HM Treasury

Implementation of the Basel 3.1 standards

Consultation

November 2022

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ISBN: 978-1-915596-36-9 PU: 3256

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Chapter 1
Introduction

The Basel standards

1.1 Banks are required to hold a certain amount of capital, which can be used to absorb any losses they may incur on their balance sheets.

1.2 The standards around the amount of capital banks need to hold against the risks they take are agreed at international level by the Basel Committee on Banking Supervision (BCBS). The BCBS has been setting standards for banks since the 1980s and the UK is represented at BCBS by the Bank of England and the Prudential Regulation Authority (PRA).

1.3 Following the 2008 financial crisis, BCBS introduced several reforms to address the failures that led to that crisis. These reforms are known as the Basel 3 standards. This included improvements to the amount and quality of capital held by banks.

1.4 The final element of the BCBS's work was to address how banks measure risk on their balance sheets. This final package of reforms is referred to as Basel 3.1 in the UK.

UK implementation of the Basel standards upon leaving the EU

1.5 On 29 April 2021, the Financial Services Act 2021 (FS Act) received Royal Assent. The Act enables the PRA to introduce reforms to update the UK's prudential regime in line with the outstanding elements of Basel 3 and Basel 3.1.

1.6 At present the Capital Requirements Regulation (CRR), which is retained EU legislation that takes the status of primary legislation in the UK, contains many of the existing prudential rules.

1.7 The FS Act enables HM Treasury to delegate responsibility to the PRA for making the firm-facing rules required to implement the Basel standards. The Act ensures that public policy considerations including sustainable growth, the relative standing of the UK, and the Basel standards themselves, are considered by the PRA when making these rules. These policy considerations are set out as "have regards" in the FS Act and are subordinate to the PRA's primary objective of maintaining the safety and soundness of firms. The overall approach is in line with that set out in the Future Regulatory Framework Review (FRF).

1.8 To facilitate the effective implementation of Basel 3.1, HM Treasury needs to amend the CRR in several ways. This includes: revoking articles of the CRR in order for them to be replaced with the PRA's proposed rules (where appropriate), consequential amendments to ensure coherence and continuity of the regime, and amendments, where appropriate, to equivalence.

1.9 This process was followed in 2021 for the PRA's "Implementation of the Basel 3 standards"[1] which covered the outstanding Basel 3 standards that the UK had not onshored into UK law as part of the second Capital Requirements Regulation (EU CRR II).

HM Treasury's proposed implementation of the Basel 3.1 standards

1.10 The matters being consulted on in this document will inform the necessary secondary legislation to be laid in Parliament and to come into effect at the same time as the PRA's final Basel 3.1 rules. This process may require additional secondary legislation (consequential amendments) thereafter.

1.11 This document is structured as follows, and seeks views on:

Chapter 2 - the CRR articles the PRA has requested HM Treasury revoke

Chapter 3 - consequential amendments required to ensure a coherent rulebook

Chapter 4 - potential reforms to equivalence

Chapter 5 - credit rating coverage in the UK

Chapter 6 - short-term competitiveness improvements

Responding to the consultation

1.12 Responses are requested by 23:45 on 31 January 2023. The government cannot guarantee that responses received after this date will be considered.

1.13 This document is available electronically at www.gov.uk/treasury. You may make copies of this document without seeking permission. Printed copies of the document can be ordered on request from the address below.

1.14 Responses can be sent by email to Prudential.Consultation@hmtreasury.gov.uk. Alternatively, they can be posted to:

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[1] HM Treasury's consultation and response for Basel 3 implementation: https://www.gov.uk/government/consultations/implementation-of-the-investment-firms-prudential-regime-and-basel-3-standards-consultation

The PRA's Basel 3 consultation and rules: https://www.bankofengland.co.uk/prudential-regulation/publication/2021/october/implementation-of-basel-standards

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1.15 When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make clear who the organisation represents and, where applicable, how the views of members were assembled.

Processing of personal data and confidentiality

1.16 This section sets out how we will use your personal data and explains your rights under the UK General Data Protection Regulation (UK GDPR) and Data Protection Act 2018 (DPA). For the purposes of the UK GDPR, HM Treasury is the data controller for any personal data you provide in response to this consultation.

Data Subjects

1.17 The personal data we will collect relates to any individuals identifiable from information provided in the consultation responses.

The data we collect (Data Categories)

1.18 The personal data will be collected through email submissions to a mailbox and is likely to include; individuals' names, addresses, email addresses, their job titles and employers, as well as their opinions. It is possible that respondents will volunteer additional identifying information about themselves or third parties.

Purpose

1.19 This personal data is processed for the purposes of obtaining the opinions of members of the public and representatives of organisations and companies about departmental policies, proposals, or generally to obtain public opinion on an issue of public interest.

1.20 We will use this personal data when we record your comments and views and take your reply into account – as far as possible with all other replies – when decisions are being made following the consultation process. Collection of your personal data is also necessary as we may need to contact you to discuss your response to the consultation.

Legal basis of processing

1.21 Article 6(1)(e) UK GDPR – The processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in HM Treasury. For the purpose of this consultation, the task is consulting on departmental policies or proposals, or obtaining opinion data, in order to develop good effective policies.

Who we share your responses with (Recipients)

1.22 Information provided in response to a consultation may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA) and the Environmental Information Regulations 2004 (EIR).

1.23 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence.

1.24 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

1.25 Where someone submits personal data relating to a third party, we will endeavour to delete that data before publication takes place.

1.26 Where information about respondents is not published, it may be shared with officials within other public bodies involved in this consultation process to assist us in developing the policies to which it relates. Examples of these public bodies appear at: https://www.gov.uk/government/organisations.

1.27 As the personal information is stored on our IT infrastructure, it will be accessible to our IT contractor NTT. NTT will only process this data for our purposes and in fulfilment with the contractual obligations they have with us.

How long we will hold your data (Retention)

1.28 Information in responses to consultations will generally be published and therefore retained indefinitely as a historic record under the Public Records Act 1958. HM Treasury will not include any personal data when publishing response to this consultation. Personal data appearing in responses will be retained for three calendar years after the consultation has concluded.

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- request information about how your personal data are processed, and to request a copy of that personal data.
- request that any inaccuracies in your personal data are rectified without delay.
- request that your personal data are erased if there is no longer a justification for them to be processed.

- in certain circumstances (for example, where accuracy is contested) request that the processing of your personal data is restricted.
- object to the processing of your personal data where it is processed for direct marketing purposes.

How to submit a data subject access request (DSAR)

1.30 To request access to personal data that HM Treasury holds about you, contact:

The Information Rights Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

dsar@hmtreasury.gov.uk

Complaints

1.31 If you have any concerns about the use of your personal data, please contact the Treasury's Data Protection Officer (DPO) at:

The Data Protection Officer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
privacy@hmtreasury.gov.uk

1.32 If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner, who is an independent regulator. The Information Commissioner can be contacted at:

Information Commissioner's Office
Wycliffe House
Water Lane
Wilmslow
Cheshire
SK9 5AF
0303 123 1113
casework@ico.org.uk

Chapter 2

Implementing Basel 3.1: Exercise of the section 3 revocation power

2.1 This chapter outlines the revocations requested by the PRA to the Capital Requirements Regulation (CRR) to make space for the PRA's implementation of the Basel 3.1 standards.

2.2 This is the second time HM Treasury has consulted on implementing prudential reforms in this manner, the first being the implementation of outstanding Basel 3 requirements (i.e., the UK equivalent of EU CRR II) in 2021/22.

2.3 This is a technical consultation. The table below does not represent the final list of revocations HM Treasury will legislate. Decisions on revocations will be made once the consultation has closed. At the point at which the PRA finalises their rules, HM Treasury will consider whether those rules have adequately replaced the articles being revoked, as required by the FS Act 2021, and legislate accordingly.

2.4 The PRA has today issued a consultation on its proposed rules which correspond to the below proposed revocations. The revocations relate to the exercise of powers in the FS Act 2021 set out in Annex A.

CRR revocations

Article or part to be revoked from the remainder of the CRR
Standardised approach (credit risk), Articles: 107(1)-(2), 110-113, 114(1)-(4), 115(1)-(3) and (5), 116(1-4), 117-118, 119(1)-(4), 120-129, 131-135, 137-141, 501, 501a, Annex 1
Internal ratings based approach (credit risk), Articles: 142-191
Credit risk mitigation, Articles: 108, 192-196, 197 (1-7), 198-241, 299(2)(c)
Operational risk, Articles: 312-324
Market risk, Articles: 325(1), (2) and (4), 325(b)-377
Credit valuation adjustment risk, Articles: 381, 382(1-3), 382(4)(a), (c), (d), 382(5), 383-386
Minimum requirements, Article 92

2.5 The above revocations are targeted at the areas required to implement Basel 3.1, and to provide as coherent a transition into the PRA rulebook as possible. Chapter 3 sets out further detail on how HM Treasury will ensure continuity and coherence between the remaining legislation and the PRA rulebook.

Scope

2.6 As set out in the PRA's consultation, the PRA intends to introduce a new capital regime for non-systemic banks and building societies, under their Strong and Simple initiative. Firms that meet the PRA's Simpler-regime criteria will be able to move on to this new capital regime if they wish to do so. These firms will not be required to comply with the PRA's Basel 3.1 rules.

2.7 The PRA's Basel 3.1 consultation sets out their intended approach to how they will give effect to this.

The Future Regulatory Framework

2.8 The government recognises that this further set of revocations leaves a complex prudential regulatory framework across legislation, PRA rules, and remaining technical standards. Following the implementation of Basel 3.1, HM Treasury and the PRA will endeavour to complete the repeal and replacement of the remainder of the prudential legislative framework as soon as possible.

Implementing Basel 3.1: Exercise of the section 3 revocation power

1. Do you have any comments on the list of CRR articles HM Treasury intends to revoke?

2. Are there any further articles which you would advise we should delete (and replace with PRA rules) to materially improve coherence of the regulatory framework?

Chapter 3
Amendments to the CRR

3.1 Where articles of the CRR are revoked, consequential amendments are required to ensure a coherent regime.

3.2 The first section of this chapter details elements which are in HM Treasury's remit, but which the PRA has asked HM Treasury to amend given their proposed rules. These relate to exemptions from holding capital requirements against Credit Valuation Adjustment (CVA) risk, and how these exemptions link to the European Market Infrastructure Regulation on derivatives, central counterparties and trade repositories (EMIR).

3.3 The second section seeks views on the removal of CRR article 142(2), which contains an equivalence provision that would apply to large financial sector entities.

3.4 The third section sets out proposed amendments to definitions contained in the CRR, supporting the PRA's implementation of Basel 3.1.

3.5 The fourth section sets out technical proposals to support legal and practical continuity.

3.6 The fifth section sets out whether HM Treasury intends to exercise its use of section 6 of the FS Act 2021. This power enables HM Treasury to amend the Credit Rating Agencies Regulation (CRAR) to align with Basel 3.1.

3.7 This chapter, as with the revocations chapter, is a technical consultation. The below does not represent the final list of amendments required to support the PRA's rules. Decisions on amendments will be made once the consultation has closed. At the point at which the PRA finalises their rules, HM Treasury will consider whether those rules adequately replace the articles to be revoked as required by the FS Act 2021 and legislate accordingly.

Amendments and revocations impacting Credit Valuation Adjustment (CVA) risk

3.8 Complementing the PRA's proposals on Credit Valuation Adjustment (CVA) risk, HM Treasury proposes to revoke most of the CRR articles relating to CVA (see table in 2.4 above). This will enable the PRA to implement the updated Basel framework.

3.9 The CVA changes being proposed by the PRA include removing exemptions to CVA capital requirements for certain activities (for example those relating to transactions with non-financial counterparties). The exemptions are currently linked to the European Market Infrastructure Regulation (EMIR). HM Treasury proposes to remove or amend these linkages in line with the changes that the PRA are making to the CVA capital requirements. This section invites consideration of HM Treasury's handling of these linkages to EMIR.

3.10 The below table sets out a summary of the proposed changes to equivalence regarding the CVA exemptions and their links to EMIR:

CVA exemption	PRA proposal	Proposed action on link to EMIR/equivalence regime	International jurisdictions and entities impacted
382(4)(a): non-financial counterparties (NFCs)	Remove	Link to EMIR Art 2: Remove given PRA propose removing the exemption	No direct overseas impact
382(4)(b): intragroup OTC derivative transactions	Retain	Link to EMIR Art 3: Retain and permit a dual regime through PRA rules	No impact – existing EMIR link is retained for UK and overseas firms
382(4)(c): pension funds	Remove	Link to EMIR Art 89(1): Remove the link to the temporary exemption given PRA propose removing the exemption	No direct overseas impact
382(4)(d): central banks, debt management offices, central and local governments	Remove	Link to EMIR Art 1 and CRR Art 114(4) and 115(2): Remove given PRA propose removing the exemption	Several jurisdictions and associated entities, including the UK, US, EU, Switzerland and Japan under EMIR Article 1(4)

3.11 HM Treasury intends to keep the CVA intragroup exemption, and the EMIR link within this (which in turn links to equivalence), and no action will need to be taken for the exemption to continue to apply. This will provide continuity for firms and maintains the option of providing a jurisdictional equivalence assessment which would enable firms to benefit from this CVA exemption. In addition, for intragroup transactions, firms will be able to benefit from the new firm-level exemption regime proposed by the PRA. HM Treasury intends to make an amendment to Article 382(4)(b) to enable PRA to make rules in this area.

3.12 The PRA's proposed removal of the CVA exemption for pension funds will mean transactions with pension funds would be in scope of the CVA risk framework, unlike today. However, this does not impact the temporary exemption from the requirements within EMIR for these firms as set out in Article 89(2).

3.13 We are interested in feedback on the linkages between CVA exemption capital requirement changes and EMIR as described above.

Amendments and revocations impacting CVA risk

3. Do you have any comments on the proposed changes relating to linkages between CVA capital requirements and EMIR?

Removal of CRR article 142(2)

3.14 Article 142 sets out several definitions that are relevant to those firms that use internal models and how they undertake their capital requirement calculation. In particular, this article introduces a definition of large financial sector entities (LFSEs) and unregulated financial sector entities, to which a multiplier of 1.25 applies for the purposes of these firms' internal model calculations.

3.15 Part of the definition of LFSE includes that the firm must be prudentially regulated, either in the UK, or in an equivalent jurisdiction i.e., "Article 142(2) equivalence".

3.16 The effect of the 142(2) equivalence can result in higher requirements for exposures to entities from equivalent jurisdictions compared to non-equivalent jurisdictions.

3.17 The PRA's proposal is that the definition of LFSEs will instead solely rely on the "scale" test of whether a firm is >£79bn assets (more details on this threshold are in the PRA's Consultation Paper).

3.18 HM Treasury is therefore consulting on the deletion of article 142 in its entirety – including the equivalence regime for LFSEs. HM Treasury is, however, also open to reforming the regime if that would be more appropriate than deleting it and welcomes views from respondents on the approach to this issue.

Removal of CRR article 142(2)

4. What are respondents' views on removing or reforming the Article 142(2) equivalence for LFSEs?

Updating definitions

3.19 There are a number of definitions contained in the CRR which need to be updated to effectively implement Basel 3.1 and where it is more appropriate for HM Treasury to make these amendments than the PRA. This is because they also affect some elements of the CRR that will remain in place after the revocations detailed in Chapter 2.

3.20 The PRA have requested that HMT update the following three definitions contained in Article 4(1) of the CRR. The definitions, along with proposed updates are set out below.

Article 4(1)(54) Probability of default

Current definition: "probability of default" or "PD" means the probability of default of a counterparty over a one-year period;

Proposed update: "probability of default" or "PD" means the probability of default of an obligor or, where applicable, facility, over a one-year period, and, in the context of dilution risk, the probability of dilution over that one-year period;

Rationale: the aim of this update is to define probability of default (PD) more accurately in the context of dilution risk. The reference to facility recognises that PD can be estimated at facility level for retail exposures under the credit risk framework.

Article 4(1)(55) Loss given default

Current definition: "loss given default" or "LGD" means the ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default;

Proposed update: "loss given default" or "LGD" means the expected ratio of the loss on an exposure related to a single facility due to the default of an obligor or facility to the amount outstanding at default of that facility, and, in the context of dilution risk, the loss given dilution meaning the expected ratio of the loss on an exposure due to dilution, to the amount outstanding according to the pledged or purchased receivable;

Rationale: the aim of this update is to clarify that loss given default (LGD) is an expected ratio (in line with the proposed updated definition of PD). Similar to the definition of PD, the reference to facility is introduced as LGD can also be estimated at facility level.

Article 4(1)(56) Conversion factor

Current definition: "conversion factor" means the ratio of the currently undrawn amount of a commitment that could be drawn and that would therefore be outstanding at default to the currently undrawn amount of the commitment, the extent of the commitment being determined by the advised limit, unless the unadvised limit is higher;

Proposed update: "conversion factor" means the expected ratio of the currently undrawn amount of a commitment from a single facility that could be drawn from a single facility before default and that would therefore be outstanding at default to the currently undrawn amount of the commitment from that facility, the extent of the commitment being determined by the advised limit, unless the unadvised limit is higher;

Rationale: the aim of this update is to clarify that conversion factor is an expected ratio (in line with the proposed updated definition of PD), and to clarify that conversion factors can also be measured at facility level.

Updating definitions

5. Do respondents have any comments on the proposed changes to the definitions contained in Article 4(1)(54)-(56)?

Ensuring coherence between CRR and the PRA's Basel 3.1 rules

3.21 For obligations which could be set out in the PRA's rulebook but read across to broader concepts (such as level of application), the PRA will make provision for these concepts within their rulebook. The corresponding provision in the CRR will be narrowed to those elements retained in legislation.

3.22 While not set out in this consultation, HM Treasury will also review the statute book to identify and make any consequential amendments required as a result of the revocations detailed in Chapter 2. This will amongst other things, include how equivalence regimes will continue to operate.

Ensuring continuity for firm permissions

3.23 The CRR allows firms to apply to the PRA for specific treatment of their capital requirements, referred to as "permissions" (for example, to use the Internal Ratings Based (IRB) approach to calculate risk-weighted assets (RWAs) for credit risk). Some of the articles containing the PRA's power to grant permissions of this kind will be revoked using the power in section 3(1) of the FS Act.

3.24 In line with those provided in Basel 3 implementation, HM Treasury intends to include a savings provision in secondary legislation so that, where appropriate, firms do not need to reapply for existing permissions that are replicated in PRA rules thus minimising disruption for firms.

Ensuring coherence between CRR and the PRA's Basel 3.1 rules

6. Do you have any comments on HM Treasury's proposed approach to ensuring coherence with the statute book and ensuring continuity for firms?

Exercise of section 6: Amendments to the Credit Rating Agencies Regulation (CRAR)

3.25 For regulatory purposes and to support their assessment of risk in the UK, banks are permitted to use external credit ratings where they are issued by an external credit assessment institution (ECAI). Credit ratings then form a valuable input into the capital requirements for these exposures (for example lending to corporates).

3.26 The regime for ECAIs is set out in the Credit Rating Agencies Regulation (CRAR), which was introduced by the EU in 2009 following the financial crisis and provides for regulatory oversight of credit rating agencies (CRAs). Following Brexit, CRAR was onshored in the UK and therefore the same requirements currently apply to UK firms.

3.27 As part of the Basel 3.1 standards, the BCBS also set out several proposals for how ECAIs should be regulated. This enables credit institutions to be able to rely on the quality of those credit ratings sufficiently to use them to risk weight their assets.[2]

3.28 HM Treasury has powers under section 6 of the FS Act 2021 to amend the CRAR where this supports the implementation of the Basel 3.1.

3.29 In coordination with the FCA and PRA, HM Treasury has reviewed the Basel 3.1 standards for ECAIs. HM Treasury does not currently believe there are gaps within the UK regulatory and supervisory framework which would warrant use of the powers available under section 6. HM Treasury therefore proposes not to commence its use of section 6.

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[2] See para 99 of Finalising Post Crisis Reforms: https://www.bis.org/bcbs/publ/d424.pdf

Exercise of section 6: Amendments to the Credit Rating Agencies Regulation (CRAR)

7. Do you agree that the CRAR broadly aligns with the Basel 3.1 standards and further changes are not required?

Chapter 4
CRR Equivalence

4.1 Following the UK's exit from the EU, the UK inherited the EU's equivalence framework under the EU (Withdrawal) Act 2018.

4.2 Equivalence can provide market access to overseas market participants, preferential treatment for UK firms accessing overseas markets, or allow for regulatory relief by removing duplicative requirements on cross-border business.

4.3 In the CRR, the equivalence regimes allow UK firms holding assets or with exposures in equivalent countries to apply preferential risk weighting treatments. In some cases, treating these assets/exposures in the same way as they would for similar assets/exposures held in the UK.

4.4 Given the PRA has asked HM Treasury to revoke the bulk of the CRR articles associated with the standardised approach to credit risk, we considered whether to amend or revoke the equivalence provisions associated with these sections of the rulebook, as well as the other equivalence provisions in the CRR as set out in the table below.

Article	Title
CRR 107	Investment firms, credit institutions and exchanges
CRR 114	Central governments and central banks
CRR 115	Regional governments and local authorities
CRR 116	Public sector entities
CRR 142	Internal models (credit institutions and investment firms)
CRR 391	Large exposures

4.5 HM Treasury has already set out in Chapter 3 a request for views on reforming Article 142 equivalence in response to the PRA's request.

4.6 For the other regimes, at this point, given the exposures covered, and the lack of alternative regimes which continue to support cross-border financial services trade to the same degree, HM Treasury has decided not to amend or revoke these equivalence regimes.

4.7 While HM Treasury does not intend to amend or revoke the equivalence regimes alongside Basel 3.1 implementation, we would welcome views on the operation of these regimes, where they can be improved and if there are alternative tools to equivalence the government should be considering.

CRR Equivalence

8. What are your views on the operation of the equivalence regimes in the CRR?
9. Which equivalence regimes result in the most material impact on firms' exposures to other counterparties? Where would you recommend improvements or amendments?
10. Is there a need to create new equivalence regimes in CRR?
11. Are there any alternative tools that you would recommend the government consider regarding the prudential treatment of overseas assets?

Chapter 5

Credit rating coverage in the UK

5.1 Consistent with the Basel standards, banks in the UK can use external credit ratings to determine the amount of capital they are required to hold against the different risks on their balance sheets.

5.2 Where a credit rating is available, it improves banks' ability to assess the risk of the counterparty. These ratings feed through to capital calculations, thereby supporting efficient use of capital.

5.3 However, today, for lending to corporates that do not have an external credit rating (i.e., where it is unrated) a flat risk weight of 100% is applied under the standardised approach. This is regardless of the corporates' fundamental underlying risk.

5.4 Given BCBS's wide categorisation of corporates[3] and the incentives of different firms to choose to get a credit rating (in some cases this is very low), many are unlikely to have them.

5.5 This, coupled with an increased reliance on the standardised approach because of the introduction of the output floor, has led industry to share concerns that a risk-insensitive treatment of unrated corporates could impact the amount they lend to unrated corporates and/or their pricing. This could potentially lead to a dislocation between the actual risk of the exposure, and the capital held against it.

5.6 The PRA has today set out further detail on their proposed approach to implementing the Basel 3.1 rules for unrated corporates in the UK. This will provide banks with a choice to apply for permission to use a more risk sensitive framework that allows banks to distinguish between high quality ("investment grade") and lower quality ("non-investment grade") unrated corporate assets. This will provide for some level of risk-sensitivity in the standardised approach (and the output floor – if it binds) for unrated corporate lending, although it will not be as risk-sensitive as the framework for corporates that are rated.

5.7 In addition to the PRA's proposals, a supplementary approach to the concerns firms have around unrated corporates could be to improve the take-up of externally available credit ratings, where the

[3] Under Basel, corporates are defined as incorporated entities, associations, partnerships, proprietorships, trusts, funds, other similar entities and exposures that don't fall into one of Basel's other exposure categories.

risk weights under the standardised approach are more risk-sensitive than under the PRA's unrated corporates proposal.

5.8 As this is a cross regulatory authority issue, HM Treasury is seeking views from affected stakeholders on the benefits and costs of an increase in credit ratings coverage.

Credit rating coverage in the UK

12. Will the PRA's proposed approach to Basel 3.1 – and the impact this has on funding costs for unrated corporates – provide sufficient additional incentive for firms who would previously not have taken out a credit rating to now do so?

13. If not, are there alternative models that HM Treasury should consider to mitigate industry concerns regarding unrated corporates?

Chapter 6
Miscellaneous

6.1 In addition to the Basel 3.1 reforms, HM Treasury is also considering competitiveness changes to the existing prudential regime which can be implemented to a shorter timeline and where the benefits can be realised more quickly as a result.

Overseas exchanges

6.2 One such change relates to the prudential treatment of overseas exchanges and the process by which they are "recognised exchanges" under the CRR.

6.3 When the UK left the EU and onshored the CRR, HM Treasury amended the definition of "recognised exchanges" to effectively link it to equivalence provided under paragraph 8 of Schedule 3 to Regulation (EU) No 600/2014 (Markets in Financial Instruments Directive (MiFIR)).

6.4 However, outside of the CRR and within the UK's broader regulatory framework, the UK has two methods of recognising overseas exchanges: the above equivalence provision, and the Recognised Overseas Investment Exchange (ROIE) regime. The ROIE regime has ensured that UK firms can continue to trade on key exchanges absent a jurisdictional equivalence decision.

6.5 However, following the end of the temporary transition period (TTP) in March 2022, the lack of an equivalence decision for the EU, or a link to the ROIEs regime in the UK CRR definition of recognised exchanges, has resulted in increased capital requirements for firms trading on these exchanges.

6.6 HM Treasury therefore proposes to:

- add a link to the ROIE regime as part of the definition of recognised exchanges; and
- set out that firms covered in the definition of recognised exchanges are either those detailed in the PRA's regulatory technical standards (RTS) which accompany the definition of recognised exchanges or are those subject to the ROIEs regime. Exchanges from UK equivalent regimes are meant to be captured in the PRA's technical standards list, while individual exchanges that choose to apply, and are granted access under the ROIEs regime are approved and confirmed by the FCA.

6.7 This change should ensure that UK firms can continue to undertake the activity they need with key exchanges from the EU and more broadly across the world. This is in line with the decisions the FCA has made to designate an exchange as a ROIE.

Overseas exchanges

14. Do you agree with the approach linking the ROIEs regime to the definition of "recognised exchange"?

Internal Total Loss Absorbing Capacity requirements for UK based material sub-groups of non-UK Global Systemically Important Banks

Deleting Article 92b of the CRR

6.8 In 2015, the Financial Stability Board (FSB) agreed a set of international standards for the purpose of ensuring a common international approach to the resolution of Global Systemically Important Banks (G-SIBs).[4]

6.9 These standards established the concept of Total Loss Absorbing Capacity (TLAC), requiring that G-SIBs have sufficient externally issued capital and subordinated debt to implement an orderly resolution that minimises any impact on financial stability, ensures the continuity of critical functions, and avoids exposing public funds to loss.

6.10 The standards also set out a requirement for the material sub-groups of G-SIBs, consisting of one or more direct or indirect subsidiaries of a resolution entity that are not themselves resolution entities, to hold "internal" TLAC (iTLAC). This is required to be set within the range of 75-90% of the full external TLAC requirement (if the subsidiary were a standalone entity), with the specific point within that range set at the discretion of the local resolution authority. The intent of iTLAC is to facilitate the resolution of complex, cross-border banking groups.

6.11 The UK was closely involved in FSB discussions and the TLAC standards are similar to the Minimum Requirements for Own Funds and Eligible Liabilities (MREL) framework.[5] This framework provides the Bank of England with the ability to set requirements for relevant UK based firms to hold sufficient capital and appropriately subordinated debt to facilitate their effective resolution, as it judges appropriate. Similar to the FSB standards, the framework also provides for the UK material subsidiaries of non-UK headquartered firms to hold "internal" MREL at the Bank of England's discretion. The Bank's

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[4] https://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf

[5] Established in the UK through the Banking Act 2009, the Bank Recovery and Resolution No.2 Order, the MREL Statement of Policy (first edition 2016) and the 2016/1450 MREL Regulatory Technical Standard.

MREL Statement of Policy sets out that the Bank expects to scale this within the range of 75-90% of the hypothetical external requirements.[6]

6.12 In implementing the TLAC standards agreed by the FSB, the European Union (EU) opted to deviate from the FSB's agreed position and remove the element of resolution authority discretion by applying a fixed 90% iTLAC requirement. The relevant European regulation was directly applicable in UK law (and subsequently onshored at the time of the UK's exit from the EU). Consequently, in those cases where CRR iTLAC requirements apply, the Bank of England has lost its discretion to set "internal" requirements scaled within the 75-90% range.

6.13 Following the UK's departure from the EU, the government does not consider there to be a clear rationale for retaining the fixed 90% requirement and so proposes legislating when parliamentary time allows to delete Article 92b of the CRR via secondary legislation using powers contained within the Financial Services and Markets Bill.

6.14 The government considers that the FSB's standards for setting "internal" loss absorbing capacity will instead be effectively implemented through the Bank of England's established MREL framework without the need for any further legislation. Under the framework, the Bank is able to exercise its discretion to set "internal" capital and subordinated debt requirements as it judges appropriate for the purposes of meeting the statutory objectives of the special resolution regime (including financial stability). The government expects the Bank will do so in line with the FSB standards.

6.15 The government will consult fully on the future of the remainder of the onshored CRR TLAC regime in due course.

Deleting Article 92b of CRR

15. Do respondents agree with the government's intention to legislate to remove the fixed 90% iTLAC requirement for UK based material sub-groups of non-UK G-SIBs?

[6] https://www.bankofengland.co.uk/-/media/boe/files/paper/2021/mrel-statement-of-policy-december-2021-updating-2018.pdf?la=en&hash=513F77100E9424C7F4019928FEFA42AC2C025AA0

Annex A
Financial Services Act 2021 revocation power

A.1 HM Treasury envisages exercising its powers under section 3 of the Financial Services Act 2021.

A.2 The revocations listed in Chapter 2 relate to, or are connected to the following matters specified in section 3(2) of the Financial Services Act:

(b) the following aspects of the standardised approach to credit risk

(i) exposure value;

(ii) risk weights for exposures to institutions;

(iii) exposures to corporates;

(iv) exposures secured by mortgages on immovable property;

(v) retail exposures;

(vi) subordinated debt and equity exposures;

(vii) the use of credit assessments;

(c) classification of off-balance sheet items;

(d) the following aspects of the internal ratings based approach to credit risk –

(i) the advanced internal ratings based approach for asset classes that cannot be modelled in a robust and prudent manner;

(ii) input parameters;

(iii) the requirement to use the internal ratings based approach for all significant exposure classes;

(iv) the 1.06 scaling factor for estimating risk-weighted assets;

(vi) risk-weighted exposure amounts for equity exposures;

(vii) the treatment of expected loss amounts by exposure types;

(e) the use of credit risk mitigation techniques for exposures risk-weighted under the standardised approach to credit risk or the internal ratings based approach to credit risk;

(g) own funds requirements for operational risk;

(h) the following aspects of own funds requirements for market risk

(i) the approaches for calculating the own funds requirements for market risk;

(j) own funds requirements for credit valuation adjustment risk

(p) any other matter which is the subject of a CRR Basel standard

A.3 HM Treasury will also exercise its use of the section 3(3) which enables further revocations of the CRR to maintain coherence of the overall prudential regime.

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