Pillar 2A capital requirements and disclosure

BSA Response to PRA CP 12/17

9 October 2017

Building Societies Association

Summary

We welcome the opportunity to respond briefly to PRA's CP 12/17. We are content with the move from ICG to a formal P2A requirement set under section 55 of FSMA. The approach to solo Pillar 2A requirements looks reasonable. But we think PRA has not adequately made the case for, in effect, attempting to mandate disclosure of the TCR by all banks and building societies. We explain the detail below.

Detail

The move from setting Pillar 2A by way of individual capital guidance to a more formal route of a "requirement" is more of form than of substance. Our members already treat the Pillar 2A ICG as equivalent to a requirement. So the formalisation of this does not, of itself, raise any concerns.

The question of disclosure is, however, more complex, and we are not clear there is sufficient justification for rolling out compulsory disclosure of the TCR to smaller building societies and banks. It is, moreover, instructive to review the reversal over time in the FSA/PRA's stance on Pillar 2 disclosure, and ask the reasons why.

When Pillar 2 was introduced as an aspect of the Basel 2 framework, given effect by the old CRD and FSA/ PRA's implementing rules, the original consensus was against general disclosure of Pillar 2. But some of the large banks departed from this consensus, either because they felt it competitively advantageous to disclose their favourable Pillar 2 figures, or they considered the disclosure obligations they were under required this, or both. Accordingly, the FSA/PRA's policy mutated to the present position that banks and building societies **may** publicly disclose their total ICG (but **not** the make-up of Pillar 2A), but are **not** obliged to do so. PRA now proposes in effect to require all such firms to disclose their TCR (= Pillar 1 plus Pillar 2A) whether or not this would otherwise be required under their individual disclosure regimes, in order to avoid "market instability or speculation generated by different levels of disclosure". As regards in particular medium and smaller building societies, the BSA is not aware that any such market instability or speculation exists or is ever likely to arise. Consequently, we see no need to change the present stance, so that disclosure of TCR would be permissive but not mandatory. (We note in passing that in the contemporaneous CP 13/17 regarding Pillar 2 Liquidity, PRA still adheres - see section 7 of draft SS 24/15 (revised) - to its original stance against Pillar 2 disclosure, and for good reason.)

We identify three possible sources of disclosure obligations – accounting standards (currently IFRS or UK GAAP); "Pillar 3" requirements under CRR / CRD ; and listing requirements – and these do not apply uniformly to all banks and building societies. Moreover, we consider the benefits of "transparency" under Pillar 3 to have been greatly over-rated – indeed it is now accepted that the full Pillar 3 requirements create an unnecessary burden for smaller, unlisted institutions, as hardly anybody ever reads the output. So much so that even the EU now proposes in its CRR2 amendments to reduce the scale of Pillar 3 disclosures for smaller credit institutions.

We also point out that, since under CRR disclosure of capital-related matters is now part of the single rule book, and an area of exclusive EU competence, the PRA cannot (at least until Brexit) automatically gold-plate the requirements in CRR Part Eight (Disclosure by Institutions) – but

the CP does not attempt to explain how the PRA's proposed policy is compatible with CRR. The key provisions are in Article 438, in particular Article 438 (b). We presume the PRA is intending to rely on the national discretion (which appears designed for use in individual cases, rather than by way of general policy) in Article 438 (b) – at least until Brexit ?

We suspect there are two principal sources of the pressure to disclose Pillar 2A. First, for some time credit rating agencies will have wanted to get hold of this information. This can be catered for under the existing policy of permissive disclosure. Second, since the Basel 3 changes implemented by CRR / CRD, the quantum of Pillar 2A affects the starting point for the various CRD capital buffers, and therefore the "maximum distributable amount" relevant to payments on capital instruments under CRD Article 141. So investors in those capital instruments wish to know the quantum of Pillar 2A in order to assess the probability that their dividends or coupons will be paid in full or reduced or stopped entirely under stress circumstances. Again, this need can be met under the existing policy.

We also note the (end 2015) Opinion[1] of the EBA on these matters, which relates the desirability of consistent disclosure under Article 438(b) explicitly to the MDA question:

24. Competent authorities should consider using the provisions of Article 438(b) of the CRR to require institutions to disclose MDA-relevant capital requirements (e.g. the TSCR and the corresponding minimum CET1 capital) as determined in accordance with Title 7 of the SREP Guidelines, or should at least not prevent or dissuade any institution from disclosing this information.

But for firms such as medium and small building societies that have, generally, neither credit ratings, nor any capital instruments on which distributions can be made, mandating disclosure of TCR seems unnecessary. Contrary, therefore, to paragraph 3.17 of the CP, the impact on mutuals will be somewhat different from the impact on banks that are listed proprietary companies. If the PRA remains minded to impose TCR disclosure under Article 438(b) we consider this should on proportionality grounds be limited either, say, to impact category 1 and category 2 firms only, and/or to firms that have capital instruments outstanding that are affected by MDA. We also suggest that in paragraph 5.37 of the revised SS 31/15 – line 3 (and perhaps elsewhere) – "publically" might be corrected to "publicly".

[1] http://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-24+Opinion+on+MDA.pdf

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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 £345 billion, and account for approximately 20% of both the UK mortgage and savings markets