ICAEW REPRESENTATION
63/17

Refining the PRA's Pillar 2A capital framework

ICAEW welcomes the opportunity to comment on the *Refining the PRA's Pillar 2A capital framework* published by PRA on 24 February 2017 a copy of which is available from this link.

This response of 31 May 2017 has been prepared on behalf of ICAEW by the Financial Services Faculty. As a leading centre for thought leadership on financial services, the Faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The Faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

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MAJOR POINTS

1. We broadly welcome the PRA's proposals and approach to fostering more competition in the UK banking market. A less concentrated banking sector will support greater sector resilience. We think there is enormous public interest in delivering an approach that will lead to a more vital banking industry. Through the proposed measures, the PRA also has an opportunity to support lending in the UK and the government's economic policies for growth.

RESPONSES TO SPECIFIC QUESTIONS

Pillar 2 adjustments

2. In some cases the PRA's proposals could make more substantive changes to support UK competition. The PRA proposes using the 'upper range' of internal-rating based (IRB) benchmarks. This risks penalising Standardised Approach (SA) firms with low risk books: the very banks the PRA might support. The PRA collects a vast amount of credit risk information which it could use to more readily benchmark the asset quality of respective portfolios. This additional information (e.g. LTV and LTI) and empirical evidence may actually support using risk weights below the 'upper range' for some firms currently using SA. The PRA should use the data it already collects to make these judgements, where appropriate, as they will be more representative of firm-specific risk profiles.

3. The PRA subsequently notes (paragraph 2.6) that the benchmarks may not be applied in all circumstances and where data quality is 'not satisfactory'. The PRA might usefully shed more light on what this means by referring to existing data quality standards that should be met.

IFRS 9

4. As above, the PRA has an opportunity to support competition and lending to the UK economy. The PRA recognises that the impact of its policies for IFRS firms using the Standardised Approach will mean double counting and firms holding excessive capital. Therefore, the PRA rightly proposes to use 'UL-only' IRB risk weights for certain IFRS firms (paragraph 2.18). In our view, the measures should apply equally to challenger firms and incumbents alike. To do otherwise risks creating 'dead capital' – capital which instead might be deployed more efficiently to support lending to the real economy. The current proposal risks a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium and long term.

Revisions to the IRB benchmark

5. There may be an opportunity for the PRA to use more up-to-date data. In the consultation the PRA proposes using benchmarks based on end-2015 data points. At the current time banks are increasingly trying to use 'big data' and enhanced analytics to deliver better outcomes. Over time the PRA might reassess how it could use the considerable amount of data it collects already and how it might use it in a more timely fashion. If a regulated firm sought to manage its portfolio using credit risk data that was two years old (end-2015 data will be 2 years old by the proposed implementation date – 1.1.2018) we would not describe that firm's data quality as 'satisfactory'. Where possible, the PRA should seek to demonstrate the standards it expects of regulated firms and use data that is up-to-date and relevant. This level of consistency helps to build credibility with key stakeholders and maintain the PRA's social licence.