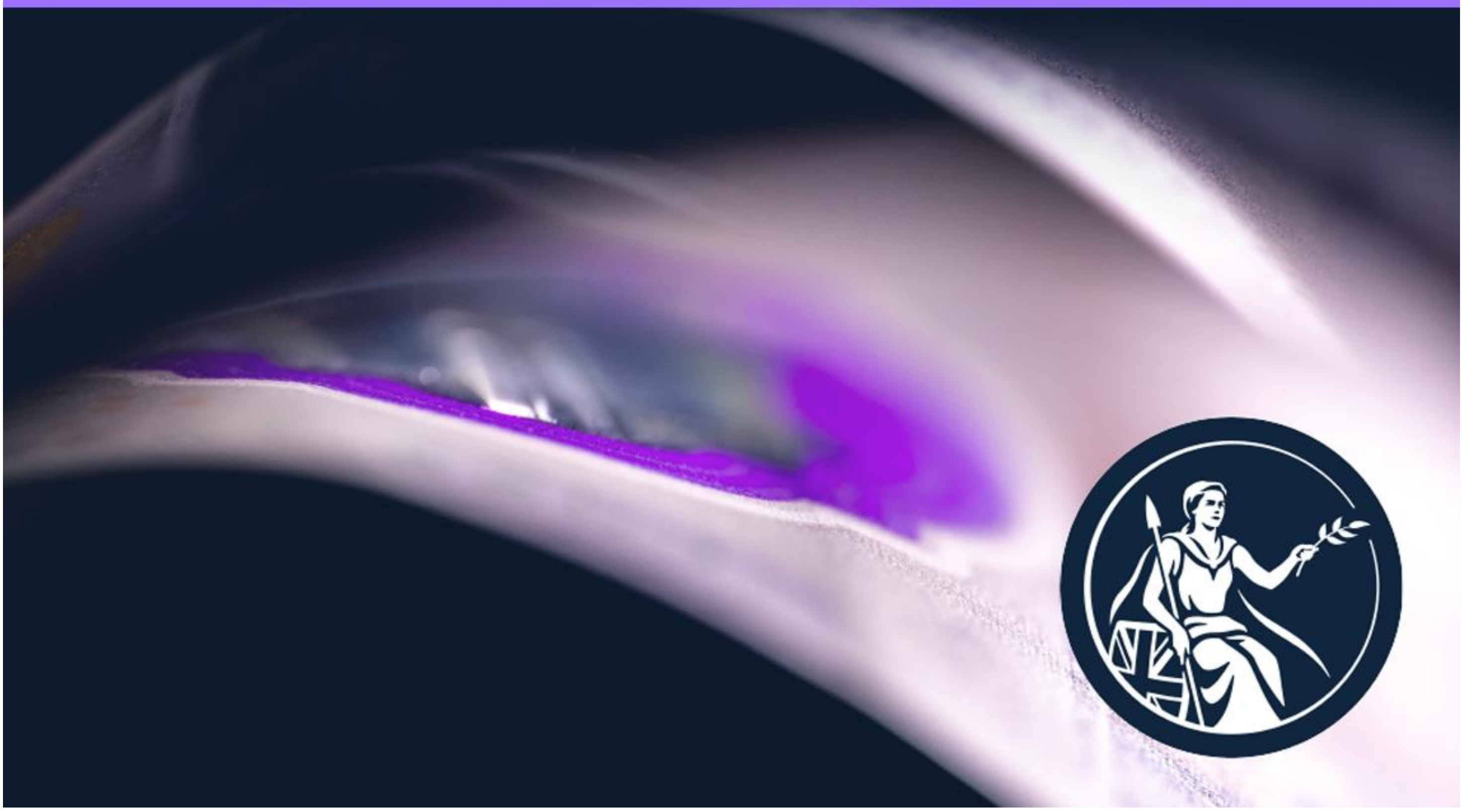
Bank of England PRA

The PRA's approach to the implementation of the O-SII buffer

Statement of policy

November 2023



The PRA's approach to the implementation of the O-SII buffer

Statement of policy

November 2023

Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

Contents

1. Introduction

1.1 This Statement of Policy (SoP) sets out the Prudential Regulation Authority's (PRA) approach to the implementation of the Other Systemically Important Institutions Buffer (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. The change resulted from the UK 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). The Capital Requirements (Capital Buffers and Macroprudential Measures) Regulations 2014, as amended (the 'Capital Buffers Regulations') require the PRA to apply the framework set out by the FPC on the O-SII buffer from Tuesday 29 December 2020.

1.3 The FPC published **The Financial Policy Committee's framework for the O-SII buffer** ('FPC framework') in May 2016 and updated this in December 2020 and May 2022. This document, along with the FPC framework, forms the Bank of England's broader framework for the O-SII buffer.

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

2. Firms in scope of the framework

2.1 [Deleted]

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 other systemically important institutions (O-SIIs)**. 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.

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. O-SII buffer capital implications

3.1 The Capital Buffers Regulations specify 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 O-SII buffer 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 the UK.

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

3.4 Group risk[1] may arise when an RFB is subject to an O-SII buffer at the level of the RFB sub-group,[2] 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 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.[3]

[1] 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.

[2] 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.

[3] 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**

3.5 The PRA amended its Statement of Policy on **The PRA's methodologies for setting Pillar 2 capital** to take account of this type of group risk when assessing capital adequacy at the consolidated group level under Pillar 2 to ensure that sufficient capital of appropriate quality is held within, and distributed appropriately across, the consolidated group to cover the risks faced by the RFB sub-group itself and, separately, group entities that are not members of the RFB sub-group.

3.6 As indicated in **SS45/15 - The UK leverage ratio framework** firms that are subject to a non-zero O-SII buffer will also be subject to an additional leverage ratio buffer (ALRB) rate.

4. Application of the framework

4.1 The PRA will apply the FPC's framework for the O-SII buffer to each firm that is subject to the O-SII buffer. As a result of this assessment, some firms that are subject to the O-SII buffer may receive a positive O-SII buffer rate while others may receive a zero rate. When applying the framework, the PRA will assign to each firm that is subject to the O-SII buffer a systemic score equal to its average of quarter-end leverage exposure measure over the previous calendar year, calculated on the applicable basis of regulatory consolidation.[4]

4.2 As outlined in SS8/16 **Ring-fenced bodies (RFBs)**, 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.

4.3 For building societies in scope of the framework, the applicable basis of calculation will be the consolidated basis for building societies that are the parents of consolidated groups and the individual basis for all others.

4.4 For each firm that is subject to the O-SII buffer, the PRA will derive an O-SII buffer 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 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.

[4] As per the FPC's updated framework, the use of an average of firms' quarter-end rather than year-end leverage exposure measure will only take effect after the PRA's 2023 review of O-SII buffer rates. Thus the PRA's 2023 review will be based on end-2022 leverage exposure measure.

4.5 The PRA expects that it will exercise supervisory judgement to deviate from the O-SII buffer 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 leverage exposure measure has 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.

4.7 The PRA confirmed in November 2022 that O-SII buffer rates would be maintained at the rates set in December 2019 until the PRA reassesses rates in line with this SoP and the updated FPC framework in December 2023, to take effect from January 2025.

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

5.1 Following application of the initial O-SII buffer rates, the PRA will re-apply the O-SII framework annually in the manner outlined in paragraphs 4.1 to 4.6 of this SoP. The PRA expects to announce the O-SII buffer 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. For example, the O-SII buffer rates announced in December 2020 would take effect as of 1 January 2022. The PRA may adapt this timeline, where appropriate, in light of its objectives and statutory responsibilities.

6. Recognition of EEA buffer rate

6.1 [Deleted]

Appendices

1 Statement of Policy updates

Appendix 1: Statement of policy updates

This annex details changes made to this statement of policy following its initial publication in December 2016.

2023

20 November 2023

This statement of policy was updated in 2023 following the publication of **An FPC Response - Amendments to the FPC's framework for the O-SII buffer**. It was updated to:

- reflect the change in the metric used to determine O-SII buffer rates from total assets to the UK leverage exposure measure;
- remove legacy EU references;
- update or remove out-dated references to other policies and PRA decisions; and
- correct minor error by removing a duplicate word.

2020

28 December 2020

This statement of policy was updated in 2020 following the publication of policy statement (PS) 29/20 – **Capital Requirements Directive V (CRD V): Final policy**. It was updated to:

- remove references to the SRB and replace with the O-SII buffer to reflect that the PRA, in line with CRD V, will now require additional loss absorbency of RFBs and large building societies via the O-SII buffer. This included amending the title of the Statement of Policy to 'The PRA's approach to the implementation of the O-SII buffer';
- include detail of how the PRA identifies O-SIIs, and how this interacts with the O-SII buffer framework; and
- include detail of how the first O-SII buffer rates are to be set under the new framework.

2018

13 December 2018

This statement of policy was updated in 2018 following the publication of policy statement (PS) 32/18 – **The systemic risk buffer: Updates to the Statement of Policy**. It was updated to:

- remove the statement that the PRA's approach to reviewing the SoP every two years is mandated by the SRB regulations;
- replace references to CP25/16 with the corresponding PRA SoP on its methodologies for setting Pillar 2 capital following publication of the final policy;

- include references to supervisory statement 45/15 ‘The UK leverage ratio framework’, which was updated in November 2018 with respect to the application of an additional leverage ratio buffer (ALRB) rate to SRB institutions; and
- change footnote 11 (paragraph 5.1) to update references to the Delegated Regulation (EU) No 1222/2014.

This SoP was also updated to simplify the formatting and aid readability, including sequential numbering of footnotes, the updating of hyperlinks to reflect the location of materials on the Bank of England’s website, and to make hyperlinks more easily identifiable.