsible for the group's compliance with the group's consolidated prudential requirements. This is a helpful

derogation and our third country members would welcome explicit confirmation that HMT intends to implement this paragraph 4 in its entirety.

We would also suggest that HMT specify that the designated subsidiary referred to in 4 (c) can be either a credit institution or a PRA supervised systemic investment firm[1]. This would ensure the scope of the derogation in the CRD5 text is reflected in UK rules.

We note HMT's has not referenced CRDV Article 21b in its consultation, which UK Finance and its antecedent trade associations strongly opposed. Even more so in the context of Brexit, we do not believe that in a single jurisdiction where all the subsidiaries of a third country group are supervised by the host state competent authorities there is any need for a mandatory requirement to establish a new intermediate parent undertaking particularly when the authorities have the powers to require an overarching holding company on a discretionary basis. In addition, the PRA already supervises "PRA-designated investment firms", so the rationale of an overarching holding company to enable a degree of supervision of investment firms by the ECB or national competent prudential authority, does not exist in the UK context.

The CRDV requirement for approval for existing holding companies covers only those entities established within the EU, and by extension we understand that the UK approach will be only to require approval for existing HoldCos that are established in the UK.

As the process of applying to become a holding company will be new for both our members and the PRA we suggest a staged approach to application would be helpful, given that paragraph 10 establishes a time frame of between four and six months for the supervisor to grant approval.

During the first few months of 2021 informal dialogue between individual firms and the supervisor would establish expectations about the information required to support a successful application prior to the submission of a formal application for approval based on a shared understanding of the documentary requirements later in the six month window.

We note that the PRA is consulting on the transposition of CRDV Article 21b into the Groups chapter of the PRA rulebook for CRR firms. We look forward to discussing our views with the PRA and HMT as the PRA considers whether or not to transpose Article 21b, which we would not support.

We also note that the FCA has issued a Discussion Paper on its proposed introduction of the IFPR for MiFID investment firms. It suggest that as an alternative to consolidation where the competent authority deems a group structure is sufficiently simple (and provided there are no significant risks to clients or to market), the FCA may allow an investment firm group to instead apply a group capital test. We find this an attractive and proportionate approach and encourage HMT and the PRA to consider if a similar approach for credit institutions may be an appropriate alternative to the creation of an intermediate HoldCo.

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[1] In the EU systemic investment firms will have to re-authorise as credit institutions pursuant to the IFR/D and so would be included in CRD 21 a 4 (c). However, per the HM Treasury policy statement on "Prudential Standards in the Financial Services Bill: June Update" we note that UK systemic investment firms will not be required to apply for authorisation as investment firms.

Do you have any comments on the power the government intends to give to the PRA to remove individuals from management bodies of holding companies under the circumstances given above?

We support the PRA being given a power to remove a director from the management body of a holding company but would not wish to see the SMCR regime extended to individual members of the management bodies of holding companies. Clarification that this is not contemplated would be welcome.

extend the Senior Managers and Certification Regime to members of the managing body of holding companies.

Equal pay framework and enforcement

Do you have any comments on the government's proposed approach?

We agree with the approach but consider that HMG should take the opportunity to address an anomaly within the UK legislation. The gender pay gap reporting requirements have served the purpose of holding organisations to account and accelerated the pace at which gender disparities in pay are addressed. There is an anomaly in the reporting, however, as the salary figures upon which the reporting is based are subject to a pro-rata calculation, whereas there is no such arrangement for the reporting of bonuses. As a consequence, to the degree that a higher percentage of part time roles are filled by women, there is a mechanical widening of the gender bonus gap, with e.g. a three day a week would generate a 40% gap in comparison to a full time post based upon a five day working week. Progressive employers encourage women to return to work sooner after maternity leave and offer the opportunity to balance work and family in terms of caring responsibilities also. Whilst there may be a case in favour of saying the bonus gap disclosure illustrates societal difference, we consider more that it portrays good employers in an unfavourable light.

Do you have any comments on the PRA benchmarking remuneration trends and practices using information currently available on the gender pay gap provided by institutions?

We fully support the PRA utilising the existing publicly available UK gender pay gap reports to benchmark remuneration trends and practices, which will avoid unnecessary extra reporting requirements for our members.

Exemptions

Do you have any comments on the government's approach to exempted institutions under CRDV?

No.

Responsible Executive

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