

Capital Requirements Regulation

Guidance on the PRA's use of the transitional direction

Introduction

- This document provides guidance on the PRA's transitional direction in relation to firms' obligations in the context of the CRR EU Exit SI (the "CRR") and related onshoring instruments.
- Firms should have regard to this guidance while the transitional relief granted under the direction is in effect. Firms should note that this guidance is non-binding in nature, that it may be amended from time-to-time and that the direction should be followed in the case of any inconsistency with this guidance.
- The transitional direction will come into effect on exit day and will apply until 30 June 2020 unless the PRA decides to make any changes to this timing in the future.
- Any reference to an EU regulation, including to a Binding Technical Standard, is a reference to the UK version of that regulation, unless otherwise stated.
- This guidance document covers transitional modifications effected by the transitional direction to the onshoring changes introduced by:
 - a. the Capital Requirements (Amendment) (EU Exit) Regulations 2018 ("CRR EU Exit SI");
 - b. the Securitisation (Amendment) (EU Exit) Regulations 2019; and
 - c. the Technical Standards (Capital Requirements) (EU Exit) (No.3) Instrument 2019.
- For further details on the PRA's general approach to the exercise of the transitional direction, firms should consult:
 - a. the Bank of England's Policy Statement on the amendments to financial services legislation under the European Union (Withdrawal) Act 2018; and
 - b. general guidance provided with the PRA's transitional direction.

1. Definitions

- a. There are no substantive changes to the definitions for different types of firms while the transitional relief is in place. The only change to highlight is from defining the scope of firms to which onshored CRR applies (i.e. the definition of "CRR firm"). Therefore, the following definitions continue to capture the same types of entities and undertakings as before 'exit day' (i.e. 29 March 2019 – referred to as 'exit' or 'exit day' in this document):
 - i. "investment firm", "insurance undertaking", "reinsurance undertaking", "collective investment undertaking", "asset management company", "third-country insurance undertaking", "third country re-insurance undertaking", "third country investment firm" (which captures the same firms as the pre-exit definition of "recognised third-country investment firm", "financial institution", "financial sector entity", "multilateral trading facility", and "regulated market").
- b. The new definition of "CRR covered bonds" does not take effect. Instead, EU issued covered bonds continue their pre-exit treatment under CRR (i.e. exposures to covered bonds shall qualify for the preferential treatment set out in Article 129(4) and (5)). This treatment is

available when the bonds are collateralised by eligible EU assets which qualify under Article 129(1)(a), the third sentence of Article 129(1)(c), 129(1)(d)(ii), 129(1)(e) and 129(1)(f)(ii).

- c. There will be no changes to the group undertakings and levels of consolidation that are captured while the transitional relief is in place. The definitions of “parent undertaking”, “subsidiary”, “participation” and “common management relationship” continue to capture the same types of relationship as before exit.

2. Consolidated supervision.

- a. Pan-EU consolidated supervision (i.e. the oversight of EU supervisory authorities and the role of related regulatory frameworks) ends. How the United Kingdom (“UK”) consolidating supervisor is to be determined is set out in Regulation 20 of the CRR Regulations 2013 (as amended by the CRR Exit Instrument). This designation is not affected by transitional relief. The only changes will be in the specific circumstances we have noted in this document.

3. Joint decisions.

- a. The EU joint decision making framework ends. Pre-exit joint decisions continue to have effect until such time as the PRA or FCA take different decisions. Where joint decision applications were submitted before exit day, the joint decision process will cease to apply. Decisions will be taken by the relevant regulators with any necessary co-ordination with EU supervisory authorities.

4. Level of application of requirements.

- a. The level of application of CRR requirements for UK headquartered groups is unaffected by onshoring changes.
- b. Onshoring changes will require UK groups that sit below an EU-parent institution to establish a new level of consolidation at the UK level under Article 11(3). But this will not apply during the transitional period.
- c. For the transitional period, UK groups that sit below an EU-parent institution should continue to disclose at the same levels as they did before exit under Article 13.

5. Definition of capital.

- a. All instruments, items or minority interests that qualified as own funds before exit continue to qualify to the same extent for [15] months after exit. This includes minority interests in EU investment firms and other undertakings subject to CRR/D requirements under Articles 81(1)(a)(ii) and 82(a)(ii).
- b. The transitional relief extends to the changes made to the Own Funds RTS (241/2014). This includes the amendments which reduce the scope of the treatment provided for in Articles 15a (in relation to indirect holdings in EU-authorized credit institutions) and 17 (in relation to deductions for certain types of EU-authorized e-money and payment institutions and EU AIFMs and management companies).

6. Pillar 1 capital requirements: credit risk

- a. Any preferential treatments afforded to EU assets and exposures continues for the transitional period. This includes:

- i. exposures to EU investment firms, credit institutions, clearing houses and exchanges (under Article 107(3));
- ii. exposures to the central government and the central bank of a Member State or the EU that are Union denominated and funded in the domestic currency of that central government and central bank (under Article 114(4));
- iii. exposures to EU regional governments and local authorities (under Article 115(2) and Article 115(5));
- iv. exposures to EU public sector entities (under Article 116(4));
- v. exposures to the European Investment Fund (under Article 117(3));
- vi. exposures in EU international financial institutions (Article 118(f));
- vii. exposures to international financial institutions established by Member States (under Article 119(4));
- viii. exposures to EU institutions (Article 119);
- ix. residential and commercial EU mortgage exposures (Articles 124, 125, and 126); and,
- x. exposures to EU CIUs (Article 132(3)).

7. Harmonising Pillar 1 treatment

- a. Pre-exit decisions taken by EU authorities on risk weights for residential and commercial real estate in their territories made under Article 124(2) and 164(2) will continue to have effect for 15 months. Existing decisions are saved by the new Article 522 CRR.

8. Market Risk: Calculation of net position in equity instruments under Article 341(2) CRR

- a. The transitional relief applies to the amendment made in Article 1 of RTS 525/2014 to treat all equities listed in stock markets located in countries that have the euro as one market for these purposes.

9. Model permissions. Existing model permissions are saved by the new Article 522 CRR and will continue to have effect. These permissions cover:

- a. Credit risk: the Internal Ratings Based (IRB) approach models (Articles 143(1);
- b. Market risk: the Internal Model Method (Article 283 CRR);
- c. Operational risk: Advanced Measurement Approaches (Article 312(2) CRR); and,
- d. Definition of capital: internal models for certain own funds calculations (Article 363 CRR).

10. Use of credit ratings

- a. The cumulative effect of the run-off period applied by the direction and the separate transitional provision in article 4(1A) of the CRA Regulation is that UK regulated entities may, for a period of one year beginning with exit day, use a credit rating for regulatory purposes if it was issued or endorsed by an EU credit rating agency before exit day and was not withdrawn immediately before exit day. For further guidance on this exception, firms should refer to the guidance issued by the FCA in Annex A to the FCA Transitional Direction.

11. **Individual (Pillar 2) capital requirements.** Onshoring changes will not impact any firms' Pillar 2 capital requirements on exit day. Therefore transitional relief is not relevant.

12. **PRA buffer and combined buffer requirements.** Onshoring changes will not of themselves change firms' buffer requirements on exit day. Therefore transitional relief is not relevant.

13. **Securitisation**

- a. The transitional recognition of EU Simple, Transparent and Standardised ('STS') introduced in the Securitisation (Amendment) (EU Exit) Regulations 2019 will be exempted from the exercise of the transitional power. The additional flexibility introduced for cross-border STS securitisation will also be exempted from the transitional power.
- b. Therefore, for the purposes of Chapter 5, Title II, Part Three of the CRR, transactions recognised as 'Simple, Transparent and Standardised' under Article 18 of Onshored Securitisation Regulation are eligible for differentiated capital treatment where the other criteria in Article 243 are met.
- c. As a consequence of the exercise of the transitional power, with respect to the remainder of Chapter 5, Title II, Part Three of the CRR, any preferential treatments afforded to EU assets and exposures continue. This includes:
 - i. The definition of 'promotional entity' in Article 242(19) will continue to encompass entities set up by a Member State's central, regional or local government.
 - ii. Senior positions in SME securitisations as referenced in Article 270 remain eligible for preferential treatment where the third party to which the credit risk is the central government or the central bank of a Member State, or an EU promotional entity (see point a). However, as requirements relating to Simple, Transparent and Standardised securitisation are exempt from the exercise of the transitional power, the modifications to Article 270(a) and introduction of 270(aa) in the onshored text will remain applicable.
- d. Where the transitional measures listed in Article 2 Regulation (2017/2401) (Amendments to the CRR) and Article 43 of Regulation (2017/2402) (Securitisation Regulation) apply, firms may continue to recognise preferential treatments afforded to EU assets and exposures which existed in the CRR as applicable at 31 December 2018. This includes:
 - i. In the circumstances specified in Article 405(2), the risk retention requirements outlined in Part V Article 405(1) CRR may be satisfied on the basis of the consolidated situation of the related EU parent credit institution, EU financial holding company or EU mixed financial holding company.
 - ii. The risk retention requirements outlined in Part V Article 405(1) CRR do not apply where the securitised exposures are exposures on or fully, unconditionally and irrevocably guaranteed by regional governments, local authorities and public sector entities of Member States.
- e. Firms should also have regard to the PRA's separate guidance on the transitional direction in relation the Securitisation Regulation.

14. **Large exposure requirements.** Any preferential treatments afforded to EU assets and exposures continue. This includes EU assets and exposures that are currently exempt under Article 400(1) that are assigned a 0% risk weight under Chapter 2, Title II, Part Three of the CRR.
15. **Liquidity requirements.** Any preferential treatments afforded to EU assets and exposures continue. This includes the recognition of EU member states' sovereign debt as Level 1 assets in firms' liquidity buffer for the purposes of calculating the liquidity coverage ratio, regardless of their credit rating.
16. **Reporting and disclosure requirements**
 - a. The level of application of reporting and disclosure requirements will remain unchanged while the transitional relief is in effect.
 - b. The application of reporting requirements on material losses stemming from operational risk events as set out in ITS 680/2014 Article 5(b)(2) will remain unchanged while the transitional relief is in effect. In particular, firms should continue to apply the criteria set out in Article 5(b)(2)(v) based on whether they are the parent of subsidiaries, which are themselves credit institutions established in at least two Member States (other than the UK).
 - c. While the transitional relief is in effect, firms should continue to report and disclose data according to the same methodology as used for reporting and disclosure before exit. The PRA has set out expectations for how firms should interpret EU references in reporting and disclosure requirements after exit in Supervisory Statement SS 2/19 "PRA approach to interpreting reporting and disclosure requirements and regulatory transactions forms after the UK's withdrawal from the EU". The expectations set out in the SS should be read in light of the transitional relief. In particular:
 - i. Where the guidance in SS 2/19 expects firms to treat references to an EU regulation, directive or technical standard as a reference to a piece of UK legislation or a PRA or FCA rule, these should be treated as a reference to that legislation or rule as modified by the transitional relief.
 - ii. Where the guidance in SS 2/19 expects firms to refer to nationalised legislation to interpret a reporting or disclosure definition that is based on a CRR or Solvency II requirement, firms should refer to that nationalised legislation as modified by the transitional relief.
17. **Own funds requirements for exposures to CCPs**
 - a. Own funds requirements for exposures to CCPs. In addition to the use of the transitional direction in the context of the CRR, firms will continue to recognise QCCPs according to the transitional relief provided in HMT's SI.

Guidance on specific Binding Technical Standards

- The CRR is supplemented by a range of binding technical standards made under it and the CRD4. Some are considered above, with the provisions of the CRR to which they relate. Many binding technical standards made under the CRR are onshored without any significant amendment and they will operate after exit as they did before exit.

- Readers should take into account the below binding technical standards as changes have been made which are subject to transitional relief.

RTS 527/2014 (Classes of Instruments to be used for Variable Remuneration)

- The transitional relief applies to the amendment made in Article 2(c)(i). This amendment changes the reference to the Eurostat Consumer Price Index to the UK Statistics Board's Consumer Prices Index. We expect firms to start to use the UK Statistics Board CPI with effect from the first performance period that falls on or after 1 January 2020.

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