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Directive 5 published by the Prudential Authority

What is the impact on capital from a bank's perspective?

- The PVA will decrease the amount of qualifying capital reported.

What was the publication date?

- September 2020.

What is the objective of the directive?

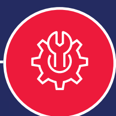
- To direct banks to follow the methods and processes for the calculation of the individual PVAs in order to enable the banks to comply with the Pillar 3 disclosure requirements.
- The Pillar 3 disclosure requirements increase transparency on a bank's exposure to risk, the overall adequacy of its regulatory capital and the general confidence in the banking sector.

What are the regulatory reporting and disclosure requirements of the PA?

- The aggregate PVA must be reported in line item 203 of the form BA 700.
- PVA to be estimated at least quarterly and reported annually.
- The PVAs are in respect of unearned credit spreads, closeout costs, operational risks, early termination, investing and funding costs, future administrative costs and model risk.

Why now?

- To assist banks in providing for a PVA on all financial instrument positions, in both the trading book and the banking book.
- In response to the revised Basel II market risk framework, and the ongoing process of global derivative reform, which is likely to alter the composition and risks of the fair-valued portfolio of banks.



Which financial instruments are impacted?

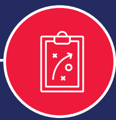
- All financial instruments measured at fair value fall within the scope of the Directive, where the fair value adjustments impact CET 1 capital, and for which a bank is unable to sell or hedge the said instruments, products or positions in the desired short period of time.

Is there application relief?

- A materiality threshold was set by the PA to determine which methodology the banks must employ in calculating the PVAs.
- The materiality threshold must be applied at the following levels: bank solo, bank consolidated, total adjustments controlling company consolidated, foreign branch and foreign subsidiary of a bank incorporated in the Republic.
- If Total adjustments to fair values which affect CET 1/sum of the absolute value of FV assets and liabilities is less than 1%: apply the simplified approach, otherwise, apply the core approach.
- If the threshold is exceeded at controlling company level, the core approach must be applied at all levels in the banking group.

How should the simplified approach be applied?

- PVAs, under the simplified approach, are calculated as equal to 0.1% of the sum of the absolute value of fair-valued assets and liabilities which are included in the materiality threshold calculation.



How should the core approach be applied?

- Calculate PVAs for each of the categories described in the PVA Framework, and sum the resulting amounts for each category level PVA to provide the aggregate PVA.

Are additional disclosures required in the annual report?

- Each PVA is calculated as the excess of valuation adjustments required to achieve the identified prudent value over and above any adjustments applied under IFRS.
- The aggregate PVA is presented and disclosed as a prudent valuation adjustment in the bank's total regulatory capital reconciliation, included in the annual financial statements.
- If material, banks should disclose the composition of the prudential valuation adjustment, in order to improve the user's understanding of the determination of a prudent fair value.

FOR A CLEAR PERSPECTIVE, PLEASE CONTACT US:

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