

**PRA RULEBOOK CRR FIRMS: – CAPITAL BUFFERS INSTRUMENT 2014**

**Powers exercised**

- A. The Prudential Regulation Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137G (The PRA’s general rules); and
  - (2) section 137T (General supplementary powers).
- B. The rule-making powers referred to above are specified for the purpose of section 138G (Rule-making instrument) of the Act.

**Pre-conditions to making**

- C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority (“FCA”), the PRA consulted the FCA. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

**PRA Rulebook CRR Firms: Capital Buffers Instrument 2014**

- D. The PRA makes the rules in Annex A and Annex B to this Instrument.

**Commencement**

- E. The rules in Annex A of this instrument come into force on 1 May 2014.
- F. The following rules in Annex B of this instrument come into force on 1 May 2014: Rules 1.1 to 1.3, 3.2, 4.1 to 4.5, 5.1 to 5.6.
- G. The following rules in Annex B of this instrument come into force on 1 January 2016: Rules 2.1; 2.2, 3.1.

**Citation**

- H. This instrument may be cited as the PRA Rulebook CRR Firms: Capital Buffers Instrument 2014.

By order of the Board of the Prudential Regulation Authority  
25 April 2014

**Annex A**

**PRA RULEBOOK – GLOSSARY**

In the Glossary Part of the PRA Rulebook insert the following new definition:

*credit institution*

has the meaning given in point (1) of Article 4(1) of the *CRR*.

## Annex B

In this Annex, the text is all new and is not underlined.

Part

# CAPITAL BUFFERS

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## 1 APPLICATION AND DEFINITIONS

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1.1 This Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

*capital conservation buffer*

means the amount of *common equity tier 1 capital* a *firm* must calculate in accordance with Chapter 2.

*combined buffer*

means the sum of

- (a) the *capital conservation buffer*, and
- (b) the *countercyclical capital buffer*.

*countercyclical buffer rate*

means (in accordance with point (7) of Article 128 of the *CRD*) the rate:

- (a) expressed as a percentage of *total risk exposure amount* set by the FPC or an *EEA countercyclical buffer authority*; or
- (b) expressed in terms equivalent to a percentage of *total risk exposure amount* set by a *third country countercyclical buffer authority*;

that a *firm* must apply in order to calculate its *countercyclical capital buffer*.

*countercyclical capital buffer*

means the amount of *common equity tier 1 capital* a *firm* must calculate in accordance with Chapter 3.

*distribution in connection with common equity tier 1 capital*

includes (in accordance with Article 141(10) of the *CRD*):

- (a) a payment of cash dividends;
- (b) a distribution of fully or partly paid bonus shares or other capital instruments referred to in Article 26(1)(a) of the *CRR*;
- (c) a redemption or purchase by an institution of its own shares or other capital instruments referred to in Article 26(1)(a) of the *CRR*;
- (d) a repayment of amounts paid up in connection with capital instruments referred to in Article 26(1)(a) of the *CRR*; and
- (e) a distribution of items referred to in points (b) to (e) of article 26(1) of the *CRR*

*EEA countercyclical buffer authority*

means the authority or body of an *EEA State* other than the *UK* designated for the purpose of Article 136 of the *CRD* with responsibility for setting the *countercyclical buffer rate* for that *EEA State* or the European Central Bank when it carries out the

task of setting a countercyclical buffer rate for an *EEA State* conferred on it by Article 5(2) of Council Regulation (EU) No. 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

*FPC*

means the *Financial Policy Committee*

*MDA*

means maximum distributable amount calculated in accordance with 4.3(4).

*parent financial holding company in a Member State*

means (in accordance with point (26) of Article 3(1) of the *CRD*) a *financial holding company* which is not itself a *subsidiary* of an *institution* authorised in the same *EEA State*, or of a *financial holding company* or *mixed financial holding company* set up in the same *EEA State*.

*parent institution in a Member State*

means (in accordance with point (24) of Article 3(1) of the *CRD*) an *institution* authorised in an *EEA State* which has an *institution* or *financial institution* as *subsidiary* or which holds a *participation* in such an *institution* or *financial institution*, and which is not itself a *subsidiary* of another *institution* authorised in the same *EEA State* or of a *financial holding company* or *mixed financial holding company* set up in the same *EEA State*.

*parent mixed financial holding company in a Member State*

means (in accordance with point (28) of Article 3(1) of the *CRD*) a *mixed financial holding company* which is not itself a *subsidiary* of an *institution* authorised in the same *EEA State*, or of a *financial holding company* or *mixed financial holding company* set up in the same *EEA State*.

*relevant credit exposures*

means (in accordance with Article 140(4) of the *CRD*) exposures other than those referred to in points (a) to (f) of Article 112 of the *CRR* that are subject to:

- (a) the *own funds* requirements for credit risk under Part Three, Title II of the *CRR*; or
- (b) where the exposure is held in the *trading book*, *own funds* requirements for specific risk under Part Three, Title IV, Chapter 2 of the *CRR* or incremental default and migration risk under Part Three, Title IV, Chapter 5 of the *CRR*; or
- (c) where the exposure is a *securitisation*, the *own funds* requirements under Part Three, Title II, Chapter 5 of the *CRR*.

*third country countercyclical buffer authority*

means the authority of a *third country* empowered by law or regulation with responsibility for setting the *countercyclical buffer rate* for that *third country*.

*total risk exposure amount*

means the total risk exposure amount of a *firm* calculated in accordance with Article 92(3) of the *CRR*.

- 1.3 Unless otherwise defined, any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*.

## 2 CAPITAL CONSERVATION BUFFER

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- 2.1 A *firm* must calculate a *capital conservation buffer of common equity tier 1 capital* equal to 2.5% of its *total risk exposure amount*.

**[Note: Art 129(1) (part) of the CRD]**

- 2.2 This rule modifies 2.1 for a transitional period between 1 January 2016 and 31 December 2018:

- (1) from 1 January 2016 until 31 December 2016 for 2.5% there is substituted 0.625%;
- (2) from 1 January 2017 until 31 December 2017 for 2.5% there is substituted 1.25%; and
- (3) from 1 January 2018 until 31 December 2018 for 2.5% there is substituted 1.875%.

**[Note: Art 160(1) to (5) (part) of the CRD]**

## 3 COUNTERCYCLICAL CAPITAL BUFFER

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Calculation of the countercyclical capital buffer

- 3.1 (1) A *firm* must calculate a *countercyclical capital buffer of common equity tier 1 capital* equal to its *total risk exposure amount* multiplied by the weighted average of the *countercyclical buffer rates* that apply to exposures in the jurisdictions where the *firm's relevant credit exposures* are located.

**[Note: Art 130(1) (part) of the CRD]**

- (2) In order to calculate the weighted average referred to in (1), a *firm* must apply to each applicable *countercyclical buffer rate* its total *own funds* requirements for credit risk, specific risk, incremental default and migration risk that relates to *the relevant credit exposures* in the jurisdiction in question, divided by its total *own funds* requirements for credit risk, specific risk, incremental default and migration risk that relates to all of its *relevant credit exposures*.
- (3) For the purposes of (2), a *firm* must calculate its total *own funds* requirement for credit risk, specific risk, incremental default and migration risk in accordance with Part Three, Titles II and IV of the *CRR*.
- (4) The *countercyclical buffer rate* for an exposure located in the *UK* is the rate set by the *FPC* for the *UK*.
- (5) The *countercyclical buffer rate* for an exposure located in an *EEA State* other than the *UK* is:
  - (a) the rate set by the *EEA countercyclical buffer authority* for that jurisdiction; or

- (b) if that rate exceeds 2.5% and has not been recognised by the *FPC*, 2.5%.
- (6) The *countercyclical buffer rate* for an exposure located in a *third country* is the rate set by the *FPC* for that jurisdiction.
- (7) If the *FPC* has not set a rate for a *third country*, the *countercyclical buffer rate* for an exposure located in that jurisdiction is:
  - (a) the rate set by the *third country countercyclical buffer authority* for that jurisdiction; or
  - (b) if that rate exceeds 2.5% and has not been recognised by the *FPC*, 2.5%.
- (8) If the *FPC* has not set a rate for a *third country* and either there is no *third country countercyclical buffer authority* for that country or the authority has not set a rate for that jurisdiction, the *countercyclical buffer rate* for an exposure located in that jurisdiction is zero.
- (9) If the rate for the *UK* is increased, that increase takes effect from the date specified by the *FPC*.
- (10) If the rate for an *EEA State* other than the *UK* is increased, subject to (5)(b) that increase takes effect from:
  - (a) the date specified by the *EEA countercyclical buffer authority* for that jurisdiction, if the rate applied under this Chapter does not exceed 2.5%;
  - (b) the date specified by the *FPC* if the rate applied under this Chapter exceeds 2.5%.
- (11) If the rate for a *third country* is increased by the *FPC*, that increase takes effect from the date specified by the *FPC*.
- (12) If the *FPC* does not set a rate for a *third country* and the rate for that *third country* is increased by the *third country countercyclical buffer authority* for that jurisdiction, subject to (7)(b) that increase takes effect from:
  - (a) the date 12 months after the date on which the increase was published by the *third country countercyclical buffer authority* in accordance with the relevant law the *third country*, if the rate applied under this Chapter does not exceed 2.5%;
  - (b) the date specified by the *FPC* if the rate applied under this Chapter exceeds 2.5%.
- (13) If a rate is reduced, that reduction takes effect immediately.

**[Note: Art 140 of the CRD.]**

3.2 This rule applies until 31 December 2015

- (1) A *firm* must calculate a *countercyclical capital buffer of common equity tier 1 capital* equal to its *total risk exposure amount* multiplied by the weighted average of the *countercyclical buffer rates* that apply in the jurisdictions where the *firm's relevant credit exposures* are located.
- (2) In order to calculate the weighted average referred to in (1), a *firm* must apply to each applicable *countercyclical buffer rate* its total *own funds* requirements for credit risk, specific risk, incremental default and migration risk that relates to the *relevant credit exposures* in the jurisdiction in question, divided by its total *own funds* requirements for credit risk that relates to all of its *relevant credit exposures*.
- (3) For the purposes of (2), *firm* must calculate its total *own funds* requirement for credit risk, specific risk, incremental default and migration risk in accordance with Part Three, Titles II and IV of the *CRR*.

- (4) The *countercyclical buffer rate* for an exposure is the rate recognised or set by the *FPC* for the jurisdiction in which that exposure is located.
- (5) If the *FPC* does not recognise or set a rate for the jurisdiction in which an exposure is located, the *countercyclical buffer rate* for that exposure is zero.
- (6) If the rate recognised or set by the *FPC* for a jurisdiction is increased, that increase takes effect from the date specified by the *FPC*.
- (7) If a rate is reduced, that reduction takes effect immediately.

**[Note: Art 160(6) (part) of the CRD]**

#### 4 CAPITAL CONSERVATION MEASURES

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##### Combined buffer

- 4.1 A *firm* does not meet the *combined buffer* if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under Article 92(1)(c) of the *CRR* does not meet the *combined buffer*.

**[Note: Art 129(5) (part) and 130(5) (part) of the CRD]**

##### Restrictions on distributions

- 4.2 A *firm* that meets the *combined buffer* must not make a *distribution in connection with common equity tier 1 capital* to an extent that would decrease its *common equity tier 1 capital* to a level where the *combined buffer* is no longer met.

**[Note: Art 141(1) of the CRD]**

- 4.3 (1) A *firm* that does not meet the *combined buffer* must:
  - (a) calculate the *MDA* in accordance with (4); and
  - (b) report the *MDA* to the *PRA* in writing no later than 5 working days after the *firm* identified that it did not meet the *combined buffer*.
- (2) A *firm* that does not meet the *combined buffer* must not undertake any of the following actions before it has calculated the *MDA*:
  - (a) make a *distribution in connection with common equity tier 1 capital*;
  - (b) create an obligation to pay variable remuneration or *discretionary pension benefits* or pay variable remuneration or *discretionary pension benefits* if the obligation to pay was created at a time when the *firm* did not meet the *combined buffer*; and
  - (c) make payments on *additional tier 1 instruments*.
- (3) If a *firm* does not meet the *combined buffer*, it must not distribute more than the *MDA* calculated in accordance with (4) through any action referred to in points (a) to (c) of (2).
- (4) A *firm* must calculate the *MDA* by multiplying the sum calculated in accordance with (5) by the factor determined in accordance with (6). The *MDA* shall be reduced by any of the actions referred to in point (a), (b) or (c) of (2)..
- (5) The sum to be multiplied in accordance with (4) shall consist of:



- (a) interim profits not included in *common equity tier 1 capital* pursuant to Article 26(2) of the *CRR* that have been generated since the most recent decision on the distribution of profits or any of the actions referred to in points (a), (b) or (c) of (2);
  - plus
  - (b) year-end profits not included in *common equity tier 1 capital* pursuant to Article 26(2) of the *CRR* that have been generated since the most recent decision on the distribution of profits or any of the actions referred to in points (a), (b) or (c) of (2);
  - minus
  - (c) amounts which would be payable by tax if the items specified in points (a) and (b) were to be retained.
- (6) The factor referred to in (4) shall be determined as follows:
- (a) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under Article 92(1)(c) of the *CRR* expressed as a percentage of the *firm's total risk exposure amount*, is within the first (that is, the lowest) quartile of the *combined buffer*, the factor shall be 0;
  - (b) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under Article 92(1)(c) of the *CRR*, expressed as a percentage of the *firm's total risk exposure amount*, is within the second quartile of the *combined buffer*, the factor shall be 0.2;
  - (c) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under Article 92(1)(c) of the *CRR* expressed as a percentage of the *firm's total risk exposure amount* is within the third quartile of the *combined buffer*, the factor shall be 0.4; and
  - (d) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under Article 92(1)(c) of the *CRR* expressed as a percentage of the *firm's total risk exposure amount*, is within the fourth (that is, the highest) quartile of the *combined buffer*, the factor shall be 0.6.

(7) A *firm* must calculate the lower and upper bounds of each quartile of the *combined buffer* as follows:

Lower bound of quartile

$$= \frac{\text{Combined buffer}}{4} \times (Q_n - 1)$$

Upper bound of quartile

$$= \frac{\text{Combined buffer}}{4} \times Q_n$$

"Qn" indicates the ordinal number of the quartile concerned.

- (8) The restrictions imposed by this rule only apply to payments that result in a reduction of *common equity tier 1 capital* or in a reduction of profits, and where a suspension of payment or failure to pay does not constitute an event of default or a condition for the commencement of proceedings for an order for the appointment of a liquidator or administrator of the *firm*.
- (9) If a *firm* does not meet the *combined buffer* and intends to distribute any of its distributable profits or undertake an action referred to in points (a), (b) and (c) of (2) it must give the *PRA* notice of its intention at least one month before the intended date of distribution or action

unless there are exceptional circumstances which make it impracticable to give such a period of notice in which event the firm must give as much notice as is practicable in those circumstances. When giving notice a *firm* must provide the following information:

- (a) the amount of *own funds* maintained by the *firm*, subdivided as follows:
  - (i) *common equity tier 1 capital*;
  - (ii) *additional tier 1 capital*; and
  - (iii) *tier 2 capital*.
- (b) the amount of its interim and year-end profits;
- (c) the *MDA* calculated in accordance with (4);
- (d) the amount of distributable profits it intends to allocate between the following:
  - (i) dividend payments;
  - (ii) share buybacks;
  - (iii) payments on *additional tier 1 instruments*; and
  - (iv) the payment of variable remuneration or *discretionary pension benefits*, whether by creation of a new obligation to pay, or payment pursuant to an obligation to pay created at a time when the *firm* did not meet its *combined buffer*.

(10)A *firm* must maintain arrangements to ensure that the amount of distributable profits and the *MDA* are calculated accurately and must be able to demonstrate that accuracy to the *PRA* on request.

**[Note: Art 141(2) to 141(10) of the CRD]**

Capital conservation plan

4.4 When a *firm* does not meet the *combined buffer*, it must prepare a capital conservation plan and submit it to the *PRA* no later than 5 working days after the *firm* identified that it did not meet the *combined buffer*.

**[Note: Art 142(1) of the CRD]**

4.5 The capital conservation plan must include the following:

- (1) the *MDA*;
- (2) estimates of income and expenditure and a forecast balance sheet;
- (3) measures to increase the capital ratios of the *firm*; and
- (4) a plan and timeframe for the increase of *own funds* with the objective of meeting the *combined buffer*.

**[Note: Art 142(2) of the CRD]**

## 5 APPLICATION ON AN INDIVIDUAL AND CONSOLIDATED BASIS

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### Application on an individual basis

- 5.1 This Part applies to a *firm* on an individual basis whether or not it also applies to the *firm* on a *consolidated basis* or *sub-consolidated basis*.

### Application on a consolidated basis

- 5.2 A *firm* which is a *parent institution in a Member State* must comply with this Part on the basis of its *consolidated situation*.
- 5.3 A *UK bank* or *building society* controlled by a *parent financial holding company in a Member State* or a *parent mixed financial holding company in a Member State* must comply with this Part on the basis of the *consolidated situation* of that holding company, if the *PRA* is responsible for supervision of the *UK bank* or *building society* on a *consolidated basis* under Article 111 of the *CRD*.
- 5.4 A *UK designated investment firm* controlled by a *parent financial holding company in a Member State* or a *parent mixed financial holding company in a Member State* must comply with this Part on the basis of the *consolidated situation* of that holding company, if:
- (1) there is no *subsidiary* of the holding company which is a *credit institution*; and
  - (2) the *PRA* is responsible for the supervision of the *UK designated investment firm* on a *consolidated basis* under Article 111 of the *CRD*.

### Sub-consolidation in cases of entities in third countries

- 5.5 A *firm* that is a *subsidiary* must apply this Part on a *sub-consolidated basis* if the *firm*, or the *parent undertaking* where it is a *financial holding company* or *mixed financial holding company*, have an *institution* or *financial institution* as a *subsidiary* in a *third country* or hold a *participation* in such an *institution* or *financial institution*.

### Extent and manner of prudential consolidation

- 5.6 If this Part applies to a *firm* on a *consolidated basis* or on a *sub-consolidated basis*, the *firm* must carry out consolidation to the extent and in the manner prescribed in Articles 18(1), 18(8), 19(1), 19(3), 23 and 24(1) of the *CRR* and Groups 2.1-2.3.

**[Note: Art 129(1) (part) and 130(1) (part) of the *CRD*]**