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Please see: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/capital-requirements-directive-v-further-implementation

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Appendix 3 – Statements of Policy and Supervisory Statements

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1 Draft amendments to Statement of Policy 'The PRA's approach to the implementation of the systemic risk buffer'

In this appendix, new text is underlined and deleted text is struck through. Footnote references will be updated when the final policy is published.

Please note that the title of this SoP would be changed to 'The PRA's approach to the implementation of the other systemically important institutions (O-SII) buffer'.

1 Introduction

1.1 This statement of policy (SoP) sets out the Prudential Regulation Authority's (PRA) approach to the implementation of the ~~systemic risk buffer (SRB)~~ other systemically important institutions (O-SII) buffer.

1.1A The O-SII buffer replaces the previous buffer used to address the risk posed by systemically important institutions, the systemic risk buffer (SRB). The change resulted from the UK's implementation of the Capital Requirements Directive (2019/878/EU) (CRD V).

1.2 UK legislation implementing the O-SII buffer requires the Financial Policy Committee (FPC) to establish a framework for an O-SII buffer that applies to large building societies and ring-fenced bodies (RFBs). ~~In line with the Independent Commission on Banking (ICB) recommendations, the UK legislation implementing the SRB requires the Financial Policy Committee (FPC) to establish a framework for an SRB that applies to large building societies and ring-fenced bodies (RFBs).~~ The O-SII buffer ~~SRB~~ Regulations[1] require the PRA to apply the framework set out by the FPC on the O-SII buffer ~~SRB~~ from Tuesday 29 December 2020 ~~1 January 2019~~.

1.3 The FPC published 'The Financial Policy Committee's framework for the O-SII buffer ~~systemic risk buffer~~' (FPC framework) in December 2020 ~~May 2016.~~[2] Alongside the FPC framework, this SoP will form the Bank of England's broader framework for the O-SII buffer ~~SRB~~.

1.4 The PRA will review this SoP at least every two years.

2 Firms in scope of the framework

2.1 [Deleted] ~~This SoP is relevant to RFBs, within the meaning of section 142A of the Financial Services and Markets Act 2000 (FSMA), and large building societies that hold more than £25 billion in deposits (where one or more of the accountholders is a small business) and shares (excluding deferred shares) – jointly 'SRB institutions'.~~

2.2 Firms in scope of the O-SII buffer are narrower in scope than the list of O-SIIs, which the PRA identifies in line with its Statement of Policy 'The PRA's approach to identifying O-SIIs'.[3] The UK legislation implementing the O-SII buffer restricts the application of the O-SII buffer to RFBs and large building societies as defined in paragraph 2.3. This is reflected in the FPC framework.

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1 The Financial Holding Companies (Approval etc.) and Capital Requirements (Capital Buffers and Macro-prudential Measures) (Amendment) (EU Exit) Regulations 2020. ~~The Capital Requirements (Capital Buffers and Macro-prudential Measures) (Amendment) Regulations 2015~~

2 Available at [Update link for FPC's framework doc for O-SII buffer].

3 PS6/16: https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-approach-toidentifying-other systemically-important-institutions-o-siis.

2.3 The PRA only applies an O-SII buffer to all banking groups containing RFBs, within the meaning of section 142A of the Financial Services and Markets Act 2000 (FSMA), and large building societies that hold more than £25 billion in deposits (where one or more of the account holders is a small business) and shares (excluding deferred shares). Jointly, these are referred to as 'firms that are subject to the O-SII buffer'.

3 ~~SRB~~ O-SII buffer capital implications

3.1 The Capital Requirements Directive (2019/878/EU) specifies that the level of application of the O-SII buffer is determined on the basis of the nature and distribution of the risks embedded in the structure of the O-SII. ~~The SRB is defined in the Capital Requirements Directive (2013/36/EU) as a buffer that can be used to prevent and mitigate long term non-cyclical macroprudential or systemic risks not covered by the Capital Requirements Regulation (EU) 575/2013 (CRR).~~ The O-SII buffer ~~SRB~~ can be used where there is a risk of disruption in the financial system with the potential to have serious negative consequences for the financial system and the real economy of a specific member state.

3.2 The O-SII buffer ~~SRB~~ is a firm-specific buffer (ie its amount may vary from firm to firm). It is based on a firm's worldwide risk-weighted exposures and each firm will be required to ensure that it is met solely with Common Equity Tier 1 capital.

3.2A Where it has decided to impose an O-SII buffer ~~SRB~~ on a firm that is subject to the O-SII buffer, ~~SRB institution,~~ the PRA will invite that firm to apply for a requirement to be imposed on it under section 55M of FSMA in order to set the O-SII buffer ~~SRB~~. Where firms do not apply, the PRA would consider imposing such a requirement on its own initiative. The requirement would have the effect of increasing the size of the combined buffer a firm must meet to avoid restrictions on distributions. This is in line with the approach taken with regard to the PRA's implementation of the global systemically important institutions (G-SII) buffer, which is also a firm-specific buffer, and is set using the PRA's powers under section 55M FSMA.

3.3 Firms that are subject to the O-SII buffer ~~SRB institutions~~ will be prevented from using capital maintained to meet the O-SII buffer ~~SRB~~ to meet any other capital requirements or buffers. Where a~~n~~ firm that is subject to an O-SII buffer ~~SRB institution~~ is subject to both a G-SII buffer and an O-SII buffer ~~SRB~~ on the same basis of consolidation, the higher of the two shall apply.

3.4 Group risk[4] may arise when an RFB is subject to an O-SII buffer ~~SRB~~ at the level of the RFB sub-group,[5] but the consolidated group is either not subject to a G-SII buffer, or its G-SII buffer rate is lower than its O-SII ~~SRB~~ buffer rate. In May 2016 the FPC recommended to the PRA that it should seek to ensure that, where systemic buffers apply at different levels of consolidation, there is sufficient capital within the consolidated group, and distributed appropriately across it, to address both global systemic risks and domestic systemic risks.[6]

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4 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.

5 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.

6 See Chapter 4 of FPC framework available at https://www.bankofengland.co.uk/paper/2016/the-financial-policy-committees-framework-for-the-systemic-risk-buffer.

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3.6 As indicated in SS45/15 'The UK leverage framework',[7] firms that are ~~SRB institutions~~ subject to a~~n~~ non-zero O-SII buffer ~~SRB~~ will also be subject to an additional leverage ratio buffer (ALRB) rate. As set out in the June 2018 Financial Stability Report, the FPC intends to review the UK leverage ratio framework once there is clarity on the finalised implementation of the leverage ratio requirement in EU law.[8]

4 Application of the framework in ~~2019~~2020

4.1 The PRA will apply the FPC's framework for the O-SII buffer ~~SRB~~ to each firm that is subject to the O-SII buffer. ~~SRB institution.~~ As a result of this assessment, some firms that are subject to the O-SII buffer ~~institutions~~ may receive a positive O-SII buffer ~~SRB~~ rate while others may receive a zero ~~SRB~~ rate. When applying the framework, the PRA will assign to each firm that is subject to the O-SII buffer~~SRB institution~~ a systemic score equal to its total assets at the end of the previous calendar year, calculated on the applicable basis of regulatory consolidation.

4.2 As outlined in SS8/16,[9] the applicable basis of consolidation for ring-fenced entities will be the sub-consolidated basis where an RFB sub-group is in place. In cases where an RFB is not a member of an RFB sub-group (ie where the PRA has determined that an RFB should not be required to meet prudential requirements on a sub-consolidated basis), the PRA will consider on a case-by-case basis at which level to apply the FPC framework and set the O-SII buffer ~~SRB~~.

…

4.4 For each firm that is subject to the O-SII buffer, ~~SRB institution,~~ the PRA will derive an O-SII buffer ~~SRB~~ rate corresponding to its systemic score. This will be in accordance with the mapping outlined in the FPC framework. Before setting each institution's O-SII buffer ~~SRB~~ rate the PRA may, in the exercise of sound supervisory judgement, deviate from the rate derived from the FPC framework, or waive the requirement and set no buffer rate for the firm that is subject to the O-SII buffer. ~~SRB institution~~.

4.5 The PRA expects that it will exercise supervisory judgement to deviate from the O-SII buffer ~~SRB~~ rates derived from the FPC framework or waive the requirement only in exceptional cases. The PRA expects that these will primarily be cases where the outcome of the methodology is not in adherence with the spirit of the FPC framework. An example of such a case could be actions by a firm to manipulate its systemic score deliberately, so that the rate derived from the framework underestimates its systemic importance. Other circumstances could include where a firm's total assets have changed materially between the year-end and the point at which rates are set or are projected to grow by the time that the rates would take effect.

4.6 When making such decisions, the PRA will have regard to applicable statutory obligations and regulatory principles.~~, including the requirement that the SRB should not entail disproportionate effects on the whole or parts of the financial system of other Member States, or of the European Union as a whole, therefore forming or creating an obstacle to the functioning of the internal market~~.

4.7 The PRA expects to announce the rate applicable to each firm that is subject to the O-SII buffer in December 2020. The buffer rate will apply with immediate effect in order to effect the

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7 SS45/15 'The UK leverage framework': https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-uk-leverage ratio-framework-ss.

8 'Financial Stability Report', June 2018: https://www.bankofengland.co.uk/financial-stability-report/2018/june-2018.

9 'Ring-fenced bodies (RFBs)', July 2016: https://www.bankofengland.co.uk/prudential-regulation/publication/2016/ring-fenced-bodies-ss.

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continuation of the same rates from the date on which the SRB rates no longer apply. The PRA confirmed in April 2020 that SRB rates would be maintained at the rates set in December 2019 until the PRA reassesses rates in line with its policy in December 2021, to take effect from January 2023.[10] As this decision also applied to any successor buffer, including the O-SII buffer, firms' O-SII buffer rates remain be the same as the SRB rates set in December 2019. ~~When setting the 2019 SRB rates, the PRA will announce the SRB rate of each SRB institution and the date from which each SRB institution will have to apply the buffer. The PRA expects to announce the first rates in early 2019 and apply them three months after the date of the announcement. The PRA may adapt this timeline, where appropriate, in light of its objectives and statutory responsibilities.~~

5 Application of the framework following the initial O-SII buffer ~~SRB~~ rates

5.1 Following the application of the initial O-SII buffer ~~SRB~~ rates, the PRA will re-apply the O-SII buffer ~~SRB~~ framework annually in the manner outlined in paragraphs 4.1 to 4.7~~6~~ of this SoP. The PRA expects to announce the O-SII buffer ~~SRB~~ rates resulting from its assessment by 15 December of each year and to require institutions to apply them on an ongoing basis by 1 January of the second year following the calendar year when the rates were announced.[11] For example, the O-SII buffer ~~SRB~~ rates announced in December 2020~~19~~ would take effect as of 1 January 2022~~1~~. The PRA may adapt this timeline, where appropriate, in light of its objectives and statutory responsibilities.

6 [Deleted] ~~Recognition of EEA buffer rates~~

6.1 [Deleted] ~~The PRA notes its responsibility for deciding whether EEA SRB rates should be reciprocated from 1 January 2019.[12] The PRA will make such decisions on a case-by-case basis. When doing so, the PRA will take into account the information set out in the relevant notification submitted by the EEA authority, as well as the materiality and effect of any decision to the UK financial system and PRA regulated firms.~~

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[10] https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pra-decision-on-srb-rates.

[11] This will align the implementation timelines of the O-SII buffer ~~SRB~~ with those of the G-SII buffer as outlined in the 'Commission Delegated Regulation (EU) No 1222/2014 with regard to regulatory technical standards for the specification of the methodology for the identification of global systemically important institutions and for the definition of subcategories of global systemically important institutions': https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1608&from=EN.

~~[12] 'Reciprocated' for these purposes refers to the process of recognition of EEA buffer rates under regulation 34J of the Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014. Under these regulations, the PRA may not require an SRB institution to apply the EEA buffer rate if it has set an SRB for that institution and the SRB rate is greater than the EEA buffer rate.~~

2 Draft amendments to Statement of Policy 'The PRA's methodologies for setting Pillar 2 capital'

In this appendix, new text is underlined and deleted text is struck through. Footnote references will be updated when the final policy is published.

…

9 The PRA buffer

…

Purpose and objective of the PRA buffer

Footnote 34: The combined buffer comprises the Capital Conservation Buffer (CCoB), the Countercyclical Buffer (CCyB), the buffer for global ~~and other~~ systemically important institutions (G-SIIs ~~and O-SIIs~~), and (for ring-fenced banks and the largest building societies) the other systemically important institutions buffer (O-SII buffer) ~~the Systemic Risk Buffer (SRB)~~.

…

Overall supervisory judgement

…

Group risk

…

9.40 The PRA's assessment of the total amount of the PRA buffer applicable to the consolidated group will be informed by:

(a) for systemically important institutions, the amount by which any other systemically important institutions (O-SII) buffer ~~systemic risk buffer (SRB)~~ exceeds the RFB sub-group's share of any buffer for global systemic importance (the G-SII buffer) at the consolidated group level. If the G-SII buffer is zero, RFB group risk will be informed by the full amount of any O-SII buffer ~~SRB~~, taking account of the RFB sub-group's size relative to the consolidated group.

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3 Draft amendments to Statement of Policy 'The PRA's approach to identifying other systemically important institutions (O-SIIs)'

In this appendix, new text is underlined and deleted text is struck through. Footnote references will be updated when the final policy is published.

1 Introduction

1.1 This statement of policy sets out the criteria and scoring methodology that the Prudential Regulation Authority (PRA) uses to identify other systemically important institutions (O-SIIs), as is required under the Capital Requirements Directive (EU Directive 2019/878 amending Directive 2013/36/EU) (CRD) as implemented in the Capital Requirements (Capital Buffers and Macro-prudential measures) Regulations 2014.[13]

…

2 Which firms can be identified as O-SIIs?

2.1 In line with the CRD and EBA Guidelines, the framework outlined in this statement of policy is to be applied in relation to all credit institutions, investment firms, and groups that are headed by ~~EEA~~ UK parent institutions, ~~EEA~~ UK parent financial holding companies, or ~~and~~ ~~EEA~~ UK parent mixed financial holding companies within the domestic financial sector at their highest level of consolidation in the United Kingdom.[14]

…

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[13] http://www.legislation.gov.uk/uksi/2014/894/contents/made.
[14] References in this statement of policy to the designation of a firm as an O-SII should be taken to include the designation of a group of firms at the highest level of consolidation in the UK.

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5 Draft amendments to the 'The PRA's approach to banking supervision'

In this appendix, new text is underlined and deleted text is struck through.

…

3 Identifying risks to our objectives

…

80. For all firms we determine a minimum regulatory capital level and buffers on top of this, as applicable, expressed in terms of the Basel and EU risk-weighted framework. The UK capital framework comprises four parts:

- …
- CRD ~~IV~~ buffers, as applicable – these comprise the capital conservation buffer and the countercyclical buffer, which are relevant to all firms. For globally systemically important institutions (G-SIIs), the G-SII buffer will also be relevant, and for domestic systemic firms the other systemically important institutions buffer (O-SII buffer) ~~systemic risk buffer~~ will be relevant. Where a firm is subject to both a G-SII buffer and an O-SII buffer ~~a systemic risk buffer~~ at the same consolidation level, the higher of the two requirements may apply.
- …

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6 Draft amendments to SS45/15 'The UK leverage ratio framework'

In this appendix, new text is underlined and deleted text is struck through.

…

2 Leverage Ratio Buffers

…

2.3 The global systemically important institution (G-SII) and other systemically important institution (O-SII) ~~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 an O-SII buffer ~~a SRB~~ on the same basis of consolidation, the higher of the two buffers shall apply for the purpose of calculating the ALRB.

…

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7 Draft amendments to SS16/16 'The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions'

In this appendix, new text is underlined and deleted text is struck through.

…

2 Buffers

…

Risk-weighted capital buffers

2.1 The PRA's capital buffer framework comprises the Capital Requirements Directive (EU Directive 2019/878 amending Directive 2013/36/EU) and Capital Requirements Regulation (Regulation (EU) 2019/876 amending Regulation (EU) 575/2013) (jointly CRD ~~I~~V) combined buffer (which includes the capital conservation buffer, the countercyclical capital buffer, the Global Systemically Important Institutions buffer (G-SII buffer) and the other systemically important institutions buffer (O-SII buffer) ~~systemic risk buffer~~ – if applicable to a firm) and the PRA buffer.

…

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8 Draft amendments to SS6/14 'Implementing CRD IV: Capital buffers'

In this appendix, new text is underlined and deleted text is struck through. Footnote references will be updated when the final policy is published.

Please note that the title of this SS would be changed to 'Implementing CRD: Capital buffers'.

Introduction

1.1 This supervisory statement is aimed at firms to which CRD ~~IV~~ applies.[1]

1.2 The purpose of this supervisory statement is to set out the expectations of the Prudential Regulation Authority (PRA) on CRD ~~IV~~ capital buffers and provide some clarifications of the PRA rules.[2] This statement complements the requirements set out in Title VII Chapter 4 of the CRD and the capital buffers rules[3] of the PRA Rulebook and the high-level expectations on capital outlined in The PRA's approach to banking supervision.[4]

2 Combined buffer

2.1 The combined buffer will include the capital conservation buffer (CCoB), the countercyclical capital buffer (CCyB), the buffer for Global Systemically Important Institutions (G-SII buffer), the buffer for other systemically important institutions (O-SII buffer) and the systemic risk buffer — if applicable to a firm, as required by CRD ~~IV~~. The frameworks for the ~~capital conservation buffer~~CCoB, the CCyB and capital conservation measures when a firm does not meet its combined buffer are set out in the PRA's capital buffers rules.

…

3 Capital conservation measures

3.1 Firms may use their combined buffer as required in times of stress, but should not use it in the normal course of business or propose to enter it as part of their base business plan. As set out in the PRA's capital buffers rules, firms that do not meet their combined buffer shall face restrictions on their distributions, and be subject to a maximum distributable amount (MDA).[5] The MDA must be calculated as the product of 60%, 40%, 20% or 0% (depending on which quartile of its combined buffer the firm is in)[6] and the sum of interim and year-end profits (as defined in Capital Buffers 4.3(5)), net of any distribution of profits or any payment resulting from ~~generated since the most recent decision on~~:

a) ~~the distribution of profits;~~

b) making a distribution in connection with Common Equity Tier 1 capital;

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[1] The Capital Requirements Regulation (Regulation (EU) 2019/876 amending Regulation (EU) 575/2013) (CRR) and Capital Requirements Directive (EU Directive 2019/878 amending Directive 2013/36/EU) (CRD V) jointly 'CRD V'.

[2] This supervisory statement instead does not address the PRA's expectations on the relationship between MREL and buffers, which are set out in PRA SS 16/16 - The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions.

[3] http://fshandbook.info/FS/html/PRA/D226.

[4] www.bankofengland.co.uk/pra/Pages/supervision/approach/default.aspx.

[5] Firms that do meet their combined buffer cannot make a distribution that will cause them to stop meeting it.

[6] Where firms are in the first quartile of their combined buffer (when they meet between 75% and 100% of it), 60% of such profits can be distributed. In the second quartile, 40% can be distributed; in the third quartile, 20%; and in the fourth quartile, 0%.

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c) ~~creating an~~ any obligation to pay variable remuneration or discretionary pension benefits or ~~pay~~ payment of variable remuneration or discretionary pension benefits ~~if the obligation to pay was created at a time when the institution failed to meet the combined buffer requirements~~; or

d) making payments on additional Tier 1 instruments.

Where these are available, the PRA expects firms to use verified interim (as well as year-end) profits for calculating the MDA. ~~The MDA shall be reduced by any of the actions described in (i) to (iv) above.~~

…

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9 Draft amendments to SS6/14 'Implementing CRD IV: Capital buffers' (2021)

In this appendix, new text is underlined and deleted text is struck through. Footnote references will be updated when the final policy is published.

Please note that the title of this SS would be changed to 'Implementing Capital buffers'.

Introduction

1.1 This supervisory statement is relevant to all PRA-regulated banks, building societies, and investment firms operating, or intending to operate, in the UK.~~aimed at firms to which CRD V applies.[21]~~

1.2 The purpose of this supervisory statement is to set out the expectations of the Prudential Regulation Authority (PRA) on ~~CRD V capital~~ the combined buffers and provide some clarifications of the PRA rules.[22] This statement complements the requirements set out in Title VII Chapter 4 of the CRD and the capital buffers rules[23] of the PRA Rulebook and the high-level expectations on capital outlined in The PRA's approach to banking supervision.[24]

2. Combined buffer

2.1 The combined buffer will include the capital conservation buffer (CCoB), the countercyclical capital buffer (CCyB), the buffer for global systemically important institutions (G-SII buffer), the buffer for other systemically important institutions (O-SII buffer) and the systemic risk buffer — if applicable to a firm, as required by CRD V. The frameworks for the CCoB, the CCyB and capital conservation measures when a firm does not meet its combined buffer are set out in the PRA's capital buffers rules.

…

3. Capital conservation measures

3.1 Firms may use their combined buffer as required in times of stress, but should not use it in the normal course of business or propose to enter it as part of their base business plan**.** As set out in the PRA's capital buffers rules, firms that do not meet their combined buffer shall face restrictions on their distributions, and be subject to a maximum distributable amount (MDA).[25] The MDA must be calculated as the product of 60%, 40%, 20% or 0% (depending on which quartile of its combined buffer the firm is in)[26] and the sum of the last four calendar quarter ~~interim and year-end~~ profits (as defined in Capital Buffers 4.3(5)), net of any distribution of profits or any payment resulting from:

a) making a distribution in connection with Common Equity Tier 1 capital;

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~~21~~

22 This supervisory statement instead does not address the PRA's expectations on the relationship between MREL and buffers, which are set out in SS 16/16,'The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions'.

23 http://fshandbook.info/FS/html/PRA/D226.

24 www.bankofengland.co.uk/pra/Pages/supervision/approach/default.aspx.

25 Firms that do meet their combined buffer cannot make a distribution that will cause them to stop meeting it.

26 Where firms are in the first quartile of their combined buffer (when they meet between 75% and 100% of it), 60% of such profits can be distributed. In the second quartile, 40% can be distributed; in the third quartile, 20%; and in the fourth quartile, 0%.

b) any obligation to pay variable remuneration or discretionary pension benefits or payment of variable remuneration or discretionary pension benefits; or

c) making payments on additional Tier 1 instruments.

Where these are available, the PRA expects firms to use verified ~~interim (as well as year-end)~~ profits for calculating the MDA.

3.2 This means that where the sum of the previous four quarters ~~interim and year-end~~ profits ~~since the above decisions~~ is zero or negative, a firm's MDA will be zero and it will not be able to make any distributions. This will be the case, for example, where a firm makes a loss that initially causes it to stop meeting its combined buffer.

3.2A Where a firm intends to make a distribution in connection with Common Equity Tier 1 capital that would decrease its Common Equity Tier 1 capital to a level where the combined buffer is no longer met, the firm should provide the PRA with appropriate advance notice of the proposed distribution and the reasons for it.

…

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10 Draft amendments to SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)'

In this appendix, new text is underlined and deleted text is struck through.

Please note that a number of sub-headings would be introduced to improve readability, due to the large number of paragraphs that would be inserted into Chapter 2.

…

2. Expectations of firms undertaking an ICAAP

…

IRRBB

2.7 All firms must have appropriate systems and processes, proportionate to the nature, scale, and complexity of their business, to identify, evaluate, and manage IRRBB.

2.7A The PRA expects a firm to include small trading book business as part of its identification, evaluation, and management of IRRBB unless its interest rate risk is captured in another risk measure.

Supervisory Actions

2.7B. A firm that, under Internal Capital Adequacy Assessment 9.4A, must immediately notify the PRA if its economic value of equity (EVE) would decline by more than 15% of its Common Equity Tier 1 capital as a result of the application of the interest rate scenarios in Internal Capital Adequacy Assessment 9.7, shall be considered an outlier firm. The PRA will review each outlier firm to determine whether the PRA considers that the firm has excessive IRRBB or inadequate management of IRRBB. The PRA may also conduct such a review for firms that are not outlier firms.

2.7C Where the review in 2.7B leads the PRA to consider that a firm's risk management of IRRBB is inadequate for the purposes of its obligations in the PRA Rulebook, or that the risk is excessive relative to the firm's capital or earnings, the PRA is likely to expect the firm to take one or more of the following actions:

(i) take steps to reduce its IRRBB exposures;

(ii) hold additional capital for its IRRBB;

(iii) implement constraints to internal risk parameters; or

(iv) make other corrective actions to address deficiencies in its models or risk management framework.

General Requirements on IRRBB

2.8 A firm's management body should oversee and approve the firm's risk appetite and framework for managing IRRBB. This framework should be consistent across consolidated and

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sub-consolidated entities. The risk appetite should be expressed in terms of the risk to economic value and the risk to earnings.

2.8A The systems and processes should allow the firm to:

(i) identify and quantify the major sources of IRRBB exposures;

(ii) retrieve accurate information in a timely manner;

(iii) compute economic value and earnings measures of IRRBB for different scenarios;

(iv) incorporate constraints specified by the PRA on the firm's internal risk parameter estimates;

(v) compare risk figures over different periods (eg by monitoring the impact of changes to the cash-flow slotting criteria);

(vi) assess all material cash flows from relevant interest rate sensitive instruments, including non-performing exposures (net of provisions), interest rate derivatives, and off-balance sheet items such as interest rate sensitive loan commitments;

(vii) measure the exposure and sensitivity of its activities, if material, to gap risk, yield curve risk, basis risk, and risks arising from embedded optionality (eg pipeline risk and prepayment risk), as well as changes in assumptions (eg those relating to customer behaviour);

(viii) consider whether a purely static analysis of the impact on its current portfolio of a given shock or shocks should be supplemented by a more dynamic simulation approach;

(ix) model scenarios in which different interest rate paths are computed and in which some of the assumptions (eg about behaviour, contribution to risk and balance sheet size and composition) are themselves functions of interest rate levels; and

(x) measure the exposure and sensitivity of its fair value exposures to changes in value resulting from yield curve and basis risk.

2.8B The PRA expects a firm to set and apply policy limits for IRRBB that are consistent with the firm's risk appetite. When setting policy limits, a firm should ensure that:

(i) policy limits are appropriate to the nature, size, complexity, and capital adequacy of the firm;

(ii) policy limits are reviewed at least annually; and

(iii) gap risk, basis risk, and positions with explicit and embedded options are considered in the setting of policy limits where the firm has significant exposures to these risks and positions.

2.8C The PRA expects a firm's management body to have the appropriate expertise to understand:

(i) the nature and the level of IRRBB;

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(ii) the implications of a firm's strategies for managing IRRBB, including the potential linkages with and impact on market, liquidity, credit, and operational risk; and

(iii) the most significant behavioural and modelling assumptions and their implications, including for hedging strategies.

2.8D A firm's management body may delegate the management and monitoring of IRRBB to senior management, the firm's Asset and Liability Committee, or to one or more individuals with sufficient expertise. The relevant delegate(s) should include members with clear lines of authority over the units responsible for establishing and managing positions.

2.8E A firm's management body should regularly review timely and sufficient information for assessing the performance of its delegates in monitoring and controlling IRRBB and credit spread risk in the non-trading book in accordance with its framework and its risk appetite.

2.8F A firm's management body or its delegates should establish and maintain an adequate risk management framework for IRRBB. The PRA expects that the framework should include measures to establish, apply, and maintain at least the following:

(i) appropriate limits on IRRBB;

(ii) procedures for ensuring compliance with the limits in (i);

(iii) an approvals process for exceptions from the limits in (i);

(iv) adequate systems, standards, and controls for measuring IRRBB;

(v) standards for measuring IRRBB, valuing positions, and measuring performance;

(vi) an appropriate reporting and review process for IRRBB;

(vii) adequate internal controls and management information systems for IRRBB;

(viii) an adequate approval process for approving major hedging or risk-taking initiatives prior to implementation;

(ix) appropriate governance processes for ensuring the adequacy of the models;

(x) a formal policy process for the validation of IRRBB measurement methods and assessment of corresponding model risk; and

(xi) a process to regularly measure IRRBB based on outcomes of economic value and earnings-based measures.

2.8G A firm's management body or its delegates should approve major hedging or risk-taking initiatives relating to IRRBB in advance of their implementation.

2.8H A firm should ensure that the functions responsible for identification, measurement, monitoring, and control of IRRBB are, where appropriate to its nature, size, and complexity as well as business activities and overall risk profile, sufficiently independent from risk-taking functions and report directly to the management body or its delegates.

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2.8I A firm should review and evaluate the effectiveness of its framework on a regular basis, and at least annually. Where appropriate to its nature, size, and complexity as well as business activities and overall risk profile, the reviews and evaluations should be carried out by individuals that are sufficiently independent of the individuals responsible for designing and implementing the framework.

2.8J A firm should have its framework reviewed by an independent internal auditing function on a regular basis.

Measurement of IRRBB

2.9 Moved to 2.11

2.9 A firm should ensure that the internal risk measurement system used to comply with the obligation in the PRA Rulebook captures all material sources of IRRBB exposures. If the PRA determines the internal risk measurement systems of a firm inadequate in risk capture or for other reasons, the firm should take such steps as the PRA may direct or require, including use of the standardised framework under Internal Capital Adequacy Assessment 9.13 when performing the evaluation under Internal Capital Adequacy Assessment 9.2 and 9.4A.

2.9A Under Internal Capital Adequacy Assessment 9.4A, a firm is required to calculate the impact of the change in interest rates described in Internal Capital Adequacy Assessment 9.7 on the economic value of equity of a firm's non-trading book activities. A firm should perform this calculation regularly, and at least quarterly. When performing the calculation, a firm should, where appropriate to its nature, size, and complexity, as well as business activities and overall risk profile, apply the following principles:

(i) the calculation should exclude the firm's own equity;

(ii) the change in EVE (ΔEVE) should be computed with the assumptions of a run-off balance sheet;

(iii) a maturity-dependent post-shock interest rate floor should be applied for each currency, starting with -100 basis points for immediate maturities, and increase by 5 basis points per year, eventually reaching 0% for maturities of 20 years and more (where the observed rates are lower than the current lower reference rate of -100 basis points, a firm should apply the lower observed rates);

(iv) when calculating the aggregate ΔEVE for each interest rate shock scenario, a firm should add together any negative and positive ΔEVE occurring in each currency, and any positive changes should be weighted by a factor of 50%;

(v) the automatic and behavioural options, including the assumptions identified in 2.9J, should be reflected in the calculation;

(vi) the assumed behavioural repricing date for retail and non-financial wholesale deposits without any specific repricing dates (non-maturing deposits) should be constrained to a maximum average of five years for each individual currency;

(vii) the calculation should include all cash flows from all interest rate-sensitive assets (assets which are not deducted from Common Equity Tier 1 capital and which exclude (i) fixed assets such as real estate or intangible assets as well as (ii) equity exposures in the non-

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trading book), liabilities, and off-balance sheet items in the non-trading book in the computation of their exposure; and

(viii) if commercial margins and other spread components are included in the cash flows calculated for measurement of IRRBB, the firm should also include commercial margins and other spread components in the rates used for discounting those cash flows.

2.9B Alongside the requirement to monitor and evaluate the potential impact of changes in interest rates on economic value, the PRA expects firms to monitor and evaluate the potential impact on earnings volatility. A firm should include in its evaluation:

(i) assessment based on an appropriate timeframe of three to five years;

(ii) the firm's forward-looking view of product volumes and pricing, based on its proposed business model during the scenario, and the projected path of interest rates;

(iii) careful consideration as to how any resulting volatility is managed;

(iv) consideration on the effects on its cash flow (ie interest income and expenses), and for large or more complex firms, the projected cash flow under different interest rate scenarios;

(v) consideration on the effects of the market value changes of interest rate sensitive instruments; and

(vi) careful consideration of how to manage any resulting volatility on its' earnings.

2.9C The models used to comply with the obligation in the PRA Rulebook should incorporate a wide and appropriately prudent range of interest rate shock and stress scenarios by currency. Those scenarios should include:

(i) interest rate shock scenarios selected by the firm reflecting its risk profile in accordance with Internal Capital Adequacy Assessment 9.2;

(ii) historical and hypothetical interest rate stress scenarios;

(iii) the interest rate shock scenarios in Internal Capital Adequacy Assessment 9.7; and

(iv) any additional interest rate shock scenarios required by the PRA.

2.9D For the range of interest rate shock scenarios, a firm should ensure:

(i) they encompass a wide range of severe and plausible interest rate shock scenarios relevant to the firm's material sources of IRRBB;

(ii) where relevant to the firm's own material sources of IRRBB, the scenarios consider gap risk, basis risk, and option risk (including sensitivity to interest rate movements), concentrated risks, and interaction with other risks;

(iii) the scenarios consider vulnerability to reduced economic value or earnings under stressful market conditions – including the breakdown of key assumptions;

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(iv) they assess the effect of adverse changes in the spreads of new assets/liabilities replacing those assets/liabilities maturing over the horizon of the forecast on its earnings-based measures; and

(v) the scenarios consider potential changes in the firm's non-trading book activities.

2.9E In addition to considering the range of interest rate shock scenarios in 2.9D for the purpose of ongoing management, a firm should also use other larger and more extreme shifts and changes in interest rates for testing vulnerabilities under stressed conditions.

2.9F Under Internal Capital Adequacy Assessment 9.12, a firm should determine the interest rate shock scenarios for material positions in currencies not listed in Internal Capital Adequacy Assessment 9.11 by considering:

(i) a sufficiently long time-series of daily 'risk-free' interest rates for each currency for relevant maturities;

(ii) the baseline global shock parameters on the average interest rate, which comprises: (i) 60% for parallel shocks; (ii) 85% for short rate shocks; and (iii) 40% for long rate shocks; and

(iii) a floor of 100 basis points and caps of: (i) 500 basis points for the short-term; (ii) 400 basis points for the parallel; and (iii) 300 basis points for the long-term interest rate shock scenario.

2.9G A firm should develop and implement an effective stress testing framework that:

(i) is commensurate with its nature, size, and complexity, as well as business activities and overall risk profile;

(ii) is performed regularly, at least annually, and more frequently in times of increased interest rate volatility and increased IRRBB levels;

(iii) where relevant, stress testing should incorporate the risks identified in 2.9D;

(iv) includes relevant qualitative and quantitative reverse stress tests in order to:

a. identify interest rate scenarios that could significantly threaten the firm's capital and earnings; and

b. reveal vulnerabilities arising from the firm's hedging strategies and the behavioural reactions of its customers.

2.9H A firm should reflect in its risk management framework how an instrument's actual maturity or repricing behaviour may vary from the instrument's contractual terms because of behavioural optionalities.

2.9I A firm should establish and maintain documentation setting out the key behavioural assumptions and modelling assumptions it uses in measuring IRRBB.

2.9J For the documentation of behavioural and modelling assumptions, a firm should set out:

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(i) expectations for the exercise of explicit and embedded interest rate options by both the firm and its clients under specific interest rate shock and stress scenarios;

(ii) treatment of balances and interest flows arising from non-maturity deposits;

(iii) the treatment of fixed rate loan commitments;

(iv) the treatment of fixed term deposits with risk of early redemption;

(v) treatment of own equity in economic value measures;

(vi) the implications of accounting practices for IRRBB; and

(vii) how the assumptions in 2.9I may affect the firm's hedging strategies.

2.9K A firm should review significant assumptions at least annually, and when market conditions change significantly. These assumptions should be aligned with the firm's business strategies.

2.9L For the assumptions identified in 2.9I, a firm with significant exposure to products with embedded customer optionality should consider and identify the following:

(i) the potential impact on current and future loan prepayment speeds arising from the interest rate scenario, underlying economic environment, and contractual features;

(ii) the responsiveness of product rates to changes in market interest rates; and

(iii) the migration of balances between product types as a result of changes in their features, terms, and conditions.

2.9M For the assumptions identified in 2.9I, a firm with significant exposure to products without specific repricing dates should consider and identify the following:

(i) the proportion of 'core' balances that are stable and unlikely to reprice even under significant changes in interest rate environment;

(ii) the depositor characteristics (eg retail/wholesale) and account characteristics (eg transactional/non-transactional);

(iii) the potential migration between deposits without specific repricing dates and other deposits that could modify, under different interest rate scenarios, key behavioural modelling assumptions;

(iv) the potential constraints on the repricing of retail deposits in a low or negative interest rate environment;

(v) ensure that assumptions about the decay of core and other modelled balances are prudent and appropriate in balancing the benefits to earnings against the additional economic value risk entailed in locking in a future interest rate return on the assets financed by these balances, and the potential forgone revenue under a rising interest rate environment; and

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(vi) the impact of the assumptions on the firm's own chosen risk measurement outputs and internal capital allocation decisions, including by periodically calculating sensitivity analyses on key parameters (eg percentage and maturity of core balances on accounts and pass-through rate) and the measures using contractual terms rather than behavioural assumptions to isolate the impact of assumptions on both economic value and earnings.

2.9N A firm should have assumptions which are conceptually sound and reasonable, and consistent with historical experience, and establish and apply a robust process for testing the validity of the assumptions. The testing process should include sensitivity analyses to monitor the impact of the assumptions on economic value and earnings-based measures.

2.9O Where a firm decides to adopt a policy intended to stabilise earnings arising from its own equity, it should:

(i) have an appropriate methodology for determining what elements of equity capital should be considered eligible for such treatment;

(ii) determine what would be a prudent investment maturity profile for the eligible equity capital that balances the benefits of income stabilisation arising from taking longer-dated fixed-return positions against the additional economic value sensitivity of those positions under an interest rate stress, and the risk of earnings underperformance should rates rise;

(iii) include appropriate documentation of these assumptions in its policies and procedures, and include a process for keeping them under review;

(iv) understand the impact of the chosen maturity profile on the firm's own chosen risk measurement outputs, including by regular calculation of the measures without inclusion of the equity capital to isolate the effects on both EVE and earnings perspectives; and

(v) undertake stress testing to understand the sensitivity of risk measures to changes in key assumptions for equity capital, taking the results of such tests into account in its IRRBB internal capital allocation decisions.

2.9P The data on which a firm's measurement systems and models for IRRBB are based should be sufficiently accurate and appropriately documented.

2.9Q A firm should set up appropriate processes to ensure that the data referred to in 2.9P is consistent with the data used for financial planning.

2.9R A firm should establish, maintain, and apply appropriate governance processes for ensuring the ongoing adequacy of the models. This includes ensuring models are subject to adequate controls and testing, including any data mapping, to provide assurance on the accuracy of their calculations. A firm should ensure that its internal audit function annually reviews the integrity and effectiveness of the risk management system and the model risk management process.

2.9S Prior to deployment, and on a regular basis, the model should be reviewed and validated independently of model development.

2.9T A firm should establish exception trigger events that require notification to the management body or its delegates under 2.8D in a timely manner if those events occur.

2.9U When using third-party models, a firm should:

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(i) document and explain model specification choices as part of the validation process;

(ii) ensure the models can be adequately customised to properly reflect the specific characteristics of the firm; and

(iii) determine if inputs to models that are provided by third parties are reasonable for its business and the risk characteristics of its activities.

2.10 Moved to 2.12.

2.10 The management body or its delegates should receive:

(i) the outcomes of the firm's measurement of IRRBB; and

(ii) reports on the level and trend of the firm's IRRBB. This should be at least quarterly, and more frequently for firms with greater or more complex risk profiles.

2.10A The reporting referred to in 2.10(ii) should be broken down by the appropriate levels of consolidation and currency, and include at least:

(i) summaries of the firm's aggregate exposures to IRRBB, including information on exposures to gap risk, basis risk, and option risk;

(ii) explanation of assets, liabilities, cash flows, and strategies that are driving the level and direction of the firm's IRRBB;

(iii) reports showing the extent of compliance of current exposures with policies and limits in 2.8A and 2.8B;

(iv) the key modelling assumptions, such as characteristics of non-maturity deposits, prepayments on fixed rate loans, early withdrawals of fixed term deposits, drawing of commitments, currency aggregation, and treatment of commercial margins;

(v) the results of stress tests and measurements from the scenarios referred to in 2.9C, including sensitivity analysis for key model assumptions and parameters;

(vi) the results of the calculation under Internal Capital Adequacy Assessment 9.4A;

(vii) comparisons of past forecasts or risk estimates with actual results to inform potential modelling shortcomings on a regular basis; and

(viii) identification of portfolios that may be subject to significant mark-to-market movements.

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2.11 Under Internal Capital Adequacy Assessment 13.1, a firm is required to make a written record of its assessments made under those rules. A firm's record of its approach to evaluating and managing interest rate risk as it affects the firm's non-trading book activities should cover the following issues as appropriate:

(i) the internal definition of the boundary between 'banking book' and 'trading activities';

(ii) the definition of economic value and its consistency with the method used to value assets and liabilities (eg discounted cash flows);

(iii) the size and the form of the different shocks to be used for internal calculations;

(iv) the use of a dynamic and/or static approach in the application of interest rate shocks;

(v) the treatment of commonly called 'pipeline transactions' (including any related hedging);

(vi) the aggregation of multi-currency interest rate exposures;

(vii) the inclusion (or not) of non-interest bearing assets and liabilities (including capital and reserves);

(viii) the treatment of current and savings accounts (ie the maturity attached to exposures without a contractual maturity);

(ix) the treatment of fixed-rate assets or liabilities where customers still have a right to repay or withdraw early;

(x) the extent to which sensitivities to small shocks can be scaled up on a linear basis without material loss of accuracy (ie covering both convexity generally and the non-linearity of pay-offs associated with explicit option products);

(xi) the degree of granularity employed (eg offsets within a time bucket);

(xii) whether all future cash flows or only principal balances are included;

(xiii) the results of the calculation under Internal Capital Adequacy Assessment 9.4A;

(xiv) the use of conditional or unconditional cash flow modelling approaches;

(xv) the internal definition of commercial margins and adequate methodology for internal treatment of commercial margins;

(xvi) the definition of earnings risk and its consistency with the method used for developing financial plans and financial forecasts;

(xvii) the size and tenor of internal limits on IRRBB, and whether these limits are reached at the point of capital calculation;

(xviii) the effectiveness and expected cost of hedging open positions that are intended to take advantage of internal expectations of the future level of interest rates;

(xix) the sensitivity of the internal measures of IRRBB to key modelling assumptions;

(xx) the impact of shock and stress scenarios on positions priced off different interest rate indices (basis risk);

(xxi) the impact on economic value and earnings of mismatched positions in different currencies;

(xxii) the impact of embedded losses;

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(xxiii) the distribution of capital relative to risks across legal entities that form part of a capital consolidation group, in addition to the adequacy of overall capital on a consolidated basis;

(xxiv) the drivers of the underlying risk; and

(xxv) the circumstances under which the risk might crystallise.

2.12 For building societies, interest rate risk should also be managed with reference to PRA Supervisory Statement SS20/15, 'Supervising building societies' treasury and lending activities'.[27] Only societies not on the administered or matched approach to financial risk management should incur any significant interest rate risk.

2.11 [Deleted] ~~In accordance with Internal Capital Adequacy Assessment 9.2, a firm should apply a 200 basis point shock in both directions to each major currency exposure. The PRA will periodically review whether the level of the shock is appropriate in light of changing circumstances, in particular the general level of interest rates (for instance, during periods of very low interest rates) and their volatility. The level of shock required may also be changed in accordance with guidelines issued by the European Banking Authority (EBA).11 A firm's internal systems should, therefore, be flexible enough to compute its sensitivity to any standardised shock that is prescribed.~~

2.12 Moved to 2.9B.

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5 The SREP

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5.16 Where the PRA sets a firm-specific Pillar 2A capital requirement it will generally specify an amount of capital (Pillar 2A) that the firm should hold at all times in addition to the capital it must hold to comply with the CRR (Pillar 1). It will usually do so by stating that the firm should hold capital of an amount equal to a specified percentage of the firm's Pillar 1 RWAs (the total risk exposure amount calculated in accordance with Article 92(3) of the CRR), plus one or more static add-on in relation to specific risks in accordance with the overall Pillar 2 rule in Internal Capital Adequacy Assessment 3.1. The PRA requires firms to meet Pillar 2A with at least 56.25% CET1 capital, no more than ~~44~~43.75% additional Tier 1 (AT1) capital and no more than 25% Tier 2. For these purposes, firms should follow the provisions on the definition of capital set out in the Definition of Capital Part of the PRA Rulebook and Supervisory Statement 7/13.[28]

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[27] PRA Supervisory Statement 20/15, 'Supervising building societies' treasury and lending activities', April 2015; https://www.bankofengland.co.uk/prudential-regulation/publication/2015/supervising-building-societies-treasury-and-lendingactivities-ss.

[28] PRA Supervisory Statement 7/13, 'CRD IV and capital', December 2013: https://www.bankofengland.co.uk/prudentialregulation/publication/2013/crdiv-and-capital-ss.

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11 Draft amendments to SS20/15 'Supervising building societies' treasury and lending activities'

In this appendix, new text is underlined and deleted text is struck through.

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4 Financial risk management

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Interest rate risk and structural risk management policy

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4.118 Societies are expected to inform their supervisors of all material changes to their policy, and provide a marked-up version of the policy statement on request. Supervisors will review interest rate risk and structural risk policies periodically, as part of their assessment against the guidance in this supervisory statement, and in accordance with the Internal Capital Adequacy Assessment (ICAA) Part of the PRA Rulebook and PRA Supervisory Statement SS31/15, 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)' ~~EBA/GL/2014/13 Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP)~~.

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12 Draft amendments to SS28/15 'Strengthening accountability in banking'

In this appendix, new text is underlined and deleted text is struck through.

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2 The Senior Managers Regime

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Minimum number of SMFs and proportionality

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2.6 Senior Management Functions 2.2 requires all banks, building societies and designated investment firms (Relevant CRR firms), all of which are in scope of the Capital Requirements Regulation,[7] to have separate individuals preapproved as Chief Executive (SMF1), Chief Finance (SMF2) and Chair of the Governing Body (SMF9) (referred to in this statement as 'mandatory SMFs'). This reflects the requirements in the ~~fourth~~ Capital Requirements Directive IV ~~(CRD IV)~~ as amended by the Capital Requirements Directive V (referred to in this statement as 'CRD')[8] and Markets in Financial Instruments Directive (MiFID II)[9] to have at least two individuals who effectively direct the business of a firm, and the restriction on combining the roles of Chair and Chief Executive in CRD ~~IV~~.

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Footnote 8 ~~Directive 2013/36/EU of the European Parliament and the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV); http://eurlex.europa.eu/legalcontent/EN/TXT/PDF/?uri=CELEX:32013L0036&from=EN , Article 13(1).~~ Directive (EU) 2019/878 of the European Parliament and the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers, and capital conservation measures; https://eur-lex.europa.eu/legal content/EN/TXT/PDF/?uri=CELEX:32019L0878&from=EN.

2.8 Conversely, larger firms are often subject to pre-existing legal or regulatory obligations which, in effect, require them to have certain SMFs. For instance, under CRD ~~IV~~, significant CRR firms must establish Risk, Nomination and Remuneration Committees.[11] The Chairs of these committees require preapproval as the relevant SMFs (SMFs11–13).

…

Table B

SMF	**Category of Relevant Firm**	**Required by**
Chief Risk (SMF4)	Banks, building societies and PRA-designated investment firms where proportionate	CRD ~~IV~~, Article 76(5). Risk Control 3.1.

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Head of Internal Audit (SMF5)	Banks, building societies and PRA-designated investment firms where proportionate	Article 16(5) MiFID II Compliance and Internal Audit 3.12
Chair of the Risk Committee (SMF10)	Banks, building societies and PRA-designated investment firms which are classed as 'significant' CRR firms.	CRD ~~IV~~, Article 76(3). Risk Control 3.1.
Chair of the Audit Committee (SMF11)	Banks, building societies and PRA- designated investment firms which have their securities admitted to trading on a regulated market and have to appoint a statutory auditor.	Disclosure and Transparency Rules [FCA], Rule 7.1.13
Chair of the Remuneration Committee (SMF12)	Banks, building societies and PRA-designated investment firms which are CRR firms with assets above £15 billion.	CRD ~~IV~~, Article 95(1) Remuneration 7.4.

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Independence requirements and banned combinations of SMFs

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Table E

SMF	**Restriction**	**Required by**
Chief Executive (SMF1) and Chair of the Governing Body (SMF9)	A firm must ensure that an individual who performs the Chair of the Governing Body Function on its behalf does not simultaneously perform the Chief Executive Function within the same firm.	CRD ~~IV~~, Article 88(1)(e). Senior Management Functions 7.2.
Chief Risk (SMF4)	Must be an independent senior manager with distinct responsibility for the risk management function. Where the nature, scale and complexity of the activities of the CRR firm do not justify a	CRD ~~IV~~, Article 76 (5). Risk Control 3.5.

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	specifically appointed person, another senior person within the firm may fulfil that function, provided there is no conflict of interest.	
Head of Internal Audit (SMF5)	Must be separate and independent from the other functions and activities of the firm.	Article 16(5) MiFID II Compliance and Internal Audit 3.18
Chair of the Risk Committee (SMF10)	Must not perform any executive function in the firm.	CRD ~~IV~~, Article 76(3). Risk Control 3.1.
Chair of the Remuneration Committee (SMF12)	Must not perform any executive function in the firm.	CRD ~~IV~~, Article 95(2) Remuneration 7.4(2).

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4 Assessing fitness and propriety

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Assessing the fitness and propriety of Notified NEDs

4.11 The United Kingdom is required under the following EU Directives and guidelines to ensure that all members of the management body of a Relevant Firm are fit and proper:

- CRD ~~IV~~ (Articles 13, 88 and 91);
- MiFID II (Article 9); and
- the EBA Suitability guidelines.

4.12 CRD ~~IV~~ requires ~~Member States to ensure~~ that firms have primary responsibility for ensuring board members of CRR firms are ‘at all times be of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties’. According to the EBA Suitability Guidelines, this includes ensuring the appointment of all board members is subject to a regulatory approval or notification process. The EBA Suitability Guidelines recognise that as members of the management body have specific roles, the assessment process and criteria can differ.

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4.15 The approach and criteria for assessing the fitness and propriety of Notified NEDs should, for the most part, be identical to that used to assess NEDs in scope of the SMR. Differences

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may, however, arise, where the specific responsibilities of a NED in scope of the SMR require specific expertise or skills.

4.15A Where the PRA has reasonable grounds to suspect that money laundering or terrorist financing has been committed or attempted, or there is increased risk thereof in connection with a firm, the PRA will assess the impact this has on the fitness and propriety of notified NEDs.

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5 Conduct rules and associated notification requirements

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Footnote 34 See also Article 91(1) of CRD~~IV~~.

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13 Draft amendments to SS15/13 'Groups'

In this appendix, new text is underlined and deleted text is struck through. Footnote references will be updated when the final policy is published.

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2 Approach to consolidation

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Application process

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2.3 Where a parent institution does not wish to ~~fully~~ proportionately consolidate its undertakings subject to CRR Article 18(5), it will be expected to make a formal application to the PRA. The application should seek to demonstrate how ~~fully~~ proportionately consolidating those undertakings is disproportionate to the risk carried by the firm.

2.3A CRR Article 18(7) permits the PRA to allow or require a firm to use a method other than the equity method for valuing certain holdings where specific criteria are met. Where a parent institution does not wish to apply the equity method, but instead wishes to use another valuation method, it will be expected to make a formal application. The application should seek to demonstrate how the criteria set out in Article 18(7) are met. The PRA may then be able to permit the use of a different method, such as the one used by the firm under its applicable accounting framework, where the relevant criteria are met. The PRA may also require a firm to use a different valuation method if it determines that the equity method is unduly burdensome or does not adequately reflect the risks of a holding.

2.3B CRR Article 18(8) permits the PRA to require the full or proportional consolidation of certain undertakings where an institution has a subsidiary or participation relationship with them and where there is 'substantial step-in risk'.[29] This is consistent with the Basel Committee's guidelines on the 'Identification and management of step-in risk'.[30] The PRA intends to exercise this power on a case-by-case basis where it assesses that there is evidence that such substantial step-in risk exists.

…

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29 Defined in CRR Article 18(8)(b) as, 'a substantial risk that the institution decides to provide financial support to that undertaking in stressed conditions, in the absence of, or in excess of any contractual obligations to provide such support.'
30 Basel Committee on Banking Supervision, 'Guidelines: Identification and management of step-in risk', October 2017: https://www.bis.org/bcbs/publ/d423.htm.