

OFFICIAL



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

Consultation Response

October 2020

OFFICIAL

OFFICIAL



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

October 2020

OFFICIAL



© Crown copyright 2020

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3.

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at: www.gov.uk/official-documents.

Any enquiries regarding this publication should be sent to us at public.enquiries@hmtreasury.gov.uk

ISBN 978-1-913635-41-1PU 2977

Contents

Chapter 1	Introduction	2
Chapter 2	Summary of responses	5
Chapter 3	Government response	8
Chapter 4	Next steps	12
Annex A	List of respondents	13

Chapter 1

Introduction

- 1.1 HM Treasury launched a consultation on 16 July 2020 entitled 'Consultation on updating the UK's Prudential Regime before the end of the Transition Period'. The consultation document outlined how the government intends to implement the Capital Requirements Directive V (CRDV). The consultation closed on 20 August 2020.
- 1.2 During the Transition Period, and under the terms of the Withdrawal Agreement, the government will implement EU legislation that applies before the end of 2020. This includes the transposition of CRDV by 28 December 2020.
- 1.3 The UK played a pivotal role in the design of EU financial services regulation. The government remains committed to maintaining prudential soundness and other important regulatory outcomes such as consumer protection and proportionality. However, rules designed for 28 countries cannot be expected in every respect to be the right approach for a large and complex international financial sector such as the UK. Now that the UK has left the EU, the EU is naturally already making decisions on amending its current rules without regard for the UK's interests. We will therefore also tailor our approach to implementation to ensure that it better suits the UK market outside the EU.
- 1.4 This consultation only sought comment on those areas requiring legislation, which include:
 - the intention to exempt investment firms prudentially regulated by the Financial Conduct Authority (FCA) from the scope of CRDV, given the planned introduction of the Investment Firms Prudential Regime (IFPR) in summer 2021
 - various updates to the capital buffers that the Prudential Regulation Authority (PRA) can require of institutions. This allows the Financial Policy Committee (FPC) and the PRA to maintain their current level of macro-prudential flexibility
 - extending the PRA's powers for consolidated supervision to - and creating a new approval regime for - financial holding companies (FHCs) and mixed financial holding companies (MFHCs), to be described jointly as "holding companies" for the rest of this document. In addition, granting the PRA an express power to remove members of the management body of institutions and holding companies in certain circumstances
 - amendments to the list of entities exempted from the Directive

- 1.5 In addition, whilst the government does not intend to legislate to prescribe changes to the framework for gender neutral remuneration policies and the gender pay gap, as it considers them covered by existing provisions, the government felt it important to invite comment on its approach in this area.
- 1.6 The consultation ran from 16 July 2020 to 20 August 2020, during which time the government received 8 responses from industry (see Annex A for a list of respondents). This document summarises the responses received and gives the government's response to them, as well as explaining the next steps for the instrument.

The Fifth Capital Requirements Directive (CRDV)

- 1.7 CRDV was published in the Official Journal of the European Union (OJEU) on 7 June 2019 and entered into force on 27 June 2019. Alongside the Capital Requirements Regulation II (CRR II), the Directive updates prudential requirements and continues the EU's implementation of further elements of the internationally agreed Basel framework, agreed by the Basel Committee on Banking Supervision (BCBS).
- 1.8 Much of CRDV builds on the existing Directive, the 4th Capital Requirements Directive, referred to as CRDIV. The government's implementation of CRDIV delegated significant responsibility to the PRA. Therefore, we only intend to legislate in areas where the government deems it necessary to ensure that the PRA has the tools to implement the relevant parts of the Directive.
- 1.9 Article 21a of CRDV sets new requirements for holding companies to seek supervisory approval and be subject to consolidated or sub-consolidated supervision, as required. It gives the circumstances under which holding companies must apply for approval, where they are exempt from approval and the sanctions that the relevant competent authority must have available to them to ensure compliance with the regime.
- 1.10 Article 91 of CRDV stipulates that institutions and holding companies shall have the primary responsibility for ensuring that members of their management body are of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties. The article also requires that where, as determined by the relevant competent authority, members of the management body fail to fulfil the requirements set out above the competent authority must have the power to remove such members from the management body.
- 1.11 CRDV also makes various changes and clarifications to the macro-prudential toolkit available to competent authorities. Article 131 sets out the ability for competent authorities to apply an Other Systemically Important Institutions (O-SII) buffer to address the risks posed by domestic systemic importance. Articles 133 and 134 set out a framework for a revised Systemic Risk Buffer, which can be used by competent authorities to address macro-prudential or systemic risks not already addressed by minimum requirements or other capital buffers.
- 1.12 Article 2 of CRDV exempts non-systemic investment firms from the scope of CRDV as well as updating the list of other institutions exempt from the scope of CRDV.

- 1.13 Articles 74, 75 and 92 create new requirements for both institutions themselves and member states to ensure that institutions' remuneration policies are gender neutral. It also requires competent authorities to collect information on - and benchmark - gender pay gap data.

Chapter 2

Summary of responses

- 2.1 The government received eight written responses to this consultation. The consultation asked eight questions. The responses to each question are summarised here, as well as additional areas flagged in the consultation.
- 2.2 The responses broadly highlighted agreement with the government's proposed approach but noted a few areas which required clarification or highlighted specific complexities. These related to the macro-prudential updates and the holding company approval regime.

Question 1: Do you agree with the government's intention not to apply CRDV to FCA-regulated investment firms?

- 2.3 All those who responded to this question agreed with the government's approach not to apply CRDV requirements to non-systemic investment firms.
- 2.4 Responses noted the disproportionately high-cost burden that would be placed on non-systemic investment firms if they were required to comply with the new CRDV regime for a short period of time, prior to the implementation of IFPR.

Question 2: 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?

- 2.5 Responses which addressed this question noted the need to give the PRA and the FPC powers over the O-SII buffer.
- 2.6 One response recommended that the O-SII buffer be implemented in a way that continued to use the existing FPC framework for the CRDIV Systemic Risk Buffer (CRDIV SRB), which is based on total assets, in determining relevant buffer rates. The respondent also asked for confirmation that there would be no change in capital requirements as a result of the introduction of the O-SII buffer.
- 2.7 This response also expressed a preference to avoid additional notification and reporting requirements over and above what was necessary under the existing approach, noting they would raise this point in the subsequent PRA consultation. It also sought confirmation on whether a UK ring-fenced bank would have to be designated an O-SII by the European Banking Authority before an O-SII buffer could be applied.

Question 3: 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?

- 2.8 Responses that addressed this question noted the need to give the PRA the ability to set a revised CRDV SRB, given CRDV prevents the use of Pillar 2 capital requirements for macro-prudential purposes.
- 2.9 One response proposed that the FPC and the PRA should both be required to publish a policy as to how they will exercise their respective powers relating to the CRDV SRB, covering among other things the types of sectoral exposures that would be recognised.
- 2.10 One response noted that the CRDV SRB would consist of a different quality of capital to Pillar 2 capital and if used may have implications for Maximum Distributable Amounts. Another suggested the name of the CRDV SRB should be changed to something else to make its function clearer.

Question 4: Do you have any comments on the powers the government intends to give to the PRA to enable them to supervise holding companies?

- 2.11 A response highlighted that CRD V article 21a (1) limits the approval process to parent financial holding companies and other financial holding companies subject to the requirements of CRRII or CRDV.
- 2.12 Another respondent highlighted their desire to see CRDV Article 21a (4) implemented. Further, it was requested that the implementation of point (c) of the same paragraph be implemented to allow for the designated subsidiary referred to in 4(c) to be either a credit institution or a PRA-designated systemic investment firm.
- 2.13 A response noted that the FCA has issued a Discussion Paper on its proposed introduction of the IFPR for MiFID investment firms in which they argue that as an alternative to consolidated supervision the FCA may allow the group to apply a group capital test. The response made the case that this is an attractive and proportionate approach for banks as well as investment firms and encouraged the government to consider this approach instead of requiring the creation of a holding company.
- 2.14 Several responses highlighted their opposition to the implementation of Intermediate Parent Undertakings (IPUs) requirements in CRDV. The PRA are responsible for the implementation of the IPU requirements and several responses noted the PRA's consultation and their support for the PRA's proposed approach.¹

Question 5: 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?

- 2.15 A response highlighted that whilst they agree with the power, they had concerns should the vehicle to give the PRA this power of removal be the

¹ <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/capital-requirements-directive-v>

Senior Managers and Certification Regime (SMCR). They noted their opposition to the extension of SMCR and asked for clarity that this is not the government's intention.

Question 6: Do you have any comments on the government's proposed approach? (To gender neutral remuneration)

2.16 All responses to this question highlighted their agreement with the government's proposed approach and welcomed that no additional burdens would be placed on firms.

Question 7: 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?

2.17 Responses agreed with the government's proposed approach noting that it would place no new requirements onto firms.

2.18 One response argued that there is an aberration with the UK's current system of measuring the gender pay gap in variable remuneration. They highlighted that whilst the gender pay gap in fixed remuneration is measured on a pro-rata basis, variable remuneration (primarily bonuses) is not measured pro-rata. They suggest that this means that firms that are flexible and allow women to work part-time (for example post-maternity) but on that basis pay a pro rata bonus, would appear to have a very significant gender bonus gap, whilst those who did not allow flexible working for women would appear to be doing more to ensure a minimal gender bonus gap. They highlighted that this could show more progressive firms in an unfair light.

Question 8: Do you have any comments on the government's approach to exempted institutions under CRDV?

2.19 Responses highlighted their support for the continued exemption of credit unions.

Additional comments

2.20 A response noted that CRDV places new requirements on the European Banking Authority (EBA) to assess the potential inclusion in the review and evaluation performed by competent authorities of environmental, social and governance risks (ESG risks). The response considered that the government might wish to review the PRA/FPC's role in monitoring these risks.

Chapter 3

Government response

Question 1: Do you agree with the government's intention not to apply CRDV to FCA-regulated investment firms?

3.1 Respondents raised no issues with these amendments.

Question 2: 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?

- 3.2 The government intends to legislate in a way that is consistent with the original policy intent set out in the consultation. The PRA and FPC will be given powers to set an O-SII buffer, to require ring-fenced banks and large building societies to hold a sufficient level of capital. To ensure consistency with the wider changes made by the statutory instrument, the legislation envisages allowing the PRA to apply the O-SII buffer at the level of approved intermediate holding companies which contain ring-fenced banks, where those approved intermediate holding companies are required to meet sub-consolidated requirements. The maximum rate of the O-SII buffer will be 3%, in line with what is currently in place for the CRDIV SRB. The legislation requires the FPC to set out a framework for applying the O-SII buffer, which will then be applied by the PRA.
- 3.3 The FPC and PRA will have discretion to judge how these capital buffers should be applied, within certain parameters set by legislation. The PRA will consult on their proposed approach to implementing the O-SII buffer. The PRA confirmed in April that it would maintain current CRDIV SRB rates, and those of any successor buffer (in this case the O-SII buffer), and next reassess them in December 2021, with any decision taking effect from January 2023. Therefore, there should be no change in capital requirements as a result of this change.
- 3.4 The legislation will also make necessary updates to the definition of Other and Globally Systemically Important Institutions to reflect changes set out in the Directive. O-SII identification will continue to be done by the PRA at the level of the group. All ring-fenced banks are already part of groups that have been identified as O-SIIs. The PRA's implementation of these provisions will be covered in its Autumn consultation.
- 3.5 The legislation will also clarify that the counter-cyclical capital buffer and capital conservation buffer are capable of being applied by the PRA at the level of approved holding companies on a consolidated/sub-consolidated basis, to ensure consistency with the other changes made by the legislation in respect of the PRA's powers over holding companies.

Question 3: 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?

- 3.6 The PRA will be given a power over the CRDV SRB, which will be capable of being applied to UK banks, building societies and PRA-designated investment firms, including at the level of holding companies in line with the broader changes made by CRDV and the CRRII.
- 3.7 This will allow the FPC and PRA to continue to be able to apply macro-prudential Sectoral Capital Requirements. The PRA will be able to set a rate up to 5%, reflecting the level of regulatory discretion envisaged by the Directive, subject to certain provisions that place a limit on the cumulative level of capital buffers. The PRA will also have the ability to recognise third-country Systemic Risk Buffers.
- 3.8 As noted during the consultation, and to be consistent with the Directive, the CRDV SRB will need to be met with Common Equity Tier 1 capital and will form part of relevant firms' combined buffer requirement.
- 3.9 The FPC has already published a statement on how it would apply Sectoral Capital Requirements in certain situations.
- 3.10 The PRA intends to explain its approach to the revised CRDV SRB in its Autumn consultation. There are no macro-prudential Sectoral Capital Requirements in place at the current point in time.
- 3.11 As is the case now, the FPC will have the ability to make recommendations to the government if it believes further changes to the macro-prudential framework are warranted in future.

Question 4: Do you have any comments on the powers the government intends to give to the PRA to enable them to supervise holding companies?

- 3.12 The government intends to legislate in a way that is consistent with the intent expressed in the original consultation. A bespoke holding company approval regime will be created for parent holding companies and other holding companies required to comply with the Directive or CRR on a consolidated or sub-consolidated basis. The government will legislate to provide the PRA with the enforcement powers required to supervise holding companies, as required for transposition of CRDV.
- 3.13 The PRA will also be given the power to remove members of management boards where an individual is no longer of sufficiently good repute, no longer possesses sufficient knowledge, skills, experience, honesty, integrity or independence of mind or is no longer able to commit sufficient time.
- 3.14 The government can confirm that the provisions in the SI are in line with the provisions in CRDV in that they only apply to UK parent financial holding companies and those other holding companies which are in scope of the CRD or CRR. Other holding companies that are not the ultimate parent or responsible for sub-consolidated requirements will not be subject to approval.

- 3.15 The SI will fully implement Article 21a (4) and allows for the same exemptions as are allowed under the same article. In addition, the instrument allows for the designated subsidiary mentioned in Article 21a(4)(c) to be either a credit institution or PRA regulated investment firm.
- 3.16 The group capital test mentioned in the FCA discussion paper and the extension of the SCMR go beyond the scope of the CRDV instrument so are not included as part of this legislation.

Question 5: 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?

- 3.17 As above, we can confirm that the SMCR will not be extended as part of this legislation.

Question 6: Do you have any comments on the government's proposed approach? (To gender neutral remuneration)

- 3.18 Respondents raised no issues with this approach.

Question 7: 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?

- 3.19 Responses were supportive of the fact that no additional requirements would be placed on firms.
- 3.20 The UK's transposition of CRDV does not impose a requirement on the PRA to report publicly on the gender pay gap. Public reporting of the gender pay gap is a role designated to the EBA in the EU legislation, whilst benchmarking by member states is only required in so far as it facilitates the EBA's public reporting. The Government Equalities Office (GEO) and the Equality and Human Rights Commission will remain responsible for monitoring compliance with, publishing inquiries on, and enforcing relevant legislation concerning gender pay gap issues for firms including those in the financial services sector.
- 3.21 Fixing specifics of the wider gender pay gap reporting goes beyond the goal of the implementation of CRDV and therefore this instrument would be an inappropriate vehicle for this change. The respondent's concerns have been passed on to the GEO.

Question 8: Do you have any comments on the government's approach to exempted institutions under CRDV?

- 3.22 Responses highlighted their support for the continued exemption of credit unions.

Additional comments

- 3.23 The PRA does consider climate risks as part of its Supervisory Review and Evaluation Process (SREP).

3.24 The PRA's approach to SREP approach is covered in their supervisory statement SS3/19. ¹

¹ <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2019/ss319>

Chapter 4

Next steps

- 4.1 The government would like to thank respondents for their helpful and constructive engagement with the consultation. The responses to this consultation have informed the proposed legislation.
- 4.2 The government consulted with the Bank of England, the PRA and the FCA throughout the drafting of this statutory instrument.
- 4.3 The statutory instrument which transposes the relevant provisions of CRDV is laid in Parliament on 15 October 2020.

Annex A

List of respondents

BNY Mellon

Building Society Association

Charles Stanley & Co Limited

ClientEarth

FIA European Principal Traders Association

The Investment Association

UK Finance

One respondent wished to remain anonymous.

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk