HM Treasury

Prudential standards in the Financial Services Bill

Policy statement

March 2020

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HM Treasury's approach to implementing prudential standards through the Financial Services Bill

1.1 HM Treasury and the Financial Services Regulators – the Bank of England ("the Bank"), Prudential Regulation Authority (PRA), and Financial Conduct Authority (FCA) – are committed to a prudential regulation regime that supports financial stability, economic growth, and competition amongst firms. After the transition period, the Government will prioritise the implementation of global standards to maintain the UK's position as a world-leading financial services centre.

1.2 The UK played an active role in negotiating and agreeing the Third Basel Accord (Basel III, as finalised by Basel 3.1) at the international level and is committed to its full, timely, and consistent implementation alongside other major jurisdictions. Through the Financial Services Bill, HM Treasury intends to take powers to enable the implementation of the remaining Basel III standards that will not have been incorporated into UK legislation by the end of the EU exit transition period.

1.3 In addition, to ensure continued proportionality and UK competitiveness, HM Treasury intends to take powers to enable the implementation of a new prudential regime for investment firms through the Financial Services Bill.

Prudential regulation and the Basel Standards

1.4 Prudential regulation ensures firms have enough capital and liquidity to operate effectively through periods of economic stress without causing harm to their customers, markets, and the wider financial system.

1.5 Due to the interconnected nature of banking and systemic investment activities, international standards on prudential regulation are crucial. For internationally active banks, these standards are set by the Basel Committee on Banking Supervision (BCBS), of which the UK is a member.

1.6 The initial Basel Accord (Basel I) was agreed in 1988 and introduced minimum levels of capital for internationally active banks. A revised version was finalised in 2004 (Basel II), introducing a three-pillar approach: Pillar I, which sets minimum capital requirements to be held against risk-weighted assets (RWAs); Pillar II, which defines the key principles of supervisory review, transparency,

and accountability; and Pillar III, which uses disclosures to promote market discipline.

1.7 The BCBS agreed the Basel III standards in 2010 in the wake of the financial crisis. This was finalised with a series of amendments from December 2017 to 2019 (sometimes referred to as Basel 3.1), which complement these improvements to the global regulatory framework.

1.8 The reformed package aims to restore credibility in the calculation of risk-weighted assets and improve the comparability of banks' capital ratios, without significantly increasing capital requirements at a global level.

1.9 In the UK, previous Basel standards have largely been implemented through the EU's Capital Requirements Regulation (CRR as updated by CRRII) and the Capital Requirements Directive (CRDIV as updated by CRDV).

1.10 Although parts of CRRII applied from June 2019, a number of provisions are due to apply in the EU from June 2021. As this is after the end of the transition period, these elements will not automatically apply in the UK. HM Treasury therefore intends to take powers to enable the implementation of updated prudential rules for banks in the UK.

1.11 Unlike CRRII, which partly applies after the end of the transition period, CRDV must be transposed into national legislation by 28 December 2020. In line with the UK's commitments under the EU Withdrawal Agreement, it is the Government's and the PRA's intention to transpose CRDV by this date.

1.12 Most Basel 3.1 revisions are not included in CRRII and CRDV and have not yet been legislated for in the EU. HM Treasury therefore intends to take powers to enable the implementation of these most recent revisions to the Basel standards through the Financial Services Bill, demonstrating the Government's ongoing commitment to implementing leading global standards in financial services.

Prudential regulation for investment firms

1.13 Prudential regulation is key to ensure that not only banks, but also firms in other sectors of the financial system, can manage their risk in a prudent way and wind-down without causing harm to their customers and to markets.

1.14 The EU recently legislated to introduce a more proportionate regime for non-systemic investment firms, which are currently regulated under rules designed for banks. The UK played an instrumental role in the introduction of this regime at EU level. The UK is committed to ensuring that prudential requirements for investment firms are proportionate to the risks they pose to the financial system, thereby facilitating healthy competition across the industry and allowing the UK to remain competitive outside of the EU.

1.15 As the regime will only apply in the EU from June 2021, after the transition period, this regime will not automatically apply in the UK. HM Treasury therefore intends to take powers to enable the introduction of an updated prudential regime for investment firms in the UK.

HM Treasury's legislative approach

1.16 HM Treasury is committed to four overarching principles when legislating for prudential standards in the Financial Services Bill:

1. financial stability and high international standards
2. supporting the Government's wider objectives on growth, competition, and competitiveness
3. a central role for expert, independent UK regulators in designing and implementing the detailed and technical requirements that will apply to firms
4. a flexible and proportionate approach, enabling the UK to both maintain a strong future partnership with the EU and other major economies, and to account for specificities in the UK financial services market.

1.17 The legislative approach and allocation of responsibilities between HMT and the Financial Services Regulators will deliver efficient implementation of prudential standards in the period immediately after the transition period.

1.18 For the longer-term, HM Treasury is conducting a review to determine how the regulatory framework will need to adapt to the UK's position outside of the EU and will consult on proposals in due course. This will include examining the ongoing allocation of regulatory responsibilities between Parliament, HM Treasury and the Regulators.

Next steps

1.19 Public consultations will be launched on the implementation of the Basel standards, on CRRII provisions, and on the prudential regime for investment firms in due course.

1.20 The Financial Services Regulators will also set out their own plans for consultation and stakeholder engagement on amendments to their rulebooks in due course.

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