

Implementation of Capital Requirements Directive V

BSA response to PRA CP 12/20

30 September 2020

Introduction

The BSA is pleased to respond briefly to the PRA's CP on issues relevant to our members. In this response we address only the proposals in Chapters 2 (Pillar 2), 3 (Remuneration) and some of 5 (Governance). Chapters 4 (IPU's) and 6 (3rd country branch reporting) do not affect our members. We note that more significant changes derived from CRD V, more of which will affect our members, are to be consulted on (see paragraph 1.8) in an "autumn consultation" to which we look forward.

General comments

In broad terms we support the PRA's proposals, though we challenge PRA to go further, whether now or subsequently, on both proportionality and de-duplication of reporting, and to be more ambitious. We are happy to accept these proposals as a first instalment on both counts.

We also agree that the PRA should not implement (see paragraph 1.5) those parts of CRD V that do not require compliance until after the end of the Brexit transitional period.

Pillar 2

Proportionality

We welcome the increased emphasis in CRD V on proportionality in SREP processes : new Article 97 (4) requires the authorities to "***apply the principle of proportionality***" in accordance with the criteria now to be disclosed. While the CP does mention a few instances where proportionality is, or is to be, used, we form the impression that there is a missed opportunity here. We call on PRA to be much more ambitious in simplifying and streamlining the SREP for small, non-complex banks and building societies.

Tailored methodologies

We see another missed opportunity here. The SREP for non-systemic building societies, and *a fortiori* for small and non-complex building societies, could benefit from a tailored methodology, given the high degree of similarity in their risk profiles and business models.

Pillar 2A

We welcome the removal of systemic or macroprudential risk as a component of Pillar 2A as this is, and should be, covered elsewhere and double counting must be avoided.

Pillar 2B

The issues around UK consolidation groups or RFB subgroups do not affect our members.

Pillar 2 for leverage

We support the PRA's decision not to set a Pillar 2R element for leverage : the Pillar 1 leverage ratio (unlike the precisely- calibrated risk-based capital requirement) is only intended to be a “back-stop” or “guard-rail” and does not require the bogus precision of an attempted Pillar 2R add-on.

Duplicative reporting

The BSA warmly welcomes the CRD V provisions against unnecessary, and duplicative reporting. The CRD V text deserves to be quoted in full (see text box on next page, emphasis added) to appreciate its ambition in reducing supervisory burdens. Here again, we think PRA needs to be more ambitious in implementation.

We have no difficulty in agreeing that the duplications mentioned by PRA in the CP should be removed. But we cannot yet say whether PRA will have eliminated all the duplications now being prohibited by CRD V – to do that is probably a more extensive exercise. We mention one general category below. However, we appreciate that for various reasons time is short to implement these parts of CRD V, and would be content to accept these de-duplications as a first instalment toward fuller compliance with Article 104.

“.....competent authorities may only impose additional or more frequent reporting requirements on institutions where the relevant requirement is appropriate and proportionate with regard to the purpose for which the information is required and the information requested is not duplicative.

*For the purposes of Articles 97 to 102, any additional information that may be required from institutions shall be deemed as duplicative where **the same or substantially the same information has already been otherwise reported to the competent authority or may be produced by the competent authority.***

The competent authority shall not require an institution to report additional information where it has previously received it in a different format or level of granularity and that different format or granularity does not prevent the competent authority from producing information of the same quality and reliability as that produced on the basis of the additional information that would be otherwise reported.” (new Article 104 .2)

Since the PRA (as competent authority) is now simply an aspect of the Bank of England, and is no longer a separate body, the scope of Article 104 is necessarily much wider. The extensive and detailed information routinely reported to the Bank by monetary sector institutions is either “reported to the competent authority” or at the very least “may be produced by the competent authority”. This is, surely, a natural consequence of the “One Bank” strategy¹ introduced in 2014 :

*The Plan, to be implemented over the next three years, provides an ambitious agenda to transform the institution to take full advantage of the Bank’s expanded policy responsibilities. It will create a **single, unified institution – One Bank** – that will maximise its impact by working together across all its functions.*

PRA therefore also needs to test its current reporting requirements not only on internal duplication among prudential returns, but also for possible duplication with substantially the same information collected by other areas of the Bank.

¹<https://www.bankofengland.co.uk/news/2014/march/boe-launches-strategic-plan>

The restrictions in Article 104 surely apply not only to regular returns, but also to ad hoc information requests : so, PRA will in future be obligated to show reasonable diligence in meeting its information needs from substantially the same information already held (even if in differing format or granularity) before requesting anything from a society.

Although the PRA's work on proportionality is not currently addressing reporting, a BSA taskforce is doing so, and will be happy to share in due course its conclusions on duplicative reporting with regulators.

Remuneration

Building societies do not have the culture of very high remuneration, that is characteristic of some other parts of the financial services sector, nor do their remuneration structures encourage excessive risk-taking. The current PRA proportionality provisions have been helpful in ensuring requirements that are largely irrelevant to building societies do not apply to the generality of the building society sector. Reducing the threshold to €5bn would have the effect of imposing unnecessary additional requirements on some mid-sized societies. Accordingly, we welcome the UK regulators' proposal to take advantage of the flexibility available under CRD V to increase the threshold to €15bn for firms that meet certain criteria. We think building societies will be able to satisfy these criteria, so that most societies will continue to be exempt from applying the rules on deferral, pay-out in retained shares or other instruments, and holding and retention periods for discretionary pension benefits.

We note that the proportionality threshold for individuals will be reduced under CRD V. The new thresholds are annual variable remuneration of no more than one-third of total remuneration, and annual variable remuneration not exceeding €50,000 (£44,000). This change will bring more individuals into scope of the remuneration rules on retained shares or other instruments, deferral, performance adjustment and the bonus cap : FCA's cost benefit analysis indicates that 760 new individuals at level one banks will be in scope. We think a few individuals at building societies are also likely to be affected, including some at smaller societies, ie those below the €15bn threshold. We fear the impact of this will be disproportionate, representing a dramatic departure from the current criteria of total remuneration threshold of £500,000 and the cap of 33% on variable remuneration. A reduction in the variable remuneration cap to €50,000 would undermine the proportionality judgements being made elsewhere, create complexity and change the balance further away from variable pay towards fixed.

For the building societies affected, this would necessitate the introduction of schemes of significant complexity for very few (in some societies just one or two, in others a handful) staff on relatively modest remuneration. By way of illustration, an employee on a salary of £220-250k with a 20% maximum bonus would be captured. Faced with a requirement to introduce and administer a scheme for deferral for 5 years and clawback for 6 years for such small amounts (circa c£25k after tax) where the running costs may well outweigh the size of the bonuses, some of our members are indicating they would likely react by increasing base pay and reducing bonuses. This is not a move they would take lightly, as it would reduce alignment between the interests of their members (variable pay being awarded only when value is demonstrably delivered) and senior management. But that is where the CRD-V requirement is likely to drive them. As such, we would urge that the UK authorities take the earliest opportunity – ie the end of the transition period - to reinstate the

current criteria of total remuneration threshold of £500,000 and the cap of 33% on variable remuneration.

Governance

Outsourcing – operational risk

We note the proposals to implement the CRD V requirement to implement policies and processes to evaluate and manage exposures to operational risk arising from outsourcing. We expect that this will have no practical effect on building societies given the fact that the EBA guidelines on outsourcing took effect in September 2019 and the PRA's supervisory statement on outsourcing and third party risk management is currently under consultation.

Loans to board members

We note that PRA is proposing to implement the CRD V requirements for data on loans to members of the management body and their related parties to be documented and made available to PRA on request. Given that similar requirements already exist for building societies, under Section 68 of the Building Societies Act 1986, we assume that the new requirements will not entail change to current practice for societies.

Verification of fitness and propriety

We note that PRA is proposing to amend Supervisory Statement 28/15 to make clear its existing approach to assessing fitness and propriety of a firm's management body in regard to suspicions that money laundering or terrorist financing (MLTF) is being or has been committed or attempted; or there is an increased risk of MLTF; is already consistent with CRD V.

Independence of mind

We welcome PRA's proposal to amend the General Organisational Requirements (GOR) part of its Rulebook to reflect the clarification in CRD V that individuals' membership of the management body of a company or entity that is affiliated to a PRA-authorized firm does not prevent such individuals from acting with independence of mind as a member of the management body of the PRA-authorized firm.

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We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £420 billion, and account for 23% of the UK mortgage market and 19% of the UK savings market.