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The UK's Prudential Regulation Authority Proposes Changes to Deductions for Non-Performing Exposures

By Alix Prentice
Partner | Financial Regulation

On 14 March 2023, the PRA launched a consultation on the *Deductions for Non-Performing Exposures (Revocations) (CRR) Instrument 2023* to remove the current Common Equity Tier 1 ("CET1") deduction requirement for NPEs that are treated as insufficiently covered by firms' accounting provisions, along with associated regulatory reporting requirements.

Background and proposed changes

In April 2019, the EU Capital Requirements Regulation ("CRR") was amended to require CET1 deductions for all new NPEs held by EU institutions that were subject to accounting provisions below CRR levels. This requirement was intended to encourage a reduction in NPE positions and to prevent future excessive accretion as part of an overall drive to prevent systemic risk in the non-banking sector. Following Brexit, and the onshoring of CRR into UK law and the PRA Rulebook, the PRA now considers that the NPE deduction is no longer appropriate for UK CRR firms, largely because the requirement does not recognise collateral charged against an NPE and requires the calculation of a provisioning shortfall based on gross exposure amounts. The PRA has concluded that the deduction does not actually reflect expected recovery values for exposures, and that its own powers to address potential risks of under-provisioning are a sufficient backstop to deal with provisioning shortfalls when necessary.

Responses to the consultation are due by 14 June 2023.