Chapter 8 Microprudential regulation I – capital adequacy

8.5.3.2 Counter-cyclical buffer

Page 375

Delete the last 4 lines of page and replace with the following:

'Although there were plans to raise the counter-cyclical buffer rate in the UK to 2%, the onset of the Covid-19 pandemic in early 2020 and the ensuing economic lockdowns brought about economic uncertainty and contraction in activity. Hence, the Committee decided to revise the counter-cyclical buffer rate to 0% from March 2020, justifying the elasticity of the buffer as inherently responsive to economic conditions.'

8.5.3.3 Systemic risk buffer

Page 376

Delete the paragraph beginning 'It is uncertain…' right to the end of the paragraph on p377. Replace with the following text:

'The purpose of the systemic risk buffer was clarified by an amendment to the Capital Requirements Directive made in 2019.[1] The buffer allows for conservative treatment to be applied to banks with certain exposures to business activities that could exacerbate their resilience risks and systemic risk across the banking sector. It is provided in a non-exhaustive manner that the systemic risk buffer may apply to bank exposures to retail real estate and other mortgage assets, or sectoral or geographical exposures etc. For example, if Member State regulators consider bank exposures to businesses in the fossil fuels sector to be risky due to the risks of transiting to greener operations and the write-down of obsolete assets, a systemic risk buffer applicable to banks on the basis of sectoral exposure can be applied. Such application may disincentivise banks from taking on significant amounts of such exposures and addresses the collective systemic risk from the banking sector having such common exposures. This definition of the systemic risk buffer is now adopted in the UK.[2]

Previous to the 2019 amendment, the UK had adopted the systemic risk buffer as a special buffer applicable to ring-fenced banks discussed in Chapter 10. As the definition of the systemic risk buffer has changed, the buffer the UK has applied to ring-fenced banks is now renamed the 'OSII' buffer, discussed below.'

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[1] Directive (EU) 2019/878 of the European Parliament and of 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, new Article 133.
[2] The Financial Holding Companies (Approval etc.) and Capital Requirements (Capital Buffers and Macro-prudential Measures) (Amendment) (EU Exit) Regulations 2020, art 8.

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8.5.4.1 Institution-specific counter-cyclical buffer

Page 377

Insert the following paragraph:

‘ **8.5.4.1A Other Systemically Important Institution Buffer (OSII Buffer)**
The OSII buffer is provided for in the UK’s Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014[3] in order to allow the PRA to designate a financial institution as systemically important. Such an assessment would likely rely on the assessment methodology for globally systemically important institutions discussed in Chapter 9[4] and allows the PRA to extend its scope of systemic risk oversight to financial institutions, not just banking institutions, that could attain an important profile.

Although the OSII buffer has not been applied since its provision in the 2014 Regulations, in light of the changes made to the definition of the systemic risk buffer by the EU in 2019, the PRA applied the OSII buffer to cover the buffer applied to ring-fenced banks that had previously been labelled as the systemic risk buffer. Ring-fenced banks with more than £175 billion in assets would be required to meet an OSII buffer of up to an extra 3 per cent of risk-weighted assets. The OSII buffer for ring-fenced banks is set at tiered levels according to banks’ asset volumes. The top tier of banks having an excess of £755 billion in assets attracts the top systemic buffer rate of 3%.’

8.5.5.3 Leverage ratio buffer

Page 385, footnote 135

Replace the citation with ‘PRA, *Additional Leverage Ratio Buffer Model Requirements* (Dec 2020), https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/authorisations/waivers-and-modifications-of-rules/vreq-jan2021.pdf?la=en&hash=2C02B42A1919F181211944BFD22560980020AC31.’

Page 386

Insert as a final paragraph the following text:

‘In the UK, the ALRB is applicable to banks subject to the OSII buffer, i.e. the ring-fenced banks that accept deposits of £50 billion and above.[5]’

[3] Arts 29-33.
[4] See 9.5.1.1.
[5] PRA, *Additional Leverage Ratio Buffer Model Requirements* (Dec 2020), above.

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Insert:

‘8.5.5A Regulatory Suspensions to Buffer Requirements During Extraordinary Circumstances

Although capital buffers have radically enhanced the capital requirements for banks, they may also be considered to be flexible forms of capital regulation. If the economic or financial sector circumstances underpinning the capital buffers change, regulators can exercise discretion to adjust or suspend the application of capital buffers.[6] During the Covid-19 pandemic, economic lockdowns in the UK caused economic activities to contract and businesses in particular needed temporary debt forbearance and access to finance. Measures for temporary debt forbearance and government-backed loans, especially for small and medium-sized businesses, were introduced, such as the Coronavirus Business Interruption Loan Scheme for larger businesses and the Bounce Back Loan Scheme for smaller amounts. In order to incentivise banks to meet financial welfare needs during this extraordinary time, the PRA took the view that banks were sufficiently well capitalised and capital regulations could be relaxed. Besides the FPC adjusting the counter-cyclical buffer rate to 0 per cent, the PRA suspended adherence to all capital buffer regulations[7] so that banks would free up a capital cost of £190bn[8] for lending.’

Page 401, under Key Bibliography, Legislation

Insert as top items:

‘Directive (EU) 2019/878 of the European Parliament and of 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, new Article 133.

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

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[6] JS Masur and EA Posner, ‘Should Regulation be Counter-cyclical?’ (2017) 34 *Yale Journal on Regulation* 857.
[7] PRA, ‘Q&A on the usability of liquidity and capital buffers’ (20 April 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/buffer-usability-qanda.
[8] Bank of England, ‘Bank of England measures to respond to the economic shock from Covid-19’ (11 March 2020), https://www.bankofengland.co.uk/news/2020/march/boe-measures-to-respond-to-the-economic-shock-from-covid-19; PRA, ‘Statement by the PRA accompanying measures announced by the Financial Policy Committee’ (11 March 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/statement-by-the-pra-accompanying-measures-announced-by-the-fpc.

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