CP16/22 – Implementation of the Basel 3.1 standards

Consultation Paper 16/22

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Content

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Reponses are requested by Friday 31 March 2023.

The PRA prefers all responses to be sent by email to: CP16_22@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:

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Overview

1.1 The global financial crisis revealed significant shortcomings in the calculation of risk-weighted assets[1] (RWAs) and capital ratios, defined as the ratio of capital held by firms to RWAs. The Basel Committee on Banking Supervision (BCBS) identified three factors as key to mitigating the severity of subsequent financial crises:

- raising the quantity of capital in the financial system, per unit of risk;
- increasing the quality of capital held by firms; and
- improving the accuracy of risk measurement by firms.

1.2 In response, the BCBS agreed a series of reforms to its **standards** (Basel standards). These reforms, collectively known as the **'Basel III standards'**, were intended to enhance the resilience of banks throughout the economic cycle. The Prudential Regulation Authority (PRA) was actively involved in their development and in the negotiations that led to their agreement as a package.

1.3 Many of the Basel III standards have already been implemented in the UK through EU legislation that was onshored as part of the UK's exit from the EU[2] on 31 December 2020, and subsequent work by the PRA, including through new rules and policy material relating to the **'Implementation of Basel standards: Final rules'** in Policy Statement (PS) 22/21 and '**The UK leverage ratio framework'** in PS21/21.

1.4 The phases of the Basel III standards that have already been implemented primarily focused on increasing the quantity and quality of capital maintained by firms (the numerator of capital ratios) and also introduced new requirements for leverage and liquidity.

1.5 This Consultation Paper (CP) covers the parts of the Basel III standards that remain to be implemented in the UK.[3] The PRA refers to them as the 'Basel 3.1 standards'. The proposals address mainly the last element of the reforms – the measurement of RWAs (the denominator of capital ratios). The proposals would, among other things, revise the calculation of RWAs by improving both the measurement of risk in internal models (IMs) and standardised approaches (SAs), and the comparability of risk measurement across firms.

1.6 Across the overall package of proposals set out in this CP, the PRA has aligned with the Basel 3.1 standards, while exercising its judgement to tailor them where it is appropriate and the evidence is supportive. The package advances the PRA's primary objective to promote the safety and soundness of the firms that it regulates and its secondary objective to facilitate effective competition, as well as considering the various matters to which it must 'have regard', as explained in more detail below.

Purpose of this consultation

1.7 This CP sets out the PRA's proposed rules and expectations with respect to the implementation of the Basel 3.1 standards, and consists of the following:

- a revised SA for credit risk;
- revisions to the internal ratings based (IRB) approach for credit risk;
- revisions to the use of credit risk mitigation (CRM) techniques;
- removal of the use of IMs for calculating operational risk capital requirements,[4] and a new SA to replace existing approaches;
- a revised approach to market risk;[5]
- the removal of the use of IMs for credit valuation adjustment (CVA) risk, replaced by new standardised and basic approaches; and
- the introduction of an aggregate 'output floor' to ensure total RWAs for firms using IMs and subject to the floor cannot fall below 72.5% of RWAs derived under SAs, to be phased in over five years.

1.8 The proposals also revise certain areas of the Basel III standards already implemented in the UK and would have consequential impacts on the UK implementation of the leverage ratio, and elements of the liquidity and large exposures frameworks. These consequential impacts are described in paragraphs 1.57 to 1.59 below.

Scope

1.9 This consultation is relevant to PRA-authorised banks, building societies, PRA-designated investment firms, and PRA-approved or PRA-designated financial or mixed financial holding companies (collectively 'firms').

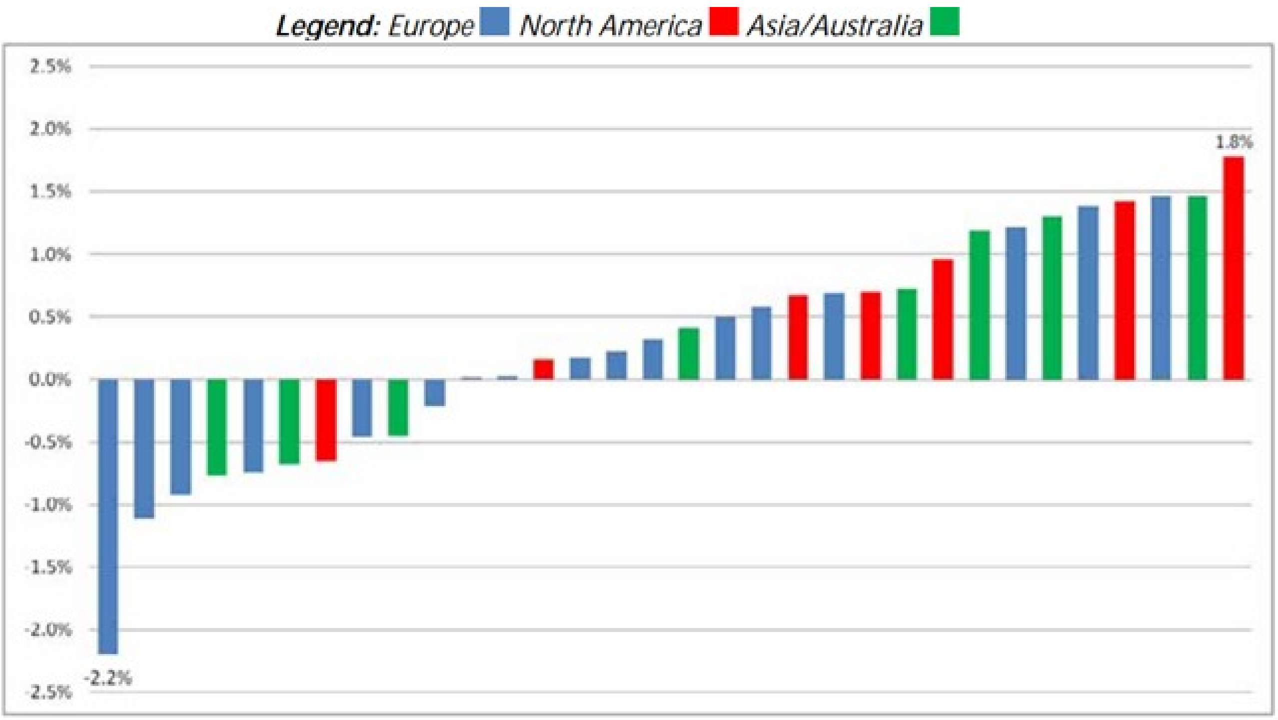
1.10 PRA-authorised banks, building societies and designated investment firms that meet the 'Simpler-regime criteria' definition, as specified in paragraph 1.53 below, Chapter 2 – Scope and levels of application, and Appendix 9, would not have to apply the proposed implementation of the Basel 3.1 standards set out in this CP, but could choose to be subject to them. However, the proposals should still be of interest to all firms meeting these criteria, for the reasons set out in paragraphs 1.53 to 1.56 below. The PRA invites responses from such firms on the proposals set out in this CP, including how aspects could be adjusted for future application to them.

Background and overview of proposals

1.11 The global financial crisis revealed significant shortcomings in the pre-crisis regulatory framework, particularly with respect to the calculation of risk-weighted capital ratios. Investors lost confidence in capital ratios that were calculated in accordance with earlier iterations of the Basel standards, known as Basel I and Basel II.

1.12 In December 2017, the BCBS also noted that its own empirical analysis showed a **‘worrying degree of variability’** in the calculation of risk weights at the peak of the crisis. Importantly, variability in RWAs also makes firms’ capital ratios less consistent and comparable. While some variability is to be expected in RWAs calculated using IMs, a high degree of variability undermines confidence in capital ratios, and; therefore, confidence in the resilience of firms. Chart 1 shows the **BCBS’s July 2013 analysis of risk weight variation on firms’ capital ratios**. It shows the results of a portfolio benchmarking exercise (a hypothetical portfolio exercise (HPE)), under which 32 large internationally active banking groups were asked to ‘evaluate the risk of a common set of (largely low-default) wholesale obligors and exposures’.[6] The HPE revealed ‘notable dispersion in the estimates of PD and LGD assigned to the same exposures’. Similar HPEs focused on market risk in the trading book found similarly high levels of variation.

Chart 1: Impact of Risk Weight variation on capital ratios



Source: BIS RCAP – Analysis of risk-weighted assets for credit risk in the banking book. Notes: Change from 10% capital ratio if individual bank risk weights from the HPE are adjusted to the median from the sample. Each bar represents one bank. The chart is based on the assumption that variations observed at each bank for the hypothetical portfolios are representative for the entire sovereign, bank, and corporate portfolios of the bank are adjusted accordingly. No other adjustments are made to RWA or capital.

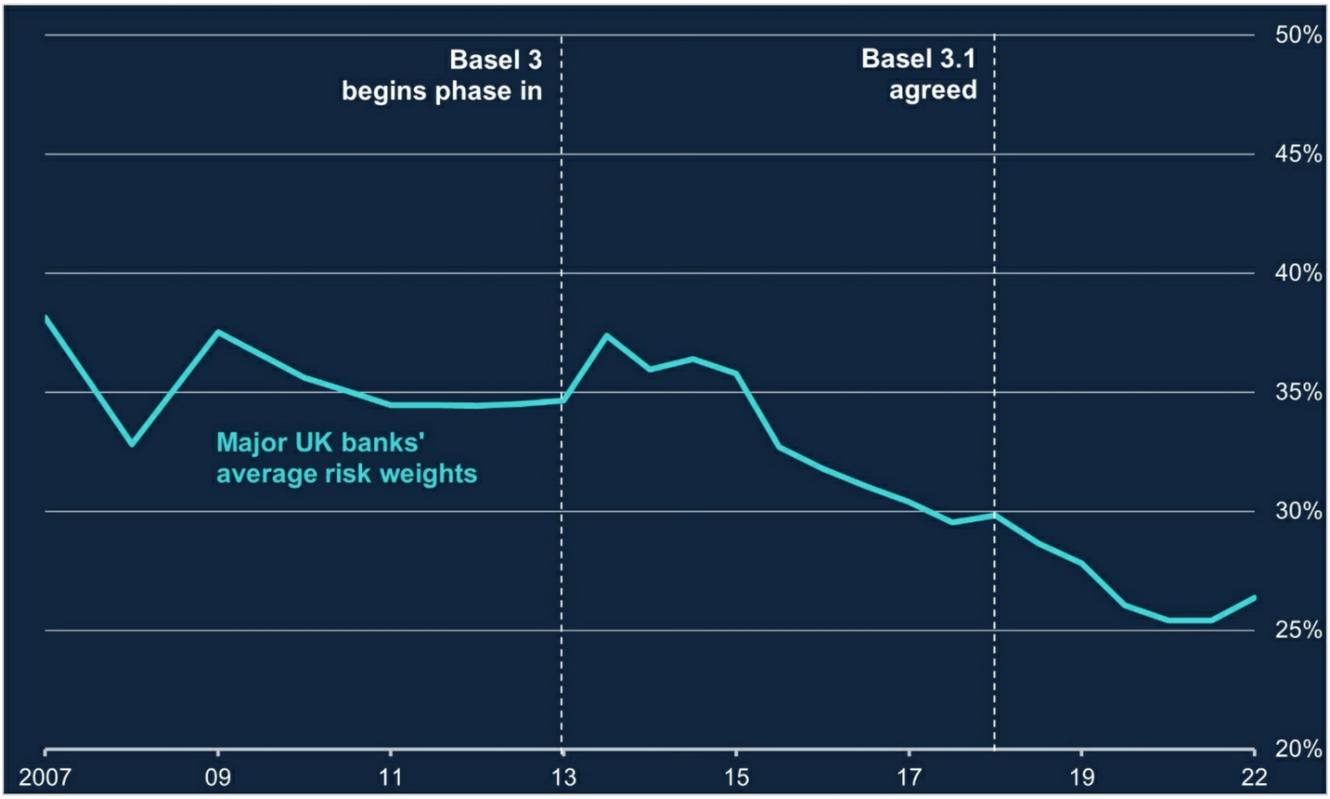
1.13 As demonstrated in the global financial crisis, if a lack of confidence in risk-weighted capital ratios increased in a downturn and put in doubt the adequacy of capital levels in firms, it could have implications for the resilience of the financial system as a whole. As a consequence, the financial system may not be able to continue lending to households and businesses during a downturn, which would amplify, rather than absorb, economic shocks.

1.14 The Basel 3.1 standards have been developed by the BCBS to address these concerns and aim to restore credibility in risk-weighted ratios, through greater robustness and risk-sensitivity in the SAs and constraints on the use of IMs, and restricting the RWA benefits that IMs can provide. These goals link closely to the PRA's primary objective.

1.15 In the UK, there has been a downwards drift in average risk weights (measured as the ratio of RWA to assets) for major UK banks in the last decade (Chart 2). Average risk weights fell from 37% in 2015, at the time of the negotiations of the Basel 3.1 standards, to historically low levels of 25% in 2020. That trend could reflect a number of factors, including firms shifting to less risky assets and historically low levels of losses, but it could also reflect, in part, under-estimation of internally modelled risks due for example to model risk and data uncertainties. This highlights the importance of ensuring risk measurement remains robust to underpin confidence in capital ratios and the quantum of capital set against risks.

Chart 2: Major UK banks'[7] aggregate risk weights have fallen over time

Major UK banks' historical aggregate risk weights



Source: Firms' published accounts and related public disclosures, PRA regulatory returns, PRA analysis and calculations.

1.16 The proposals set out in this CP aim to address the concerns described above by improving risk measurement and making the calculation of RWAs more robust and consistent across firms through proposing:

- a revised set of SAs across all risk areas to introduce more granular requirements that better reflect the risk of firms' exposures and make them a more credible alternative to using IMs; and
- changes to the IM approaches available to firms. For example, in some areas (CVA risk and operational risk), the proposals would remove IM approaches entirely in order to address concerns that the models could not effectively measure these risks and added unnecessary complexity. With respect to IRB, for exposures where IRB approaches remain available, the proposals would reduce the available flexibility in modelling approaches and introduce greater constraint on some model inputs. The most significant changes to the IM approaches are in the market risk framework, where the PRA proposes to introduce a new, more comprehensive modelling approach, alongside improvements to the robustness of the trading book/non-trading book boundary.[8]

1.17 Finally, the proposed new output floor aims to provide a backstop that limits the extent to which firms using the IM approaches (IM firms) can lower their RWAs relative to the revised SAs used by SA firms. This floors IM firm RWAs at 72.5% of their SA RWAs on average across all exposures. The PRA proposes that IM firms apply the same revised SAs in the output floor calculation to those used by SA firms. This is intended to ensure that the output floor is a consistent and transparent backstop to modelled risk weights. It would also help enhance comparability and facilitate more effective competition between SA and IM firms.

Accountability framework

1.18 In carrying out its policy-making functions, the PRA is required to comply with several legal obligations. The PRA has a statutory duty to consult when introducing new rules (FSMA s138J), or new standards instruments (FSMA s138S). When not making rules, the PRA has a public law duty to consult widely where it would be fair to do so.

1.19 The proposals set out in this CP have been developed by the PRA in accordance with its statutory objectives and informed by the regulatory principles and the matters to which it must have regard in making policy as set out in the Financial Services and Markets Act 2000 (FSMA). Appendix 6 lists the statutory obligations applicable to the PRA's policy development process. Where the rules proposed are Capital Requirements Regulation (CRR) rules, the analysis in this CP sets out how the matters to which it must have regard when making CRR rules have affected the proposals.

1.20 The Financial Services Act 2021 (FS Act) enables the implementation of the proposals set out in this CP in the UK by providing HM Treasury (HMT) with a power to revoke provisions from the CRR.[9] HMT is proposing to use this power to revoke parts of the CRR so that the PRA can make the rules proposed in this CP.[10]

1.21 However, some of the CRR provisions would remain in UK primary legislation. Firms should read this CP together with the provisions that have already been transferred to the PRA Rulebook under earlier phases of the implementation of the Basel III standards, including through new rules and policy material relating to the 'Implementation of Basel standards: Final rules' in PS22/21, 'The UK leverage ratio framework' in PS21/21 and those that would remain in the CRR to fully understand the proposals.

PRA objectives analysis

1.22 The proposals set out in this CP would advance the PRA's primary objective to promote the safety and soundness of the firms that it regulates. Improving the measurement of risk would help ensure firms are adequately capitalised given the risks to which they are exposed. Moreover, the proposals address weaknesses in the current Pillar 1 framework in a direct, consistent, and transparent way. It is important to underpin confidence in the measure of risk and the quantum of capital set against that risk. In turn, these would deliver the primary benefit of the Basel III package in lowering the likelihood of future financial crises. In particular, the proposals would advance the PRA's primary objective by:

- simplifying and reducing the range of approaches available for RWA calculations, thereby promoting the consistent application of approaches across firms through simpler and clearer requirements;
- improving the risk-sensitivity of SAs in the capital framework, resulting in RWAs that are more reflective of risk for firms using those approaches;
- constraining the use of IM approaches in areas where RWAs cannot be modelled in a robust and prudent manner, to reduce unwarranted RWA variability; and
- introducing an output floor, limiting how low internally-modelled RWAs can fall below those produced under the revised SAs, thus reducing excessive variability and cyclicality in RWAs.

1.23 The proposals would also advance the PRA's secondary objective to facilitate effective competition. In particular, they would:

- increase risk-sensitivity under the SAs which aims to ensure firms using the SAs calculate RWAs that are better aligned to the risk of their portfolio and to those calculated by IM firms;
- require more robust and prudent modelling within IM approaches, and limit the reduction in RWAs that can be achieved through their use, thereby reducing the potential competitive advantage that IM firms currently have over SA firms;

- promote a more consistent and level playing field, by basing the proposed output floor on the same SA calculation for both SA and IM firms; and
- reduce barriers to entry for SA firms to use IM approaches, for example by permitting the roll-out of the IRB approach by individual asset classes rather than across all credit risk exposures, which would improve opportunities for existing SA firms to use IM approaches.

1.24 The chapters of this CP set out in more detail how the particular proposals advance the PRA's primary and secondary objectives.

'Have regards' analysis

1.25 In developing the proposals set out in this CP, the PRA has had regard to the FSMA regulatory principles, the aspects of the Government's economic policy set out in the HMT recommendation letter from 2021 and the supplementary recommendation letter sent in April 2022. Where the proposed new rules are CRR rules (as defined in section 144A of FSMA), the PRA has also taken into consideration the matters to which it is required to have regard when proposing changes to CRR rules.

1.26 Across all the proposals set out in this CP as a whole, the 'have regard' factors that the PRA considered to be the most significant in its analysis were **relevant international standards (FSMA CRR rules)** and **the relative standing of the UK as a place for internationally active firms to operate (FSMA CRR rules)**.

1.27 In considering these have regards and the specific characteristics of the UK's financial system, the PRA has identified a number of areas where, due to the flexibility afforded by the UK's withdrawal from the EU, limited adjustments to international standards could better capture risk and further support the competitiveness and the relative standing of the UK, while advancing the safety and soundness of firms and contributing to strengthening UK financial stability. For example, the PRA proposes to apply targeted measures to address concerns with respect to risk-weighting of exposures to unrated corporates under the credit risk SA and the calibration of the standardised approach to counterparty credit risk (SA-CCR). The relevant considerations for these adjustments are described in more detail in the relevant chapters of this CP. In developing the proposals, including the proposed adjustments to international standards, the PRA has had regard to the proposals that certain other major jurisdictions have made.[11]

1.28 While the PRA is proposing limited adjustments to international standards, it considers that, overall, the proposals set out in this CP adhere to international standards, which in turn supports the relative standing of the UK. As identified by the **European Banking Authority (EBA) and European Central Bank** (ECB), the European Commission's proposals include a number of deviations from international standards.[12] If adopted, these deviations would likely make the EU an international outlier, particularly in its approach to the implementation of the output floor. The PRA's analysis of other jurisdictions' proposals suggests that the vast majority are also proposing to adhere to international standards, including for example Singapore, Hong Kong, Switzerland, Canada, and Australia.

1.29 International standards support an open, efficient, and resilient global financial system. In doing so, they reduce competitive distortions across countries, enabling firms to compete on a global level playing field. The UK, as a global financial centre, is a particularly important part of a deeply interconnected global financial system. The International Monetary Fund has described **UK financial stability as a global public good**. However, this also means that the risks that the UK faces often emerge beyond its borders. Because of the interconnected nature of the global financial system and the potential for financial distress to spread across borders, the PRA's objectives are most effectively advanced through alignment with international standards.

1.30 The PRA considers that there is a clear link between alignment with international standards and the relative standing of the UK. Adherence to international standards underpins the UK's position as one of the largest global financial centres as, in the PRA's view:

- financial services firms and other stakeholders rely on internationally aligned standards being implemented, and the resulting stability and predictability, when they choose to conduct their business in the UK;
- it is more efficient for firms to operate across jurisdictions that adopt and apply international standards in a predictable and stable way as they do not need to follow a different regime in each jurisdiction where they operate;
- regulators in other jurisdictions allow such deep interconnections with the UK financial system because of the assurance provided by UK authorities' implementation of robust standards; and
- the UK's position as a global financial centre also relies on it being open for firms from around the globe to conduct business. The financial sector, which generated 8.3% of the UK GDP in 2020 and represents the third largest proportion of the economy among OECD nations,[13] is large and open. To protect the UK economy from global shocks, it is particularly important to adhere to robust standards.

1.31 A vibrant financial sector in turn underpins core economic activities in the UK and supports a healthy and growing domestic economy. Consumers and businesses can borrow, invest, and manage risk with confidence that individual institutions within it are sufficiently robust to withstand economic shocks and can; therefore, maintain their lending.

1.32 Other 'have regards' that gave rise to particularly significant issues for consideration in individual proposals are set out in the chapters of this CP.[14] In its analysis of the proposals set out in this CP as a whole, the PRA considered the following other 'have regards' to be the most significant:

1. Efficient and economic use of PRA resources (FSMA regulatory principles):

- The PRA has considered whether the proposals would result in efficient and economic use of the PRA's resources. To gain assurance on the successful implementation of these changes, supervisors would need to monitor firms' initial implementation and ongoing application. Although some proposals would increase upfront resourcing demands to review firms' IM submissions and applications to use certain approaches, others remove modelling altogether and reduce modelling choices, which should reduce supervisory resource requirements over time.
- The proposals also aim to limit resource costs by restricting approval processes in some areas, such as CVA, to only the most advanced approach available to firms. Overall, the PRA considers that the prudential benefits of the proposals outweigh the additional resource costs.

2. Proportionality of the PRA's regulation (FSMA regulatory principles):

- The PRA has considered whether the proposals strike an appropriate balance between the expected prudential benefits gained from their implementation and the burden and restrictions imposed on any firm.
- The PRA considers that the proposals are proportionate. They would introduce a more risk-sensitive capital framework in which the regulatory burden of calculating capital requirements is proportionate with the risks faced by a firm, with simpler alternatives available for firms with lower risk profiles, such as the proposals for market risk and CVA.
- Additionally, firms meeting the proposed Simpler-regime criteria would not have to apply the proposed implementation of the Basel 3.1 standards, but could choose to be subject to it, as set out in paragraph 1.54 below and Chapter 2. This would allow the PRA to separately consider, including through responses to this CP from small firms, the appropriate risk-based capital framework for these firms, as well as ensure that small firms only experience one change to the applicable risk-based capital framework.

3. Provision of finance to UK businesses and consumers on a sustainable basis (FSMA CRR rules), sustainable growth (FSMA regulatory principles), and growth (HMT recommendation letters):

- The PRA considers that the proposals would help to ensure that firms are appropriately capitalised for the risks that they face. This would enable firms to continue providing finance for the real economy throughout the economic cycle, rather than having to reduce lending in stress, and exacerbate the economic cycle.
- Where the PRA considers risk-based adjustments to the Basel 3.1 standards are appropriate and would support the provision of finance, the proposals do so. For example, with respect to unrated corporates risk-weighted under the SA for credit risk, the PRA proposes to adjust the Basel 3.1 standards by introducing the option to risk-weight investment grade unrated corporates at a lower weight than prescribed in the Basel 3.1 standards at 65%, and non-

investment grade unrated corporates at a higher rate of 135%.

- The PRA is seeking further evidence through this consultation regarding the appropriate calibration of this adjusted approach, particularly for non-investment grade unrated corporates.
- Another example is with respect to derivatives. The PRA proposes to adjust the calibration of CVA and SA-CCR where the PRA considers the impact to be overly conservative. This 'have regard' was also factored into the PRA's considerations when developing its proposals related to the treatment of exposures to small and medium-sized enterprises (SMEs) and infrastructure projects in the credit risk framework. The PRA welcomes feedback, both quantitative or qualitative, on its proposed approach and calibration of the risk weights for these exposures, and it would encourage respondents to provide relevant evidence.

4. 2050 net-zero target in the Climate Change Act 2008 (FSMA regulatory principles introduced by the FS Act and the HMT recommendation letters):

- The Basel 3.1 standards were not designed to include specific climate risk-related measures. Therefore, the proposals set out in this CP are broadly neutral in terms of the UK net-zero target. Nevertheless, the net-zero target gave rise to some issues in the development of a number of proposals. Examples include:
  - for specialised lending under the IRB approach, were the PRA to require the 'slotting' approach for object and project finance exposures, there could be an increase in risk weights, and firms could be deterred from investing in green finance projects. The PRA's proposal instead is to continue allowing the use of the foundation internal ratings based (FIRB) and advanced internal ratings based (AIRB) approaches, or slotting for object and project finance exposures, which should avoid any potential negative impact there might otherwise have been on the net-zero target;
  - for specialised lending in the credit risk SA, the PRA considers that the proposed removal of the infrastructure support factor would be offset by the PRA's proposal for project finance exposures (which explicitly covers environmental infrastructure projects) where 'high quality' exposures would receive lower risk weights; and
  - for market risk, the PRA proposes to specify a unique risk weight for carbon emissions certificates, which could be adjusted if the PRA sees future evidence that the calibration of the Basel 3.1 standards is excessively conservative.
- In parallel to its policy development work on the proposals set out in this CP, the PRA has a significant programme of domestic policy and supervision work related to climate risk and is actively engaging in international policy development at the BCBS. The Bank of England's (the Bank) **2021 Climate Change Adaptation Report** presented initial analysis of potential policy options that could be developed. Following that report, on Wednesday 19 October and Thursday 20 October 2022, the Bank and PRA hosted a climate and capital conference to help advance work in this area. The PRA will provide an update on its approach to this issue in

due course.

5. Different business models (FSMA regulatory principles):

- The PRA considers that the proposals set out in this CP help to ensure that firms are adequately capitalised for the risks that they take. The proposed changes to the use of IMs and greater risk-sensitivity proposed in the SAs would have different impacts on firms, depending on their business mix and risk profile, which the PRA considers to be consistent with the objectives of the Basel 3.1 standards.
- This have regard was most relevant to the PRA's considerations for various issues in credit risk SA (such as the approach for real estate, regulatory retail, and unrated corporate exposures), the proposals to allow multiple approaches for market risk and CVA, and with respect to the application of the output floor to mutuals (see next paragraph).

1.33 In addition, the PRA has a statutory obligation to give an opinion on the impact of its proposals on **mutual societies (s138K FSMA)**, hereafter 'mutuals', which refers to building societies, friendly societies, co-operatives, and community benefit societies.[15] For the purpose of this CP, all references to 'mutuals' refer to building societies, which are the only group of mutuals within the proposed scope of application as set out in Chapter 2.[16] The PRA considers that mutuals as a group would not be impacted differently to other types of firms, particularly since most use SAs. With respect to mutuals that use IM approaches, the PRA considers that these firms may experience a relatively higher impact from the output floor, where IRB approaches continue to produce lower average risk weights for residential retail mortgages relative to the SA, following the implementation of changes to Supervisory Statement (SS) 11/13 – **'Internal Ratings Based (IRB) approaches'** as set out in PS13/17 – **'Residential mortgage risk weights'**, PS11/20 – **'Credit risk: Probability of Default and Loss Given Default estimation'**, and the implementation of the Basel 3.1 standards as proposed in this CP. This is because the business models of many mutuals are relatively undiversified.

1.34 The PRA has considered this impact and concluded that a prudential case nonetheless exists to apply the output floor to mutuals with IM permissions, in line with the proposed approach to other IM firms and ring-fenced bodies (RFBs). While mutuals may be more impacted by the proposed output floor due to operating with legal constraints on their capacity to diversify, this does not reduce their exposure to model risk, which may in fact be amplified by credit risk concentration, and less diversified use of models.

1.35 The PRA considers that the impact of the output floor on mutuals using IM approaches may also be smaller when considered alongside the combined impact of other elements of the capital framework, for example firm-specific buffers (see Chapter 10 – Interactions with the PRA's Pillar 2 framework). From the perspective of competition, the PRA also considers that the proposed approach would result in these mutuals being treated consistently with RFBs, which are similarly concentrated in residential retail mortgage lending.

1.36 However, in recognition of the constraints on the business models of mutuals and the potential impact due to their concentration in residential retail mortgage lending, the PRA particularly welcomes responses from mutuals using IM approaches on the impact of the output floor proposed in this CP. The PRA would additionally welcome any responses that could be useful as the PRA develops its strong and simple regime.

1.37 The PRA has considered its obligation to have 'due regard' to the need to promote equality of opportunity, eliminate discrimination and foster good relations between those with protected characteristics and others set out in the Equality Act 2010 in the context of the proposals set out in this CP, and has not identified any adverse impacts.

Cost benefit analysis[17]

1.38 In developing the proposals set out in this CP, the PRA has considered a range of factors that contribute to the cost benefit analysis (CBA) underpinning the proposals. The PRA has assessed the costs and benefits of individual policies 'bottom up' (as set out in each policy chapter) and considered the aggregate impact 'top down'. The CBA is forward-looking and; therefore, based on uncertainties and assumptions.

1.39 As described above, after the global financial crisis, the BCBS identified three key factors from the global financial crisis to be addressed with reforms to banking prudential policy. These factors were:

- more capital in the system relative to the underlying risks;
- better quality capital in terms of loss absorption; and
- more accurate risk capture and measurement.

1.40 Accurate and appropriate risk measurement and capture are the foundations that ensure that the benefits of more, and better quality, capital are able to be realised in the future. The mismeasurement of risk has significant implications for the UK economy. Underestimation of risk reduces the overall level of capital in the system for a given level of risk, increasing the likelihood of a financial crisis, misallocation of financing, and substantial losses to the UK economy. Overly conservative estimation of risk, while still realising the benefits of reducing the likelihood of financial crises, unduly raises costs, misallocates financing, and reduces the deposit-taking sectors' ability to support the wider economy.

1.41 When implementing the Basel III standards, the PRA presented research that showed[18] that increasing the amount and quality of capital in the UK financial system directly reduced the likelihood of a future financial crisis, which has significant permanent positive effects on UK economic growth, even once costs to firms are taken into account. The benefits to the UK economy are the losses to UK GDP that are avoided as future financial crises become less frequent. Importantly, these benefits are realised only if risks are appropriately identified and captured within the regulatory framework.

1.42 The proposals set out in this CP provide a more stable, internationally-consistent basis for addressing key issues with respect to the mismeasurement of risk by improving IM approaches, making the SAs more risk-sensitive, and limiting excessive variability and cyclicality in RWAs. All of these improve measurement of risk within Pillar 1.

1.43 The PRA has in the past used existing regulation, at least partly, to address potential mismeasurement of risk by firms. This includes adjustments to individual firm requirements under Pillar 2A and the PRA (stress testing) buffers. The proposals set out in this CP would deal more comprehensively and directly with measurement issues and, in particular:

- revise IM approaches to credit risk and introduce an output floor to address model risk, which raises non-stressed RWAs for some firms and more comprehensively captures risks measured under Pillar 1. In turn, all else being equal, the size of the PRA buffer for some firms may be reduced;
- amend the Pillar 1 treatment of market risk and operational risk in line with new international standards. To the extent these changes improve risk-capture in Pillar 1, Pillar 2A requirements which cover risks not adequately addressed by Pillar 1 would be adjusted accordingly;
- limit the extent to which firms can use the IM approaches, given evidence of excessive variability in RWA calculations; and
- improve transparency via Pillar 3 disclosures of these risks and improve market discipline of firms' risk considerations.

1.44 Implementation of the Basel 3.1 standards as proposed would, therefore, help to ensure that the UK is able to continue to realise the benefits of the post global financial crisis reform package, including having more, and better quality, capital in the UK banking system. If the proposals set out in this CP are not implemented, risks may not be adequately measured, particularly within Pillar 1. This outcome would reduce the safety and soundness of firms and raise the probability of crises in ways that would be difficult to detect, particularly if measures of risks within SAs and complex IMs diverge over time. The proposals set out in this CP would also help maintain trust and confidence among stakeholders (including international investors and regulators) in the UK financial system which is host to one of the largest global financial centres.

1.45 The PRA's proposed implementation of the Basel 3.1 standards also advances the PRA's secondary objective of facilitating effective competition. For some exposures, firms that use IMs can typically apply lower capital requirements than firms that use SAs, given the higher risk-sensitivity of IM approaches compared to the SAs. Improvements to the risk-sensitivity of SAs, more robust and prudent modelling requirements for use of IMs, and the application of the output floor would limit the extent to which measurement of RWAs would diverge between IM and SA firms.

1.46 In total, the benefits of the proposals set out in this CP would primarily be driven by improvements to the safety and soundness of firms. Additional benefits would be derived from more effective competition among firms, and the maintenance of trust and confidence in the UK as a global financial centre which, in turn, would support the international competitiveness of the UK.

1.47 Set against the benefits, there would be costs arising from the implementation of the Basel 3.1 standards, as the PRA updates its supervisory approach and as firms make necessary adjustments to their risk measurement approaches.

1.48 For affected firms, there would be compliance costs of implementing the Basel 3.1 standards. These compliance costs would fall most significantly on large banks and large building societies that have the most complex business models and are most able to absorb these costs.

1.49 There would also be some relatively small costs to affected firms overall, associated with the need to adjust capital resources in response to the proposals, although the impact would differ for different firms. For example, based on an analysis of past firm behaviour and quantitative impact study (QIS) data provided by firms, there would be an overall decrease in capital requirements for smaller-sized building societies, while large banks would overall see a small increase.

1.50 The QIS data provides a rough starting point for estimating the total impact that the proposals set out in this CP would have on RWAs, but it would be a significant over-estimation. Where measured RWAs increase, Pillar 1 requirements would rise. The PRA would expect measured capital ratios to fall as a result. The PRA does not; however, intend to require firms to capitalise for the same risk twice. This means that where the impact of poorly measured risk weights was previously captured by the PRA in Pillar 2A requirements or the PRA buffer, those would fall as Pillar 1 increases. This would mean that both capital ratios and minimum Pillar 2 capital requirements would fall. Moreover, the impact on RWAs at the start of the output floor transition period (which would begin from January 2025, the proposed implementation start date; see paragraph 1.64) is small and only builds slowly over the proposed five-year transitional period. This transitional period would allow firms to find the most efficient, least costly path to full compliance minimising the impact.

1.51 The analysis anticipates that the small overall cost to firms would also have a subsequent very small impact on overall UK economic activity. However, the impact of the costs set out in the analysis is a highly conservative estimate, and the actual impact on firms would likely be smaller than set out in the cost benefit analysis.

1.52 Overall, the costs and benefits of the proposals set out in the CP need to be considered in the context of all regulatory measures taken in response to the global financial crisis. The PRA’s implementation of the initial phase of the Basel III standards raised the overall amount and quality of capital relative to total risk in the financial system, the benefits of which are to reduce the likelihood of financial crisis. The implementation of the Basel 3.1 standards is a necessary foundation for these benefits to be realised. The PRA anticipates that benefits to the UK economy of avoiding future financial crises, as well as the additional benefits of improving the competitive landscape for firms in the UK and underpinning international confidence in the UK as a global financial centre, significantly outweigh the costs of implementing all the Basel III standards.

Interaction with other frameworks

Strong and simple

1.53 In Discussion Paper (DP) 1/21 – **'A strong and simple prudential framework for non-systemic banks and building societies'**,[19] the PRA discussed the most appropriate approach to designing a simpler prudential regime for small banks and building societies. The majority of respondents preferred a streamlined approach to designing the prudential requirements under the simpler regime (ie using the existing prudential framework as a starting point and modifying elements that appear to be over complex for smaller firms) to a focused approach (ie adopting a narrower, but more conservatively calibrated set of new prudential requirements).[20] Some respondents to DP1/21 were concerned that a focused regime would create an additional barrier to growth, whereas it would be more straightforward to transition out of the simpler regime under a streamlined approach.

1.54 Firms meeting the proposed Simpler-regime criteria, as set out in Box A in Chapter 2 and Appendix 9 would not have to apply the proposed implementation of the Basel 3.1 standards as set out in this CP. Instead, the PRA proposes that these firms can choose to enter a transitional regime based on current CRR provisions (the 'Transitional Capital Regime') during the interim period between the proposed implementation date for the Basel 3.1 standards and the future implementation date for a permanent risk-based capital regime for Simpler-regime Firms. However, the PRA proposes that firms that meet the Simpler-regime criteria would be able to choose to be subject to, without delay, the proposed implementation of the Basel 3.1 standards as set out in this CP should they prefer to do so.

1.55 The PRA intends to consider the Pillar 1, Pillar 2, and buffer requirements in the simpler regime in Phase 2 of the strong and simple project.[21] The PRA considers that assessing these different aspects of capital requirements together would support the development of a coherent, simple, and proportionate risk-based capital framework for Simpler-regime Firms.

1.56 In its current analysis, the PRA is considering whether the proposed revised approaches for credit risk SA and CRM, as set out in this CP, would be the appropriate starting point for designing the simpler regime's risk-based capital framework.

Leverage ratio

1.57 Effective as of 1 January 2022, the PRA implemented most of the changes to the calculation of the leverage exposure measure[22] that were made to international standards in the process of finalising Basel 3.1. However, some of the changes to those international standards were not implemented at that time, as they relate to changes to the credit risk SA in the risk-weighted capital framework set out in this CP. The proposed changes to the treatment of off-balance sheet items in Chapter 3 – Credit risk – standardised approach, and the proposed amendment to the SA-CCR set out in Chapter 7 – Credit valuation adjustment and counterparty credit risk would flow through to the leverage framework. The PRA does not propose new policy with respect to the leverage ratio requirement in this CP.

Large exposures

1.58 The large exposure requirements in the CRR have already been transferred to PRA rules and amended to implement the Basel III standards. However, the Basel 3.1-related large exposure standards were not implemented at that time because they depend on changes to the credit risk SA in the risk-weighted capital framework set out in this CP. The PRA is not proposing changes to the large exposure requirement in this CP, although the proposed changes to prudential standards set out in this CP, if implemented, would have a consequential impact on the large exposure requirements. For example, CRM techniques set out in Chapter 5 – Credit risk mitigation for calculating capital requirements would also be used for calculating net large exposures, subject to the broader conditions in the large exposure requirements.

Liquidity risk

1.59 Effective as of 1 January 2022, the PRA implemented the BCBS net stable funding ratio (NSFR) standard in PRA rules, and it transferred the BCBS liquidity coverage ratio (LCR) standard into PRA rules. The Basel 3.1 standards did not make amendments to either liquidity standard. Where relevant, however, the proposed changes to prudential standards set out in this CP would automatically flow through to the LCR and NSFR, including in relation to risk weights for mortgage loans under the credit risk SA.

Structure of the CP

1.60 The implementation of the Basel 3.1 standards would require policy to be made across a number of areas. This CP is structured into the following chapters. The draft rules and related policy material are included in the relevant appendices.

- **Chapter 2 – Scope and levels of application** – This chapter sets out the PRA's proposed scope and levels of application for the proposals set out in this CP, the proposed approach for small firms meeting the proposed Simpler-regime criteria, and an overview of the CRR provisions relating to prudential consolidation.

- **Chapter 3 – Credit risk – standardised approach** – This chapter sets out the PRA's proposals to change the SA requirements and the PRA's expectations in line with the Basel 3.1 standards. The proposed changes include a more risk-sensitive approach to residential mortgage lending, revisions to the risk weights for corporate exposures including to SMEs, the introduction of specific treatments for 'specialised lending' exposures, removal of implicit assumptions of sovereign support for exposures to banks, changes to the risk weights for equity exposures, changes to off-balance sheet conversion factors, and proposed due diligence requirements for use of external credit ratings.
- **Chapter 4 – Credit risk – internal ratings based approach** – This chapter sets out the PRA's proposals to update the IRB approach in line with the Basel 3.1 standards. The proposed changes include restrictions on the use of IRB for equities and low default portfolios, such as exposures to banks and other financial institutions, large corporates, and sovereign exposures. Other proposals include changes to the risk parameters used in IRB modelling, including new input floors for probability of default (PD), loss given default (LGD) and exposure at default (EAD), and greater specification of parameter estimation practices to reduce variability in RWAs for portfolios where the IRB approaches remain available.
- **Chapter 5 – Credit risk mitigation** – This chapter sets out the PRA's proposals to implement the Basel 3.1 standards for CRM, including changes for both funded and unfunded credit protection. It also sets out proposed amendments to the PRA's expectations with respect to CRM. The PRA considers the changes would introduce greater clarity regarding the framework.
- **Chapter 6 – Market risk** – This chapter sets out the PRA's proposals to implement the Basel 3.1 standards for market risk. These comprise the introduction of three new approaches to replace the current methodologies: the simplified standardised approach (SSA) for firms with small or simple trading activities; the advanced standardised approach (ASA), a risk-sensitive approach for firms without permission to use an IM; and the internal model approach (IMA). The proposals would also retain the existing derogation for small trading book business, which permits firms with very limited trading activity to use the credit risk approach to measure market risk.
- **Chapter 7 – Credit valuation adjustment and counterparty credit risk** – This chapter sets out the PRA's proposals to implement the Basel 3.1 standards for CVA risk. These comprise the introduction of three new approaches for calculating the CVA risk capital requirement: the fall-back alternative approach (AA-CVA); the basic approach (BA-CVA); and the standardised approach (SA-CVA). The new CVA framework and methodologies are proposed to replace the current calculation methodologies. The proposals would also adjust the calibration of the standardised approach for counterparty credit risk (SA-CCR) where the PRA considers it to be overly conservative, and remove certain existing exemptions from CVA capital requirements for transactions that the PRA considers have material CVA risk.
- **Chapter 8 – Operational risk** – This chapter sets out the PRA's proposals to implement the

Basel 3.1 standards for operational risk. The new operational risk capital framework aims to help ensure that firms maintain sufficient financial resources to mitigate the risk of loss due to inadequate or failed internal processes, people or systems, or from external events. The new operational risk framework is proposed to replace the existing methodologies.

- **Chapter 9 – Output floor** – This chapter sets out the PRA's proposals to implement the Basel 3.1 standards for the output floor with respect to firms' calculation of RWAs, which would limit the RWA reductions available to firms through their application of IMs.
- **Chapter 10 – Interactions with the PRA's Pillar 2 framework**[23] – This chapter contains no specific proposals, but describes at a high level the implications of the proposed changes to the Pillar 1 risk-weighting framework, as set out in this CP, for the PRA's Pillar 2 framework.
- **Chapter 11 – Disclosure (Pillar 3)** – This chapter sets out the PRA's proposals to update the UK Pillar 3 disclosure requirements to reflect the proposals set out elsewhere in this CP. The proposals aim to align the Pillar 3 disclosures of UK firms to the Basel 3.1 standards for Pillar 3 disclosure requirements.
- **Chapter 12 – Reporting** – This chapter sets out the PRA's proposals to align PRA supervisory reporting requirements with the proposals set out elsewhere in this CP.
- **Chapter 13 – Currency redenomination** – This chapter sets out the PRA's proposals to change certain Euro (EUR) and US Dollar (USD) references to Pound Sterling (GBP).

Changes to PRA rules and policy materials[24]

1.61 The proposals set out in this CP would result in changes to the following parts of the PRA Rulebook and existing policy materials:

Proposed changes to policy material

Policy material	Proposals

PRA Rulebook (CRR) Instrument 2023	**The instrument would introduce new Parts of the PRA Rulebook, as follows:** Required Level of Own Funds (CRR) Credit Risk: General Provisions (CRR) Credit Risk: Standardised Approach (CRR) Credit Risk: Internal Ratings-Based Approach (CRR) Credit Risk Mitigation (CRR) Market Risk: General Provisions (CRR) Market Risk: Internal Model Approach (CRR) Market Risk: Advanced Standardised Approach (CRR) Market Risk: Simplified Standardised Approach (CRR) Credit Valuation Adjustment Risk Operational Risk

Policy material	Proposals
PRA Rulebook (CRR) Instrument 2023	**The instrument would amend the following Parts of the PRA Rulebook:** Credit Risk Standardised Approach and Internal Ratings Based Approach to Credit Risk (CRR) Trading Book (CRR) Market Risk Credit Valuation Adjustment Risk (CRR) Counterparty Credit Risk (CRR) Benchmarking of Internal Approaches Operational Risk (CRR) Regulatory Reporting Reporting Pillar 2 Reporting (CRR) Disclosure (CRR) Interpretation Glossary

Policy material	Proposals
Supervisory Statements (SS)	**This CP would amend:** Credit risk: standardised approach (**SS10/13**)[25] Underwriting standards for buy-to-let mortgage contracts (**SS13/16**) (see footnote 25) Market risk (**SS13/13**) (see footnote 25) Counterparty credit risk **(SS12/13**) (see footnote 25) Credit risk mitigation (**SS17/13**) (see footnote 25) Guidelines for completing regulatory reports (**SS34/15**) (see footnote 25) **This CP would delete:** Internal Ratings Based approaches (**SS11/13**)[26] Operational risk (**SS14/13**) (see footnote 25) **This CP would introduce:** Draft SS 'Credit Risk: Definition of Default'[27] Draft SS 'Credit Risk: internal ratings based approaches' (see footnote 28)
Statements of Policy (SoP)	**This CP would amend:** SoP **'Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU**'[28] **This CP would introduce:** Draft SoP 'Operating the Simpler-regime criteria: Statement of Policy'

1.62 Appendix 4 of this CP sets out the proposed draft rules in full, including parts of the CRR that are not intended to be amended, but are being transferred to and restated in the PRA Rulebook for coherence and ease of use. Where the text is being restated and not amended, it does not form part of this CP. Appendix 9 also includes draft rules for the Transitional Capital Regime, which includes the draft rules for the Simpler-regime criteria.

References to CRR

1.63 Where the proposed new Rulebook parts are a mix of new material and material that largely restates existing provisions of the CRR, they have been written in a style and structure that maintains consistency with CRR, with article numbers that, where possible, correspond to the CRR. This is for ease of reference for firms as the framework is transitioned from CRR in primary legislation to PRA rules and to ensure workability with those parts of the CRR framework that remain in primary legislation. However, for risk areas where the existing approaches have been entirely replaced with revised approaches, the rules have been written in a style and structure that more closely aligns to other material in the existing PRA Rulebook and to the PRA's long-term aspiration to have a clear, coherent, and accessible Rulebook.[29] The table of revoked CRR provisions and their corresponding **PRA rules** will be updated in due course.

Implementation

1.64 The PRA proposes that the implementation date for the changes resulting from this CP, other than those affected by transitional provisions set out below, would be Wednesday 1 January 2025.

Transitional provisions

1.65 The PRA proposes to implement transitional provisions for the output floor. The transitional period follows that set out in the Basel 3.1 standards and would cover a five-year period beginning on the PRA's proposed implementation date of Wednesday 1 January 2025. Further details of transitional arrangements for the output floor can be found in Chapter 9.

1.66 The PRA also proposes to apply a five-year transitional period starting from the proposed implementation date of Wednesday 1 January 2025 for SA and IRB firms for the implementation of the revised treatment of equity exposures in the credit risk SA. Further details of the transitional periods for equity exposures can be found in Chapters 3 and 4.

1.67 In the CVA framework (Chapter 7), the PRA proposes to apply a five-year transitional treatment under which only legacy trades that would be exempt from CVA RWAs prior to the application of the new CVA requirements set out in this CP, remain exempted. Firms would, however, have the option to irreversibly apply the new CVA requirements to these trades instead.

1.68 In the SA-CCR framework (Chapter 7), the PRA proposes to allow firms to apply the reduced alpha multiplier to trades with certain counterparties, including legacy trades with such counterparties, from the proposed implementation date of Wednesday 1 January 2025, but to require them to maintain additional Pillar 1 capital equal to the reduction in capital requirements on the proposed implementation date for the legacy trades. The additional capital requirement for the legacy trades would reduce linearly over five years.

1.69 The PRA does not intend to introduce any transitional provisions that include a review at the end of the transitional period to consider whether they should be extended. The PRA considers that to do so would create additional uncertainty for firms, which would undermine their business planning activities. In addition, transitions with uncertain endings would reduce the speed of convergence with international standards.

Timeline and process for permissions within the Basel 3.1 standards

Market risk and CVA

1.70 On Monday 27 June 2022, the **PRA issued a letter to firms** detailing its timetable for submission of IM and SA pre-applications with respect to the revised market risk framework. The proposals set out in this CP would make existing IM permissions for market risk redundant. Current IMA firms would; therefore, automatically move to the ASA unless granted a new IMA permission.

1.71 As set out in the letter, the PRA would expect firms to submit final pre-application materials for new IMA permissions at least 12 months before the proposed implementation date of Wednesday 1 January 2025 for the proposals set out in this CP. Any submissions after this date may require the firm to use the SA at least for an initial period, pending the completion of the PRA's model review. Firms that submit by the requested date would be given priority during the PRA's review.

1.72 With respect to areas of the ASA that require permission, the PRA would expect firms to submit any related pre-application materials at least 12 months before the proposed implementation date of Wednesday 1 January 2025.

1.73 The PRA would expect firms to submit final pre-application materials for new SA-CVA permissions at least 12 months before the proposed implementation date of Wednesday 1 January 2025.

CRR permissions

1.74 Where firms' existing permissions were issued under provisions of CRR that are expected to be revoked as a consequence of the proposals set out in this CP, HMT has stated in its consultation published on or around the date of this CP that it expects to use the power in s.3(5) of the Financial Services Act 2021 to make provisions saving the effect of the granting of those permissions if appropriate. Please see the relevant chapters of this CP for information on specific permissions.

Responses and next steps

1.75 This consultation closes on Friday 31 March 2023. The PRA invites responses on any aspect of the proposals set out in this consultation, as well as any data or evidence that is pertinent to such proposals. This CP includes a number of questions in Chapters 2 to 9 to which the PRA would welcome responses, but the PRA would welcome responses on all aspects of the CP (see Appendix 2 for a full list of specific questions). The PRA also invites stakeholders to bring to the PRA's attention any relevant issues that are not addressed in the proposals set out in this CP. Please address any comments or enquiries to CP16_22@bankofengland.co.uk.

1.76 Please indicate in your response if you believe any of the proposals in this CP are likely to impact persons who share protected characteristics under the Equality Act 2010, and if so, please explain which groups and what the impact on such groups might be.

Navigation guide

1.77 This CP is divided into 13 separate chapters[30] and 20 appendices that are set out at the end of each relevant chapter (a full list of appendices is provided in Appendix 3). Each chapter contains a set of proposals, except for Chapter 10. You can use the next chapter and previous chapter buttons at the bottom of this webpage to navigate between chapters. You can also select the title of the specific chapter in the navigation pane to the left of this page and at the top of this page. You can download a copy of each chapter in PDF by selecting the 'Convert this page to PDF' button at the top right-hand corner of the webpage.

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1. Throughout this CP, the PRA uses the term 'risk-weighted assets' since it is commonly understood in the industry, as equivalent to 'risk-weighted exposure amounts' which is the term used in the CRR and proposed rules.
2. This was done through the onshored and amended UK version of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, referred to as the 'CRR' in this CP and related onshored EU level 2 regulations that are made under the CRR (CRR level 2 Regulations).
3. As set out in paragraph 1.7 of this chapter. Note that the PRA is not consulting in this CP on the implementation of minimum haircut floors for securities financing transactions (SFTs) in the capital framework – one of two approaches envisaged in the FSB's report Regulatory framework for haircuts on non-centrally cleared securities financing transactions. The PRA will consider whether implementation in the capital framework is appropriate in due course, taking into account data available under SFT reporting.
4. Throughout this CP, the PRA uses the term 'capital requirements' since it is commonly understood in the industry as equivalent to 'own funds requirements', which is the term used in the CRR and proposed rules.
5. Sometimes referred to as the 'Fundamental Review of the Trading Book'.
6. The use of a common set of exposures was intended to largely eliminate differences in risk between firms, so that remaining variation would be due to differences in firms' models and in supervisory practices.
7. Major UK banks are Barclays, HSBC, Lloyds Banking Group, Nationwide, NatWest Group, Santander UK, and Standard Chartered. Aggregate risk-weight is defined as RWAs divided by total balance sheet assets. RWAs are defined using the prevailing regulatory standards at each data. Alternative measures of aggregate risk-weights, for example dividing RWAs by the Basel III exposure measure or the UK leverage exposure measure, show a similar downward trend once adjusted for differences in levels.
8. The 'boundary' defines how positions are allocated to either the trading book or the non-trading book. This allocation determines whether they are treated under the market risk or credit risk framework.
9. The onshored and amended UK version of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending

Regulation (EU) No 648/2012, referred to as the 'CRR' in this CP.

10. The proposed CRR revocations are set out in the **HM Treasury consultation** published on the same day as this CP .

11. The PRA has primarily considered the proposals of Canada, Singapore, and Switzerland, as well as the proposals of the European Commission in detail, as they stood at the time of the PRA's policy-making process. At the time of publication, the USA had not issued its proposals. The PRA intends to continue to monitor the proposals of the USA and other major jurisdictions as they evolve and consider these before finalising its own proposals.

12. The ECB and EBA state that, if adopted, these deviations could lead to the BCBS labelling the EU 'non-compliant', the lowest possible grade.

13. **Financial services: contribution to the UK economy - House of Commons Library**.

14. Where specific analysis has not been provided against a 'have regard' for a proposal, it is because in the PRA's assessment that 'have regard' did not give rise to material issues for consideration with respect to that proposal.

15. This includes societies registered under the Industrial and Provident Societies Act 1965 (or its predecessors) that were previously referred to as 'industrial and provident societies' and are now legally referred to 'registered societies' under the Co-operative and Community Benefit Societies Act 2014.

16. For the avoidance of doubt, credit unions are excluded from the proposed scope of application.

17. See Appendix 7 for the aggregated cost benefit analysis, which should be read in conjunction with the individual policy chapters.

18. See CP5/13 – **'Strengthening Capital Standards: Implementing CRD IV'**, which sets out the PRA's approach to estimating the benefits of increased capital in the system and includes research linking higher capital to a decreased likelihood of future financial crises.

19. Paragraphs 4.25-4.26 in DP1/21.

20. Chart 4 in PRA Feedback Statement 1/21 – **Responses to DP1/21 'A strong and simple prudential framework for non-systemic banks and building societies', December 2021.**

21. On the planned phases of the development of the simpler regime, see paragraph 1.14 in CP5/22 – **'The Strong and Simple Framework: a definition of a Simpler-regime Firm'**. Phase 2 covering capital requirements will follow Phase 1 mainly covering liquidity requirements.

22. The denominator of the leverage ratio which is defined as the ratio of capital to exposures.

23. This topic is included in this CP for completeness. The PRA does not propose any new policy in this chapter.

24. Changes for Basel 3.1 purposes do not apply in respect to firms in the Transitional Capital Regime, unless this is done expressly. The existing policy material would continue in effect as appropriate for firms within the 'Strong & Simple' Transitional Capital Regime.

25. The PRA proposes that the current version of the statement will apply in respect to firms subject to the Transitional Capital Regime.

26. The PRA proposes that chapter 11 of the current version of the statement will apply in respect to firms subject to the Transitional Capital Regime.

27. The PRA proposes that this statement will not apply in respect to firms subject to the Transitional Capital Regime, except to the extent those firms are applying for an IRB permission.

28. The PRA proposes that the current version of the statement will apply in respect to firms subject to the Transitional Capital Regime, but for the 'Guidelines on disclosures of encumbered and unencumbered assets' listed in Appendix 2 of the statement. Those guidelines will no longer be applicable because they have been superseded by Article 443

of the Disclosure (CRR) Part of the PRA Rulebook.

29. See DP4/22 – **'The Prudential Regulation Authority's future approach to policy'**, which sets out for discussion the PRA's vision for its approach to policy, including accessibility of the PRA Rulebook.

30. Throughout this CP, for accessibility purposes, we have generally not capitalised the names of methods, exposure classes, and similar definitional terms, but have generally emphasised them by using single quote marks on first usage in each chapter.

Appendices

- Appendix 1: Abbreviations (PDF 0.7MB)
- Appendix 2: List of questions (PDF 0.8MB)
- Appendix 3: List of appendices (PDF 0.8MB)
- Appendix 4: Draft PRA Rulebook (CRR) Instrument [2023] (PDF 4.1MB)
- Appendix 5: Draft PRA Standards Instrument: Technical Standards (Economic Downturn) Revocation Instrument [2023] (PDF 0.1MB)
- Appendix 6: PRA Statutory Obligations (PDF 0.8MB)
- Appendix 7: Aggregated cost benefit analysis (PDF 1.1MB)
- Appendix 8: Draft amendments to Statement of Policy 'Interpretation of EU Guidelines and Recommendations: Bank of England and PRA (PDF 0.8MB)

Next chapter