

**Summary of responses:
Transposition of the Capital
Requirements Directive:
Consultation and Partial
Regulatory Impact Assessment**

July 2006



HM TREASURY



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INTRODUCTION

1.1 This document summarises the responses to HM Treasury's consultation: Transposition of the Capital Requirements Directive: Consultation and Partial Regulatory Impact Assessment. This consultation was launched on 28th February 2006, with a deadline for response by 23rd May 2006.

1.2 HM Treasury received responses from the British Bankers Association (BBA), London Investment Bankers Association (LIBA) and the Investment Management Association (IMA). The BBA and LIBA together represent more than 300 banks and investment firms doing business in London and elsewhere in the UK, while the IMA is the trade body for the UK's £2 trillion asset management industry. Responses were also received from Moody's Investor Services, Fitch Ratings and the Dominion Bond Rating Service.

1.3 HM Treasury is very grateful to all those who responded to the consultation document and partial regulatory impact assessment (RIA).

1.4 The Capital Requirements Directive (CRD) implements Basel 2 in Europe. Basel 2 is a revision of the existing capital adequacy framework, Basel 1, and is intended to further reduce the probability of consumer loss or market disruption as a result of prudential failure. It will do so by seeking to ensure that the financial resources held by a firm are commensurate with the risks associated with the business profile and the control environment within the firm.

1.5 European Community law requires that full effect be given to the CRD in national law through transposition. This task is split between HM Treasury and the UK's Financial Services Authority (FSA). The FSA is transposing the bulk of the CRD by making rules using its powers under the Financial Services and Markets Act 2000. The FSA issued its second consultation paper CP06/3 'Strengthening Capital Standards 2' on the same day as HM Treasury and will issue a feedback statement to the consultation in July.

1.6 HM Treasury's role is to transpose into domestic legislation those provisions that place new duties on the FSA. The consultation document was therefore concerned with the following two areas:

- Group model recognition for the advanced approaches to measuring Pillar 1 capital requirements (see points 1.22 – 1.29 of the consultation document and 2.28-2.47 of partial RIA); and
- Recognition of external credit assessment institutions (ECAIs) for the purposes of credit institutions measuring their Pillar 1 capital requirements using the standardised approach (see points 1.30 – 1.39 of the consultation documents and points 2.48 – 2.73 of partial RIA)

QUESTIONS ASKED BY CONSULTATION AND PARTIAL RIA

1.7 The consultation document and partial RIA outlined HM Treasury's initial view, based on early discussions with the FSA and industry, and put forward a series of questions in relation to both areas of transposition:

Consultation document

- Is there sufficient legal clarity provided for in the Directive text?
- If not, is further detail required in UK law, if so what would this be?

Partial RIA

- Do you agree with the analysis of the costs and benefits for the different implementation options, as well as the impact on competition and small firms?
- Are there any alternative options, or indeed alternative combinations of the proposed options, that should also be considered?
- Do you agree with HM Treasury's initial view? If not, please specify your reasons.

1.8 The next chapter will summarise the responses HM Treasury received to these questions in the consultation period.

2

SUMMARY OF RESPONSES

GROUP MODEL RECOGNITION – ARTICLE 129 (2)

Is there sufficient legal clarity provided for in the directive text?

2.1 All respondents agreed with HM Treasury that although the procedure for group model recognition is clear in the directive text, there is a need for the FSA to have flexibility where there has been a major structural change to a group and to request a further application i.e. provision allowing for the variation and revocation of group model recognition.

If not, is further detail required in UK law, if so what would this be?

2.2 There were no further suggestions for extra detail to be included in UK law.

Do you agree with the analysis of the costs and benefits for the different implementation options, as well as the impact on competition and small firms?

2.3 Respondents felt that the Partial RIA helpfully benchmarked the likely costs of the alternative options.

Are there any alternative options, or combinations of the proposed options, that should also be considered?

2.4 No alternative options were suggested.

Do you agree with HM Treasury's initial view?

2.5 All respondents supported HM Treasury's proposal that Option 3 be used to transpose the provision in Article 129(2) of the CRD – a copy-out approach with provision allowing for the variation and revocation of a group application.

RECOGNITION OF EXTERNAL CREDIT ASSESSMENT INSTITUTIONS – ARTICLES 81, 82, 97 AND 98

Is there sufficient legal clarity provided for in the directive text?

2.6 All respondents agreed that there is sufficient legal clarity in the directive text.

2.7 A majority of respondents also wished to stress that the additional guidance provided by the Committee of European Banking Supervisors (CEBS) would be vital at the FSA operational level.

If not, is further detail required in UK law, if so what would this be?

2.8 No further detail was suggested.

Do you agree with the analysis of the costs and benefits for the different implementation options, as well as the impact on competition and small firms?

2.9 The majority of respondents agreed with the analysis of costs and benefits for the different implementation options. All recognised that a full quantitative cost benefit analysis was not feasible in the case of ECAI recognition and therefore agreed with the more qualitative approach taken.

2.10 All agreed that CEBS would play a role in facilitating a more harmonised pan-European approach to ECAI recognition.

Are there any alternative options, or combinations of the proposed options, that should also be considered?

2.11 One respondent suggested an alternative option to copy-out where the material contained within the CRD Annexes relating to ECAI recognition is not put into UK legislation, but is laid out in the FSA handbook. This would then act as a peg on which to hang the CEBS guidance.

2.12 HMT has sought legal advice on this alternative option. The Annexes in question impose functions on the supervisory authority relating to the recognition of ECAIs and the mapping assessments for credit quality steps. As these requirements are an integral part of the functions imposed on the supervisory authority under Articles 81, 82, 97 and 98, it is appropriate for the detail to be set out in UK law in order to ensure the clarity of the FSA's statutory responsibilities. However, this does not prevent the FSA also setting out these details in their Handbook as part of their rules and guidelines. HM Treasury have referred this suggestion to the FSA.

Do you agree with HM Treasury's initial view?

2.13 All respondents supported HM Treasury's proposal that Option 2 be used to transpose the Articles on ECAI recognition into UK law. One respondent suggested the alternative option above, however, they were also content with the HMT proposal.

3

CONCLUSIONS AND NEXT STEPS

CONCLUSIONS

3.1 All of the respondents were content with HM Treasury's proposals for the transposition of CRD provisions for group model recognition and ECAI recognition.

3.2 On the transposition of Article 129 (2) – group model recognition, all were of the view that the directive text requires further clarity to deal with situations where there is a major structural change to a group. Respondents were therefore content with HM Treasury's proposal to use Option 3.

3.3 On the transposition of Articles 81, 82, 97 and 98 and related annexes for ECAI recognition, all respondents were content that the directive provides sufficient clarity to allow for a direct 'copy-out' approach into UK law. One respondent suggested an alternative to Option 2, which entailed the material contained in the annexes relating to these articles being implemented directly into the FSA Handbook, instead of into UK law. Legal advisors have said that this option would not be feasible because the Annexes impose obligations on the FSA that must be transposed into UK law along with the respective articles. HM Treasury therefore intends to transpose the provisions relating to ECAI recognition according to Option 2, direct 'copy-out'.

NEXT STEPS

3.4 Legislation to the above effect will be made in autumn 2006, supported by a full Regulatory Impact Assessment. This will be made public via the HM Treasury website: www.hm-treasury.gov.uk

3.5 The CRD will come into force from 1st January 2007 for the standardised approaches to measuring capital requirements and 1st January 2008 for the more advanced approaches.

3.6 Please direct any enquiries to:

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