HM TREASURY

Implementing amendments to the Capital Requirements Directive

December 2009

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Executive summary

In September 2009 the European Parliament and the European Council adopted a Directive amending the Capital Requirements Directive ("CRD"). The package of amendments, referred to as "CRD 2", includes measures to:

- revise rules on the large exposures regime and on derogations for bank networks from prudential requirements;
- establish principles and rules on the treatment of hybrid capital instruments within original own funds;
- revise the rules related to capital requirements for securitisation positions; and
- clarify the supervisory framework for crisis management and establish colleges of supervisors to enhance both the efficiency and the effectiveness of supervision.

The CRD aligns European legislation with international standards on capital by implementing Basel 2 in the European Union. CRD 2 updates and refines the CRD and strengthens the EU regulatory framework.

The amendments to the CRD have to be transposed into domestic law by 31 October 2010 and will be applied from 31 December 2010.

The Financial Services Authority (FSA), using their rule-making powers under the Financial Services and Markets Act 2000, will implement the majority of the CRD 2 amendments, which impose requirements on firms. The FSA has published a separate consultation document, which should be read in conjunction with this consultation.

HM Treasury will implement the remaining areas of CRD 2, which mainly place new duties on the FSA, and this consultation is limited to those provisions.

1 Introduction

Why are we consulting?

1.1 On 16 September 2009 the European Parliament and the European Council formally adopted a new Directive to amend the existing Capital Requirements Directive ("CRD"). A key piece of European legislation in delivering a single market in financial services, the CRD sets common capital standards for financial institutions across the EU.

1.2 As the financial system evolves, the legal framework needs to be regularly updated and refined. The overarching goal of these amendments is to ensure that, as financial markets evolve, the CRD continues to deliver a state-of-the art prudential framework within the EU.

1.3 The European Commission first consulted on proposed amendments to the CRD in April 2008[1]. Following the consultation period the Commission published their proposals in October 2008[2], in a package commonly referred to as CRD 2. HM Treasury has consulted a wide range of stakeholders throughout the European legislative process and now seeks comment on the proposed measures required to implement certain aspects of CRD 2 in the UK.

1.4 This chapter describes the objectives of the CRD, provides an overview of the CRD 2 amendments, sets out the proposed approach for implementation within the UK and details how to respond to this consultation.

1.5 It is important to note that the Financial Services Authority (FSA), who have published a separate consultation document, will implement a large number of the CRD amendments[3]. This chapter provides a brief overview of the full amendments package. In Chapter 2 we discuss in more detail only those amendments that the Government will implement.

The Capital Requirements Directive

1.6 Developing a Single Market in financial services lies at the core of EU Member States' commitment to economic reform in Europe. The Financial Services Action Plan 2000-2005 (FSAP) had as one of its objectives the development of state-of-the-art prudential rules and supervision.

1.7 The CRD, which comprises the (recast) Banking Consolidation Directive (Directive 2006/48/EC) and the (recast) Capital Adequacy Directive (Directive 2006/49/EC), is a key part of the FSAP and is intended to support the integration of financial markets across the EU. The CRD aligns European legislation with international recommendations by implementing Basel 2 in the European Union. The CRD aims to:

- reduce the probability of consumer loss as a result of prudential failure and thereby enhance consumer protection;

[1] http://ec.europa.eu/internal_market/bank/docs/regcapital/consultation_en.pdf
[2] http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1433&format=HTML&aged=0&language=EN&guiLanguage=fr
[3] www.fsa.gov.uk

- reduce the probability of market disruption as a result of prudential failure and thereby enhance financial stability; and
- encourage firms to further improve their risk management techniques.

1.8 By having internationally agreed capital standards in a common EU legal framework, the CRD ensures that all EU countries are in line with Basel 2, thereby creating a level playing field for all banks, building societies and affected investment firms across the EU. This in turn further deepens the Single Market in financial services.

Amendments to the Capital Requirements Directive

1.9 The CRD 2 amendments are largely designed to ensure that, as financial markets evolve, the CRD continues to deliver a state-of-the art prudential framework within the EU. The revisions can be broadly split into four categories[4]:

- revisions of rules that were brought forward from previous directives, such as the large exposures regime and derogations for bank networks from prudential requirements;
- establishing principles and rules that had not been formalised at the EU level such as the treatment of hybrid capital instruments within original own funds;
- clarifying the supervisory framework for crisis management and establishing colleges for enhancing both the efficiency and effectiveness of supervision; and
- revisions prompted by the financial crisis, most notably the rules related to capital requirements and risk management for securitisation positions.

1.10 The majority of these amendments will be implemented in the UK by the FSA. Utilising their rule-making powers under the Financial Services and Markets Act 2000 (FSMA) the FSA will implement, through changes to their Handbook, those provisions that directly affect the obligations on firms.

1.11 The Government will implement amendments that clarify the supervisory framework for crisis management and create a framework for the establishment of supervisory colleges. These amendments are described in more detail in Chapter 2.

1.12 The European Commission has adopted a proposal to further amend the CRD (CRD 3). The proposed amendments address capital requirements for the trading book and re-securitisations, disclosure of securitisation exposures, and remuneration policies. At the time of publishing, the European Parliament is discussing the CRD 3 proposals.

1.13 The European Commission has also indicated their intention to adopt a proposal for a third set of amendments (CRD 4). Details of all current proposals can be found on the European Commission website[5].

1.14 This consultation refers in several places to the Committee of European Banking Supervisors (CEBS). Readers should be aware of proposals for a new European financial supervisory architecture that will establish a European system of Financial Supervisors. Under the proposals the CEBS will be replaced by the European Banking Authority, which will have various functions, including resolving disagreements between national supervisors. These proposals entail further amendments to some of the provisions of CRD2 discussed in this consultation. More information on these proposals can be found on the Commission's website.

[4] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0602:FIN:EN:PDF
[5] http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm

Transposition into UK law

1.15 The transposition requirement of European Community law is for the full effect of the amending Directive to be given in national law. The UK Government aims to ensure that transposition does not impose additional requirements on UK firms above those specified in the amending Directive: that is, it should not be super-equivalent in respect of EC law unless it is shown to be justified on the basis of a rigorous cost–benefit analysis.

1.16 Transposition of CRD 2 is split between HM Treasury and the FSA. The FSA will be transposing the bulk of CRD 2 by making rules using its powers under FSMA. The FSA's consultation paper 'Strengthening Capital Standards 3' contains the draft Handbook text required to implement majority of the CRD provisions[6]. HM Treasury will transpose into domestic legislation those provisions that, in particular, place new duties on the FSA and the consultation in chapter 2 is limited to these.

Implementation timetable

1.17 CRD 2 was adopted on 16 September 2009. Member States are required to bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 31 October 2010 at the latest. They must apply those provisions from 31 December 2010.

How to respond

1.18 The consultation period will begin on 5 January 2010 and run for 12 weeks until 30 March 2010. Please send responses to this consultation document to:

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Room 3.20
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: (+44) (0) 207 270 5721
Email: alex.szmigin@hmtreasury.gsi.gov.uk

1.19 When responding please state whether you are responding as an individual or representing the views of an organisation.

1.20 All written responses will be made public on HM Treasury's website unless the author specifically requests otherwise. In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of e-mails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response. If you wish part, but not all, of your response to remain confidential please supply two versions - one for publication on the website with the confidential information deleted and another confidential version for the CRD implementation team.

[6] www.fsa.gov.uk

2 CRD amendments – changes introduced and proposed legislation

2.1 This consultation concerns the transposition of CRD 2 into national law and is limited to those areas of implementation that are the responsibility of HM Treasury:

- supervisory arrangements; and
- External Credit Assessment Institutions eligibility criteria.

General approach to implementation

2.2 Transposing CRD 2 into UK law will be done via a new Statutory Instrument amending the Capital Requirements Regulations 2006 (S.I. 2006/3221). While it is necessary to ensure that the new provisions mesh with the existing Regulations, in general the Government plans to take a 'copy out' approach to implementation; this means using the terms in the Directive wherever appropriate, without significant elaboration.

2.3 We therefore expect responses to this consultation to be largely centred on whether the draft legislation integrates the Directive text in a clear and appropriate manner without inadvertently introducing super-equivalence.

Amendments requiring legislation

Supervisory arrangements

2.4 CRD 2 introduces new provisions that aim to improve the supervision of cross-border banking groups. National supervisors will be required to reach a joint decision on the consolidated level of own funds held by a cross-border group, with a mediation mechanism in case of disagreement. Colleges of supervisors must be established in order to foster stronger co-operation between supervisors of cross-border groups. Supervisors in an EEA state where a branch has been established whose head office is situated in another EEA state will, where appropriate, have the ability to designate the branch as 'significant' and receive more information relating to the branch and the whole firm. Supervisors will be required to have regard to the implication of their decisions on the financial stability in other EEA states and to follow the guidelines and recommendations of CEBS, unless there are good reasons not to do so. Amendments are also made to improve information sharing amongst the relevant authorities and notification requirements in emergency situations. Each of these amendments is set out in more detail below.

Determining the adequacy of the consolidated level of own funds held by a group

2.5 CRD 2 requires national supervisors to reach a joint agreement on the consolidated level of own funds held by a cross-border group. This decision must be reached within four months of the consolidated supervisor submitting its risk assessment of the group. Once a joint decision has been reached the consolidated supervisor must provide the relevant EEA parent institution with a document setting out the fully reasoned joint decision. The joint decision must be updated at least annually.

2.6 Where a joint decision cannot be reached, any relevant national supervisor can require the consolidated supervisor to consult CEBS. The consolidated supervisor will decide the level of consolidated own funds for the group, taking into account the risk assessments prepared in relation to subsidiaries by the relevant national supervisors, and must give reasons if the decision deviates significantly from the CEBS' advice. Similarly the national supervisor of subsidiaries of the group will decide on the level of own funds for those subsidiaries and must also explain any significant deviation from CEBS' advice.

Establishment of Colleges of Supervisors

2.7 The consolidated supervisor for a cross-border banking group must establish a college of supervisors to facilitate its duties in relation to information sharing and the planning of supervisory activities, both in relation to everyday supervision and in emergency situations. Colleges will, amongst other things: enable better sharing of information; facilitate the allocation of tasks and responsibilities amongst the relevant supervisors; reduce duplication of supervisory activities; and provide for better planning and co-ordination in emergency situations. CRD 2 sets out those tasks that the consolidated supervisor must undertake in its role of co-ordinating the college. Members of the college may include third-country supervisors, central banks and host state supervisors in relation to 'significant branches' (see below). CEBS will be kept informed of the college's activities and receive information relevant to its work on supervisory convergence.

Significant branches

2.8 CRD2 introduces the concept of a 'significant branch'. Where an institution authorised in one EEA state establishes a branch in another EEA state, the host state supervisor may make a request to the national supervisor in the state where the institution is authorised (the "home state supervisor"), or the EEA consolidated supervisor (where appropriate), to have the branch designated as significant. The criteria include the likely impact of branch closure on market liquidity and payments, clearing and settlements systems in the host jurisdiction, the size and importance of the branch, and the market share of deposits in the host state. Where the branch belongs to a cross-border group, the host state supervisor may participate in the college of supervisors for the group. Where the branch is not part of a cross-border group and no college exists, the home state supervisor must establish one to facilitate co-operation with the host state supervisor. Host state supervisors will be able to gain access to relevant information about the institution or banking group to which the branch belongs through participation in the supervisory college.

The Authority's general duties

2.9 National supervisors will be required to have regard to the implication of their decisions on financial stability in other EEA states. This underlines a European dimension to supervisory decisions, in relation to which cooperation between supervisors is key.

Information sharing in emergency situations

2.10 In addition to improving access to information for host state supervisors of significant branches, CRD2 amends the provisions in the CRD requiring national supervisors to alert central banks and other government bodies about emergency situations and permitting them to share relevant information. The changes impose notification obligations on both national supervisors and central banks in emergency situations.

The Committee of European Banking Supervisors

2.11 CEBS will collect information from consolidating supervisors on the activities of colleges of supervisors and produce guidelines for the convergence of supervisory practices, particularly in regard of the joint decision processes in relation to the consolidated level of own funds held by a group. National supervisors will be required to participate in the activities of CEBS and must follow the guidelines, recommendations and other measures of CEBS unless they consider there are good reasons not to do so, in which case those reasons must be set out.

Question 1: Does the draft legislation in Annex C transpose the CRD 2 requirements relating to supervisory arrangements in full without being super-equivalent?

Question 2: Are there areas where CRD 2 is unclear and further detail in national legislation could help to remove ambiguity?

External Credit Assessment Institutions ("ECAI") eligibility criteria

2.12 CRD 2 also amends the CRD to take account of the new EU Regulation on Credit Rating Agencies ("CRAs") (Regulation (EC) No 1060/2009). The current legislation requires supervisors to recognise an ECAI as eligible for exposure and risk-weighting purposes only where its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency with respect to its assessment methodology.

2.13 CRD 2 requires that where an ECAI is registered as a CRA in accordance with the new EU regulation, supervisors shall consider those requirements to be satisfied.

Question 3: Is the draft legislation in Annex C appropriate to transpose the CRD 2 text on ECAIs into legislation?

A Impact Assessment

Impact Assessment below.

Summary: Intervention & Options

Department /Agency:	Title:	
HM Treasury (HMT)	**Impact Assessment of implementation of amendments to the Capital Requirements Directive**	
Stage: Implementation	**Version:** 1	**Date:** 5 January 2010
Related Publications: 'FSA CP09/29: Strengthening Capital Standards 3'		

Available to view or download at: **www.hm-treasury.gov.uk**

Contact for enquiries: Alex Szmigin **Telephone:** 020 7270 5721

What is the problem under consideration? Why is government intervention necessary?

The global financial crisis highlighted the need for better supervisory coordination and more information for those Member States that host branches of a material size. Without specific requirements, supervisors are less likely to cooperate and come to a common and coordinated approach. As the objectives and activities of supervisors are set out in national legislation, Government intervention is required to ensure minimum standards of supervisory coordination are set at the appropriate level. As host to a large number of foreign branches, the amendments will strengthen the FSA's ability to maintain financial stability in the UK. As this is an EU Directive, the Government must transpose these provisions into UK law.

What are the policy objectives and the intended effects?

The policy objective is to strengthen the supervisory framework for cross-border groups. The amendments are intended to increase the effectiveness of cross-border supervision, improve the exchange of information between supervisors and give better access to information for host supervisors of significant branches. The enhanced framework will reduce the likelihood and impact of further financial crises and the associated economic and social costs. Improving the coordination of supervisory activity will bring a general reduction in the compliance burden on firms.

What policy options have been considered? Please justify any preferred option.

The "do nothing" option would fail to address demonstrable weaknesses in the supervisory structure. The UK hosts a significant number of cross-border firms for which the current framework does not guarantee that the FSA can gather adequate information to protect financial stability. Furthermore, this option would lead to infraction proceedings and damage the UK's position and reputation as the leading financial centre in the EU.

The "copy out" approach will introduce the measures necessary to reinforce the prudential framework for cross-border firms. This approach will allow the Government to fulfil its obligations without being super-equivalent to the EU Directive.

The "super-equivalence" option would impose additional requirements to those contained in the Directive. We have not identified any areas where it is desirable for legislation to go further than the Directive minimum.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

A preliminary assessment of the impact of the proposals will be carried out as part of the CRD review which is required by 1 Jan 2012.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister: 

.....Date: 5 January 2010

Summary: Analysis & Evidence

COSTS

ANNUAL COSTS	Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition) **Yrs**	The net impact of the additional supervisory obligations resulting from the establishment of supervisory colleges on the Financial Services Authority is expected to be marginal.
£	
Average Annual Cost (excluding one-off)	**Total Cost** (PV) £
£	

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS	Description and scale of **key monetised benefits** by 'main affected groups'
One-off **Yrs**	We expect an overall reduction in industry compliance costs as a result of greater efficiency of supervision and a reduction in the number of overlapping and conflicting regulatory requirements. This is not quantifiable as it is not possible to determine in advance the extent of changes in supervisory behaviour.
£	
Average Annual Benefit (excluding one-off)	**Total Benefit** (PV) £
£	

Other **key non-monetised benefits** by 'main affected groups'

The amendments will increase the efficiency of supervision, reduce competitive distortions arising from an uneven playing field, enhance financial stability, increase access to information for host supervisors and improve crisis management solutions for cross-border groups. In aggregate, the amendments will reduce the potential economic and social crisis related costs for both investors and creditors.

Key Assumptions/Sensitivities/Risks

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) £	**NET BENEFIT** (NPV Best estimate) £

What is the geographic coverage of the policy/option?				EU	
On what date will the policy be implemented?				31 December 2010	
Which organisation(s) will enforce the policy?				HMT	
What is the total annual cost of enforcement for these organisations?				£	
Does enforcement comply with Hampton principles?				Yes	
Will implementation go beyond minimum EU requirements?				No	
What is the value of the proposed offsetting measure per year?				£	
What is the value of changes in greenhouse gas emissions?				£	
Will the proposal have a significant impact on competition?				Yes/No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large	
Are any of these organisations exempt?	No	No	N/A	N/A	

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ Decrease of £ **Net Impact** £

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base

Background

Significant progress has been made in developing a single market in financial services across the EU. However, while many areas of the supervisory framework have been harmonised, supervision takes place on a national basis. Cross-border branches, as they do not have independent legal status, fall under the supervision of the home Member State of their parent institutions, with limited and residual responsibilities (e.g. liquidity) entrusted to host Member State supervisors. Cross-border subsidiaries, as separate legal entities, are supervised on a solo basis by the authorities of the host Member State where they are incorporated. The home Member State authority acting as the consolidating supervisor is responsible for the consolidated overview of the financial health of a financial group, including its parent, branches and subsidiaries. Arrangements for effective cooperation and coordination between national supervisors are therefore vital to maximise the benefits of a single market and to ensure pan-EU financial stability.

Rationale for intervention

The financial crisis highlighted a number of market failures in the supervisory arrangements for cross-border firms. These are set out in the following section. Within a system of nationally based supervision, supervisors are naturally inclined to prioritise national interests. Without specific requirements in place, supervisors are less likely to cooperate and come to a common and coordinated approach. As the objectives and activities of supervisors are set out in national legislation, Government intervention is required to ensure minimum standards of supervisory coordination are set at the appropriate level. As host to a large number of foreign branches, the amendments will strengthen the FSA's ability to maintain financial stability within the UK.

Addressing market failures

Extra compliance costs for cross-border financial groups in going-concern situations - the system of national supervision fails to deliver a single set of prudential policies and practices across the EU. The result is that cross-border institutions face additional compliance and IT costs in order to meet differing regulatory requirements in each of the Member States in which they operate. Sub-optimal coordination between national supervisors, partly arising from the lack of clarity in the role of the consolidating supervisor, exacerbates this problem. Without specific requirements in place, supervisors are less likely to cooperate and come to a common and coordinated approach.

Uneven playing field - not all financial institutions within the EU will be affected in the same way by the suboptimal coordination of supervisory activities, as the additional compliance burden is a function of their size, business model and geographical spread. As a result, there is an uneven playing field.

Inadequate information for host supervisors of systemically relevant branches - under the current framework the home supervisor is not obliged to provide specific prudential information to the host supervisor of a branch. Supervisors of large branches can be in the position of receiving little or no specific prudential information about an institution that poses a financial stability risk to their markets. The host supervisor can be left with the responsibility of protecting financial stability in their domestic market without having access to the information required to do so.

Increased costs in the event of a bank failure - as and when a cross-border firm fails it is highly likely that stakeholders may act in their own interests. For supervisors, with responsibilities defined in terms of domestic markets, there is pressure to focus on national interests. The result is that as a whole, creditors, employees, shareholders and ultimately taxpayers, are left in a worse position than had all parties acted in a coordinated manner. The current legal framework does not, for example, require national authorities take into account the effect of their decisions on the financial stability of another Member State.

Potentially higher direct and indirect costs for EU economy in case of broader crisis - the global financial crisis has demonstrated the need for supervisors to be able to act collectively and in

cooperation with central banks. The CRD requires the consolidating supervisor to alert central banks where there is threat of a broader crisis but it is clear that in many cases there are legal impediments to the unrestricted multilateral sharing of information between supervisors and central banks in different jurisdictions.

Costs

Overall, the amendments discussed in this consultation should lead to a reduction in the compliance costs experienced by cross-border firms. For the Financial Services Authority the incremental costs will be marginal, as the financial crisis has already driven improved supervisory cooperation and in several areas these amendments merely formalise existing requirements.

Benefits

These measures will increase the efficiency of supervision, reduce competitive distortions arising from an uneven playing field, enhance financial stability, increase access to information for host supervisors and improve crisis management solutions for cross-border groups. In aggregate, the amendments will reduce the potential economic and social crisis related costs for investors, creditors and taxpayers.

Changes introduced to the CRD make explicit the obligations on the consolidating supervisor of a cross-border group. This will reduce the level of conflict and overlap in supervisory activity between national supervisors by improving the level of coordination that occurs. More efficient supervision will reduce the compliance burden, which in turn should lead to greater cross-border competition. The Committee of European Banking Supervisors ("CEBs") will help ensure this outcome by promoting convergence and monitoring the activities of supervisory colleges to aid consistency.

The lack of supervisory consistency affects firms in differing ways, such that their compliance burden is partly a function of their geographical footprint. Increasing the efficiency and consistency of supervision will lessen this competitive distortion.

Improving the effectiveness of colleges should also lead to better detection of the early signs of stress, as a wider range of information will be assessed on a timely basis by a broader group of supervisors, who will each benefit from seeing a fuller picture. The ability to create more coordinated contingency plans will lessen the tendency for national interests to result in suboptimal decision-making that could have an adverse outcome for the UK. It is also apparent that there may currently be legal impediments to the sharing of information between supervisors, central banks and finance ministries in crisis situations, which these amendments will force Member States to address. Taken together, these improvements will improve financial stability and lessen the social and economic costs arising from banking crises.

For host supervisors there are significant benefits arising from these amendments. Currently a host supervisor is not entitled to receive specific prudential information relating to a branch operating in their jurisdiction. The UK hosts a large number of branches, and where a branch is large enough to pose a threat to financial stability, the FSA may be left with inadequate information to match up to their responsibilities. By allowing the FSA to designate certain branches as 'significant', and therefore to participate in the relevant supervisory college, they will gain access to the information that is appropriate to their obligations and be better able to ensure financial stability.

The nature of the benefits delivered by these legislative measures makes them challenging to quantify. The reduction in compliance costs on firms is a second order effect driven by increased cooperation and coordination between supervisors and by greater harmonization of supervisory policies and procedures. Benefits in terms of increased financial stability are very hard to quantify but are potentially significant in the context of the broader economy. As London is home to a large number of foreign branches, the benefits of increased information access for host supervisors is also potentially significant in preventing crises in other Member States spilling over into the UK.

Hampton principles

The provisions we are consulting on place no direct burdens on businesses. Rather, they are largely focused around enabling the FSA to take part in a system of enhanced supervisory cooperation. The FSA has been assessed as complying well with Hampton principles: the activities of the FSA are risk-

based, principles-based and proportionate. No new information burdens will be placed on new businesses.

Super-equivalence

Implementation will be delivered using a copy-out approach and does not add to the minimum EU requirements.

Competition

Having assessed this legislation against the OFT's criteria on competition impacts, we believe these proposals raise no significant competition concerns. Rather, there are several ways in which the legislation will facilitate greater cross-border trade and reduce competitive distortions. We therefore expect the legislation to have a positive impact on competition.

Small firm impact test

The Government is required to examine the impact on businesses with fewer than 50 employees and to quantify the annual costs placed on micro, small and medium size businesses. The legislation being consulted upon places no direct obligations on firms. The obligations placed on the FSA by this legislation are targeted at larger cross-border firms. A small firm is not likely to meet the criteria to be designated as a significant branch. Further, the FSA operates a risk-based approach, focusing more supervisory resources on higher impact, higher risk firms, and ensuring regulation is proportionate to the size of the firm. This legislation will therefore have no materially adverse impact on small firms.

The following has also been considered in this assessment:

- legal aid;
- sustainable development;
- carbon assessment and other environment;
- health;
- race, disability, gender equality;
- human rights; and
- rural proofs.

There is no material impact on these areas of consideration.

Specific Impact Tests: Checklist

Type of testing undertaken	*Results in Evidence Base?*	*Results annexed?*
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

B Draft Legislation

STATUTORY INSTRUMENTS

2010 No.

FINANCIAL SERVICES AND MARKETS

The Capital Requirements (Amendment) Regulations 2010

Made - - - -	***
Laid before Parliament	***
Coming into force - -	*1st January 2011*

The Treasury are a government department designated for the purposes of section 2(2) of the European Communities Act 1972([1]) in relation to—

(a) credit and financial institutions and the taking of deposits or other repayable funds from the public([2]); and

(b) measures relating to investment firms and to the provision of investment services([3]).

The Treasury, in exercise of the powers conferred by section 2(2) of that Act, make the following Regulations:

Citation and commencement

1. These Regulations may be cited as the Capital Requirements (Amendment) Regulations 2010 and come into force on 1st January 2011.

Amendment of the Capital Requirements Regulations 2006

2. The Capital Requirements Regulations 2006([4]) are amended as follows.

([1]) 1972 c.68. By virtue of the amendment of section 1(2) made by section 1 of the European Economic Area Act 1993 (c.51) regulations may be made under section 2(2) to implement obligations of the United Kingdom created by or arising under the Agreement on the European Economic Area signed at Oporto on 2nd May 1992 (Cm 2073) and the Protocol adjusting that Agreement signed at Brussels on 17th March 1993 (Cm 2183). For the decision of the EEA Joint Committee in relation to Directive 2009/111/EC, see Decision No [ ] of [ ] amending Annex IX (Financial Services) to the EEA Agreement (OJ No [ ]).

([2]) S.I. 2001/3495.

([3]) S.I.1993/2661.

([4]) S.I. 2006/3221.

Interpretation

3. In regulation 1(2) (interpretation)—

(a) at the end of the definition of "banking consolidation directive" insert "as last amended by Directive 2009/111/EC of the European Parliament and of the Council([5])";

(b) after the definition of "banking consolidation directive" insert—

""banking or investment group" means the group to which an EEA parent credit institution, EEA parent investment firm, or EEA parent financial holding company belongs;";

(c) in the definition of "decision" after "means" insert ", for the purposes of Part 2,";

(d) after the definition of "EEA parent financial holding company" insert—

""home EEA state" means the EEA state in which a credit institution or investment firm has been authorised in accordance with the banking consolidation directive or the capital adequacy directive";

"host EEA state" means the EEA state in which a credit institution or investment firm authorised in another EEA state has a branch;";

(e) in the definition of "joint decision" after "means" insert ", for the purposes of Part 2,";

(f) after the definition of "relevant competent authority" insert—

""relevant investment firm" means an investment firm which does not meet the conditions set out in article 20(2) or (3) or 46(1) of the capital adequacy directive;

"risk assessment" means, unless the context otherwise requires, an evaluation of the risks to which a credit institution or investment firm or a banking or investment group is or might be exposed, in accordance with articles 123 and 124 of the banking consolidation directive;

"significant branch" has the meaning given by regulation 16A.".

Exercise of supervision

4. In Part 3 (exercise of supervision), before regulation 10 (the Authority's duties as an EEA consolidated supervisor) insert—

"The Authority's duties in determining the adequacy of the consolidated level of own funds held by a group

9A.—(1) This regulation applies where the Authority is the EEA consolidated supervisor.

(2) The Authority must submit a report containing its risk assessment of a banking or investment group to the relevant competent authorities.

(3) The Authority must do everything in its power to reach a joint decision with the relevant competent authorities, within four months of submitting its report, on—

(a) the application of Articles 123 and 124 of the banking consolidation directive to determine the adequacy of the consolidated level of own funds held by the group with respect to its financial situation and risk profile; and

(b) the required level of own funds for the application of Article 136(2) of the banking consolidation directive to each member of the group and to the group as a whole.

(4) The Authority must consider, for the purposes of reaching a joint decision, the risk assessments prepared in relation to subsidiaries by the relevant competent authorities.

(5) The Authority must provide the relevant institution with a document setting out the fully reasoned joint decision.

(6) Where a joint decision cannot be reached, the Authority must, at the request of any of the relevant competent authorities, consult the Committee of European Banking Supervisors, or may do so of its own initiative.

(7) If a joint decision has not been made within four months of the Authority submitting its report in accordance with paragraph (2), the Authority must—

([5]) O.J. L302, 17.11.09, p97. There are other amending Directives but none are relevant.

(a) after considering the risk assessments prepared in relation to subsidiaries by the relevant competent authorities and any advice given by the Committee of European Banking Supervisors, make a decision on the matters referred to in paragraph (3);

(b) where the Authority's decision differs significantly from any advice given by the Committee of European Banking Supervisors, give reasons for the difference;

(c) provide all relevant competent authorities and the relevant institution with a document containing its decision and the decisions of the relevant competent authorities on the levels of own funds required to be held by subsidiaries on an individual or, where appropriate, sub-consolidated basis;

(d) recognise the decisions taken by the relevant competent authorities, mentioned in sub-paragraph (c), as determinative.

(8) The Authority must update the joint decision reached in accordance with paragraph (3) or its own decision made under paragraph (7)(a)—

(a) annually; or

(b) in exceptional circumstances, on receipt of a fully reasoned written request by a relevant competent authority to update the decision on the application of Article 136(2) of the banking consolidation directive;

and, where sub-paragraph (b) applies, the updated decision may be made after consultation with the competent authority making the request, without consulting the other relevant competent authorities.

(9) In this regulation "relevant institution" means the EEA parent credit institution, EEA parent investment firm or the credit institution or investment firm controlled by an EEA parent financial holding company concerned.

9B.—(1) This regulation applies where the Authority is a relevant competent authority and receives a report containing the risk assessment of a banking or investment group from the EEA consolidated supervisor.

(2) The Authority must submit to the EEA consolidated supervisor a report containing its risk assessment of each subsidiary of the group it has authorised.

(3) The Authority must do everything in its power to reach a joint decision with the EEA consolidated supervisor and any other relevant competent authorities on the matters referred to in regulation 9A(3) within four months of the Authority receiving the report from the EEA consolidated supervisor.

(4) Where agreement on a joint decision cannot be reached, the Authority may request that the EEA consolidated supervisor consults the Committee of European Banking Supervisors.

(5) If a joint decision has not been reached within four months of the Authority receiving the report from the EEA consolidated supervisor, the Authority must—

(a) make a decision on the level of own funds required to be held by each subsidiary it has authorised, on an individual or, where appropriate, sub-consolidated basis, in accordance with Articles 123, 124 and 136(2) of the banking consolidation directive, taking into account the views of the EEA consolidated supervisor and any advice given by the Committee of European Banking Supervisors;

(b) where the Authority's decision differs significantly from any advice given by the Committee of European Banking Supervisors, give reasons for the difference;

(c) provide the EEA consolidated supervisor with a document containing its decision; and

(d) recognise the decisions taken by the EEA consolidated supervisor and any other relevant competent authorities on the levels of own funds required to be held by the banking or investment group or its subsidiaries outside the United Kingdom, as determinative.

(6) The Authority may, in exceptional circumstances, make a fully reasoned written request to the EEA consolidated supervisor to update the decision on the level of own funds required to be held by any subsidiary of the group within the United Kingdom in accordance with article 136(2) of the banking consolidation directive.".

The Authority's duties as an EEA consolidated supervisor

5. In regulation 10 for "Regulations 11 and 12" substitute "Regulations 11, 12 and 12A".

6. For paragraph (1) of regulation 11 substitute—

"(1) The Authority must take such steps as it considers appropriate—

(a) in going-concern situations—

(i) to co-ordinate the gathering and dissemination of relevant or essential information;

(ii) to plan and co-ordinate supervisory activities in co-operation with other relevant competent authorities;

(b) in preparation for and during emergency situations, including adverse developments in credit institutions or relevant investment firms or in financial markets—

(i) to co-ordinate the gathering and dissemination of relevant or essential information;

(ii) to plan and co-ordinate supervisory activities, including exceptional measures, preparation of risk assessments, implementation of contingency plans and communication to the public, in co-operation with other relevant competent authorities and, where necessary, central banks.".

Establishment of colleges of supervisors

7. After regulation 12 insert—

"Establishment of colleges of supervisors

12A.—(1) The Authority must, acting on the basis of agreements entered into pursuant to regulation 15, establish a college of supervisors to-

(a) facilitate its duties as an EEA consolidated supervisor; and

(b) ensure appropriate co-ordination and co-operation with competent authorities outside the EEA where appropriate.

(2) The college of supervisors shall facilitate the EEA consolidated supervisor and the other relevant competent authorities carrying out the following tasks—

(a) exchanging relevant information;

(b) agreeing on the voluntary allocation of tasks and the voluntary delegation of responsibilities where appropriate;

(c) determining supervisory examination programmes based on a risk assessment of the relevant banking or investment group in accordance with Article 124 of the banking consolidation directive;

(d) increasing the efficiency of supervision by removing unnecessary duplication of supervisory requirements;

(e) where appropriate, applying the prudential requirements under the banking consolidation directive on a consistent basis to all members of a banking or investment group;

(f) planning and co-ordination of supervisory activities in preparation for and during emergency situations, taking into account the work of any other relevant bodies established for such purposes.

(3) The following bodies may participate in the college of supervisors—

(a) the relevant competent authorities;

(b) the competent authorities of a host EEA state in which significant branches are established;

(c) central banks;

(d) competent authorities situated outside the EEA, provided that, in the opinion of all relevant competent authorities, they are subject to confidentiality requirements equivalent to the requirements of section 2 of Chapter 1 of Title V of the banking consolidation directive.

(4) The Authority must co-operate closely with the other competent authorities participating in the college of supervisors.

(5) The Authority must—

(a) inform members in advance about the organisation of and agenda for any meeting of the college of supervisors, including any activities to be considered at that meeting;

(b) decide which competent authorities may attend any meeting or participate in any activity;

(c) chair any meeting;

(d) inform members in a timely manner of the actions taken at any meeting or any activities carried out.

(6) When making a decision under paragraph (5)(b), the Authority must take into account the relevance to each competent authority of the supervisory activity to be planned or co-ordinated, and in particular—

(a) the potential impact on the stability of the financial system in the EEA state concerned; and

(b) the competent authority's obligations as the competent authority of the home EEA state under Article 42a(2) of the banking consolidation directive.

(7) Subject to confidentiality requirements under section 2 of Chapter 1 of Title V of the banking consolidation directive, the Authority must—

(a) inform the Committee of European Banking Supervisors of the activities of the college of supervisors, including in emergency situations; and

(b) provide the Committee with all information that is of particular relevance for the purposes of supervisory convergence.".

The Authority's duties as EEA consolidated supervisor or national consolidated supervisor

8. For regulation 14 substitute—

"**14.**—(1) Where an emergency situation, including adverse developments in financial markets, arises in the United Kingdom, which potentially jeopardises the market liquidity or the stability of the financial system in any other EEA state where an entity belonging to a banking or investment group has been authorised or where a significant branch is established, the Authority must notify as soon as practicable—

(a) the European Central Bank;

(b) the central bank of the EEA state; and

(c) the central government departments of the EEA state which are responsible for legislation on the supervision of credit institutions, financial institutions, investment services and insurance companies.

(2) The Authority, in notifying any body under paragraph (1), must provide all information that is essential for the purpose of that body's tasks, which it is not prevented from disclosing.".

9.—(1) The existing regulation 15 is re-numbered regulation 15(1).

(2) After that provision (as re-numbered) insert—

"(2) Where the agreements referred to in paragraph (1) relate to the establishment of colleges of supervisors, they shall be entered into by the Authority after consultation with the relevant competent authorities.".

10. After regulation 16 insert—

"Significant branches

16A.—(1) This regulation applies where a credit institution or relevant investment firm authorised in another EEA state has established a branch in the United Kingdom.

(2) The Authority may make a request to the competent authority of the home EEA state or, where appropriate, to the EEA consolidated supervisor (in which case a copy of the request shall be sent to the competent authority of the home EEA state), for the branch to be designated as significant.

(3) A request made under paragraph (2) must include reasons for considering the branch to be significant with particular regard to—

(a) the likely impact of a suspension or closure of the operations of the credit institution or investment firm on market liquidity and the payment, clearing and settlement systems in the United Kingdom;

(b) the size and importance of the branch in terms of the number of clients within the context of the banking or financial system of the United Kingdom; and

(c) in relation to a branch of a credit institution, whether the market share of the branch in terms of deposits exceeds 2% in the United Kingdom.

(4) The Authority must—

(a) do everything in its power to reach a joint decision with the competent authority of the home EEA state and, where appropriate, the EEA consolidated supervisor, on the designation of the branch as significant; and

(b) if a joint decision is made, provide the competent authorities concerned with a document containing the fully reasoned joint decision.

(5) If a joint decision has not been reached within two months of receipt of a request made by the Authority under paragraph (2), the Authority must—

(a) make a decision within a further period of two months on whether or not to designate the branch as significant, taking into account any views and reservations of the competent authority of the home EEA state and, where appropriate, the EEA consolidated supervisor; and

(b) provide the competent authorities concerned with a document containing the fully reasoned decision.

16B.—(1) This regulation applies where the Authority is the competent authority of the home EEA state or the EEA consolidated supervisor and has received a request (or a copy of a request) from the competent authority of a host EEA state for a branch of a credit institution or relevant investment firm established in that state to be designated as significant.

(2) The Authority must do everything in its power to reach a joint decision with the competent authority of the host EEA state and, where appropriate, the EEA consolidated supervisor, on the designation of the branch as significant.

(3) Where a joint decision has not been reached and the competent authority of the host EEA state has made and notified to the Authority its own decision to designate the branch as significant, the Authority must recognise that decision as determinative.

16C.—(1) This regulation applies where the Authority is the competent authority of the home EEA state and a decision has been made to designate a branch of a credit institution or relevant investment firm established in another EEA state as significant.

(2) The Authority must—

(a) in relation to the credit institution or relevant investment firm for which it is the home EEA state competent authority, communicate to the competent authority of the host EEA state the information referred to in regulation 11(3)(d) and (e);

(b) in preparation for and during an emergency situation, plan and co-ordinate supervisory activities in cooperation with the competent authority of the host EEA state and if necessary its central bank.

(3) Where a college of supervisors has not been established in relation to a credit institution or investment firm whose branch has been designated as significant, the Authority must establish a college of supervisors acting on the basis of agreements entered into pursuant to regulation 15.

(4) Where a college of supervisors has been established by the Authority under paragraph (3), it must—

(a) inform members in advance about the organisation of and agenda for any meeting of the college of supervisors, including any activities to be considered at that meeting;

(b) decide which competent authorities may attend any meeting or participate in any activity;

(c) chair any meeting;

(d) inform members in a timely manner of the actions taken at any meeting or any activities carried out.

(5) When making a decision under paragraph (4)(b), the Authority must take into account the relevance to each competent authority of the supervisory activity to be planned or co-ordinated and in particular—

(a) the potential impact on the stability of the financial system in the EEA state concerned; and

(b) the competent authority's obligations as the competent authority of the home EEA state under Article 42a(2) of the banking consolidation directive.

The Authority's general duties

16D. The Authority must in the exercise of its duties as the competent authority under the banking consolidation directive and the capital adequacy directive—

(a) consider the potential impact of its decisions on the stability of the financial system in other EEA states, such consideration, in particular in emergency situations, to be based on information available at the relevant time;

(b) participate in the activities of the Committee of European Banking Supervisors;

(c) follow the guidelines, recommendations, standards and other measures agreed by the Committee of European Banking Supervisors, unless it considers that there are good reasons not to do so, in which case it must set out those reasons.

The Bank of England's general duties

16E. Where—

(a) an entity belonging to a banking or investment group has been authorised, or a significant branch is established, in the United Kingdom; and

(b) an emergency situation arises, including adverse developments in financial markets, which potentially jeopardises the market liquidity or the stability of the financial system in the United Kingdom;

the Bank of England must notify as soon as practicable the national consolidated supervisor or, where appropriate, the EEA consolidated supervisor.".

Credit institutions and external credit assessment institutions

11. In regulation 22 (recognition for exposure risk-weighting purposes)—

(a) at the beginning of paragraph (1) insert "Subject to paragraph (6) below,";

(b) after paragraph (5) insert—

"(6) The Authority must consider the requirements in paragraph (1)(a) with respect to an ECAI's assessment methodology are satisfied where it is registered as a credit rating agency in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16th September 2009 on credit rating agencies([6]).".

12. In regulation 23 (recognition for securitisation risk-weighting purposes)—

(a) at the beginning of paragraph (1) insert "Subject to paragraph (9) below";

(b) after paragraph (8) insert—

"(9) The Authority must consider the requirements in paragraph (1)(a)(i) with respect to an ECAI's assessment methodology are satisfied where it is registered as a credit rating agency in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16th September 2009 on credit rating agencies.".

Amendment of the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001

13.—(1) The Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001([7]) are amended as follows.

(2) In the definition of "directive restrictions" in regulation 2, after "banking consolidation directive" insert "as last amended by Directive 2009/111/EC of the European Parliament and of the Council".

(3) In regulation 9 (disclosure by the Authority or Authority workers to certain other persons)—

(a) in paragraph (1) for "(3) and (3A)" substitute "(3), (3A) and (4)";

(b) after paragraph (3B) insert—

([6]) OJ No. L302, 17.11.09, p1.

([7]) S.I. 2001/2188; a relevant amending instrument is S.I. 2006/3413.

"(4) Paragraph (1) does not permit disclosure of information obtained in the course of discharging the Authority's functions under the banking consolidation directive to persons specified in the first column in Part 5 of Schedule 1 (except to the extent that they are referred to in other Parts of that Schedule), other than in emergency situations, as referred to in Article 130(1) of the banking consolidation directive, where such information is essential for the performance of such persons' functions.".

(4) In Schedule 1 (disclosure of confidential information whether or not subject to directive restrictions)—

(a) for the first entry in the list of persons in the left-hand column of the table substitute "The Bank of England, the European Central Bank, a national central bank of the European System of Central Banks, or any other body with a similar function, in each case in its capacity as a monetary authority";

(b) for the first entry in the list of functions in the right-hand column of the table substitute "Its statutory tasks, including the conduct of monetary policy and related liquidity provision, oversight of payments, clearing and settlement systems and safeguarding the stability of the financial system";

(c) for the second entry in the list of persons in the left-hand column of the table substitute "a body (other than a central bank) in a country or territory outside the United Kingdom having responsibility for overseeing payment systems";

(d) after Part 4 of the table insert—

"PART 5

Person	Functions
A central government department in the United Kingdom or another EEA state, responsible for legislation on the supervision of credit institutions, financial institutions, investment services and insurance companies or any inspector acting on behalf of that department in relation to such legislation	Its functions as such".

Names

Date Two of the Lords Commissioners of Her Majesty's Treasury

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations implement, in part, Directive 2009/111/EC of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements and crisis management ("the Directive") (OJ L302, 17.11.09, p97).

Regulation 3 amends certain definitions in Part 1 of the Capital Requirements Regulations 2006 (the "principal Regulations") and inserts new definitions.

Regulations 4 to 10 amend Part 3 of the principal Regulations. Regulation 4 inserts provisions establishing procedures for the Financial Services Authority ("FSA") to determine the adequacy of the consolidated level of own funds held by a group, whether as the EEA consolidated supervisor or a national supervisor for members of a banking or investment group. Regulations 5, 7 and 9 insert new provisions concerning the establishment of colleges of supervisors for pan-European groups. Regulation 6 amends the provisions in the principal Regulations on co-operation between competent authorities. Regulation 8 amends the notification provisions which apply to the FSA in the case of an emergency situation. Regulation 10 inserts provisions establishing procedures for branches to be designated as "significant", imposing new duties on

the FSA to have regard to the impact of its decisions on the stability of the financial system in other EEA states and in relation to the Committee on European Banking Supervisors. It also imposes a new notification duty on the Bank of England.

Regulations 11 and 12 update Part 4 of the principal Regulations concerning external credit assessment institutions, with reference to Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16th September 2009 on credit rating agencies (OJ L302, 17.11.09, p1).

Regulation 13 amends the provisions in the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001 (S.I. 2001/2188) relating to disclosure of single market directive information.

A Transposition Table setting out how elements of the Directive will be transposed into UK law is available from the Banking and Credit Team , HM Treasury, 1 Horseguards Road, London, SW1A 2HQ. The Transposition Table is also available on HM Treasury's website (www.hm-treasury.gov.uk).

An Impact Assessment has been produced for this instrument and has been deposited in both Houses of Parliament. It is available either from the above address or on HM Treasury's website.

HM Treasury contacts

This document can be found in full on our website at:
hm-treasury.gov.uk

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