

28 December 2020: this guidance document supports the final PRA Transitional Direction published as part of Policy Statement 30/20.

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 Regulation 575/2013 (the "CRR") and related onshoring instruments. The PRA's transitional direction is made under the temporary transitional power (TTP) conferred on the regulators by Parliament (via The Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019).¹
- Firms should have regard to this guidance while the transitional relief granted under the transitional 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 transitional direction should be followed in the case of any inconsistency with this guidance.
- The transitional direction will come into effect at the end of the transition period (11pm on 31 December 2020) and will apply until 31 March 2022 unless the PRA decides to make any changes to this timing in the future. This document refers to the period when the transitional direction is in effect as the 'TTP period'.
- 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. The UK version includes any modifications made by Parliament, HM Treasury or the relevant regulators.
- This guidance document covers transitional modifications effected by the transitional direction in the context of CRR. This relates to the onshoring changes introduced by CRR-related legislation, including, without limitation, the:
 - a. the Capital Requirements (Amendment) (EU Exit) Regulations 2018 ("CRR EU Exit SI");²
 - b. the Capital Requirements (Amendment) (EU Exit) Regulations 2019 ("CRR II EU Exit SI");³
 - c. the Financial Holding Companies (Approval etc.) and Capital Requirements (Capital Buffers and Macro-Prudential Measures (Amendment) (EU Exit) Regulations 2020 ("CRD V EU Exit SI");⁴
 - d. the Securities Financing Transactions, Securitisation and Miscellaneous Amendments (EU Exit) Regulations 2020 (this SI fixes deficiencies in parts of CRR II that apply before the end of the transition period);⁵
 - e. the Securitisation (Amendment) (EU Exit) Regulations 2019 ("Securitisation Regulation EU Exit SI");⁶ and,

¹ Available at: <<https://www.legislation.gov.uk/uksi/2019/632/contents/made>>

² Available at: <<https://www.legislation.gov.uk/uksi/2018/1401/contents/made>>

³ Available at: <<https://www.legislation.gov.uk/uksi/2019/1232/made>>

⁴ Available at: <<https://www.legislation.gov.uk/uksi/2020/1406/contents/made>>

⁵ Available at: <<https://www.legislation.gov.uk/uksi/2020/1385/contents/made>>

⁶ Available at: <<https://www.legislation.gov.uk/uksi/2019/660/contents/made>>

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- f. the PRA's EU Exit instruments relating to technical standards made under CRR and the Capital Requirements Directive.
- The PRA has not identified any further exceptions to the draft transitional direction necessary as a result of onshoring amendments to CRD V. For further details, consult the Bank of England and PRA's statement on 'The Application of the temporary transitional power to CRD V and BRRD II derived legislation' (published on 13 November 2020).⁷
- The PRA intends to revise this guidance in light of any significant changes to UK legislation (including retained EU law) and PRA rules during the TTP period. This includes any changes which implement outstanding Basel 3 and 3.1 standards, and any changes which result from the introduction of the Investment Firms Prudential Regime, as envisaged by the Financial Services Bill currently before Parliament.
- For further details on the PRA's general approach to the exercise of the transitional direction, firms should consult:
 - a. the Bank of England Policy Statement | PRA Policy Statement PS27/20 on 'the Bank of England's amendments under the European Union (Withdrawal) Act 2018: Changes before the end of the transition period'⁸
 - b. the Bank of England's Policy Statement on the amendments to financial services legislation under the European Union (Withdrawal) Act 2018 (PS5/19),⁹ and
 - c. the general guidance provided with the PRA's transitional direction).¹⁰

1. Definitions

- a. The transitional direction delays the impact of substantive onshoring changes to the definitions of different types of firms on firms' obligations. Where obligations would begin to apply, or apply differently, as a result of onshoring changes to the definitions, the transitional direction will mean that firms should comply with those obligations during the TTP period as they did immediately before the end of the transition period. The following definitions continue to capture the same types of entities and undertakings as immediately before the end of the transition period :
 - 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 definition of "recognised third-country investment firm" which applied immediately before the end of the transition period), "financial institution", "financial sector entity", "multilateral trading facility", and "regulated market".

⁷ Available at: <<https://www.bankofengland.co.uk/-/media/boe/files/eu-withdrawal/guidance-on-pra-transitional-direction.pdf>>

⁸ December 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/uk-withdrawal-from-the-eu-changes-before-the-end-of-the-transition-period>.

⁹ Available at: < <https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/the-boes-amendments-to-am-financial-services-legislation-under-the-eu-withdrawal-act-2018.pdf?la=en&hash=1B26AA88A7DCA56C731498A74DB2B688EC79CD58>>

¹⁰ Available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2020/ps3020app3.pdf>

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- b. Notwithstanding the new definition of “CRR covered bonds”, the transitional direction operates such that EU-issued covered bonds continue to be treated during the TTP period as they were treated before the end of the transition period (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. The transitional direction will delay the impact of changes to obligations which flow from changes to definitions relating to group undertakings and levels of consolidation. The definitions of “parent undertaking”, “subsidiary” and “participation” continue to capture the same types of relationship as immediately before the end of the transition period.

2. Consolidated supervision.

- a. Pan-EU consolidated supervision (i.e. the oversight of EU supervisory authorities and the role of related regulatory frameworks) ends. This designation of consolidated supervisor is not affected by the transitional direction.

3. Joint decisions.

- a. The EU joint decision making framework ends. Joint decisions made before the end of the transition period continue to have effect until such time as the PRA or FCA take different decisions. Where joint decision applications were submitted before the end of the transition period, the joint decision process will cease to apply. The UK regulators will take decisions, with any necessary co-ordination with EU regulators.

4. Level of application of requirements.

- a. The level of application of CRR requirements for UK headquartered groups is unaffected by onshoring changes.
- b. The transitional direction delays the impact of onshoring changes to Article 11(4) which would require UK groups that sit below an EU parent institution to establish a new level of consolidation at the UK level.
- c. During the TTP period, UK groups that sit below an EU parent institution should continue to disclose at the same levels as they did before immediately before the end of the transition period 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 during the TTP period. This includes minority interests in EU investment firms and other undertakings that continue to be subject to CRR/D requirements under Articles 81(1)(a)(ii) and 82(a)(ii) of the EU version of Regulation 575/2013.
- b. The transitional direction extends to obligations which are modified by the changes made to the Own Funds RTS (241/2014). This includes the amendments which reduce the scope of the treatment provided for in Article 15a (in relation to indirect holdings in EU-authorised

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credit institutions) and Article 17 (in relation to deductions for certain types of EU- authorised e-money and payment institutions and EU AIFMs and management companies).

6. **Pillar 1 capital requirements: credit risk**

- a. The equivalence determinations announced by HM Treasury on 9 November 2020 will provide preferential treatment for various EU assets and exposures. This preferential treatment is not limited to the TTP period.
- b. The transitional direction applies to the treatment of any EU assets and exposures which are not the subject of those equivalence determinations. During the TTP period, firms should continue to apply the same treatment to those assets and exposures as they applied before the end of the transition period.

7. **Harmonising Pillar 1 treatment**

- a. Decisions taken before the end of the transition period by EU authorities on risk weights for residential and commercial real estate in their territories made under Article 124(2) and 164(5) will continue to have effect. Existing decisions are saved by the onshored Article 522 CRR (as inserted by Regulation 216 of the CRR EU Exit SI).

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 so that, during the TTP period, firms can continue to treat all equities listed in stock markets located in countries that have the euro as their currency as one market for these purposes.

9. **Model permissions.** Existing model permissions are saved by the onshored Article 522 CRR (i.e. as inserted by Regulation 216 of the CRR EU Exit SI) and will continue to have effect. These permissions cover:

- a. Credit risk: the Internal Ratings Based (IRB) approach models (Article 143(1));
- b. Counterparty credit risk: the Internal Model Method (Article 283 CRR);
- c. Operational risk: Advanced Measurement Approaches (Article 312(2) CRR); and,
- d. Market risk: the internal model approach (Article 363 CRR).

10. **Use of credit ratings**

- a. This section covers the cumulative effect of the run-off period applied by the transitional direction and the separate transitional provision in Article 4(1A) of the CRA Regulation (1060/2009). UK regulated entities may, for a period of one year beginning with the end of the transition period, use a credit rating for regulatory purposes if it was issued or endorsed by an EU credit rating agency before the end of the transition period and was not withdrawn immediately before the end of the transition period. For further guidance on this exception, firms should refer to the guidance issued by the FCA in Annex A to the FCA Transitional Direction.
- b. The PRA has amended the External Credit Assessment Institutions (ECAI) mapping BTS. Under the amended BTS, firms may use ratings issued by the new UK CRA legal entities where the existing mappings currently only refer to a specific EU legal entity. The PRA has therefore excluded these changes from the application of the transitional temporary power,

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meaning that firms can use ratings issued by the new UK CRA legal entities from the end of the transition period.

11. **Individual (Pillar 2) capital requirements.** Onshoring changes will not impact any firms' Pillar 2 capital requirements at the end of the transition period. Therefore transitional relief is not relevant.
12. **PRA buffer and combined buffer requirements.** Onshoring changes will not change firms' buffer requirements at the end of the transition period. Therefore transitional relief is not relevant.

13. Securitisation

- a. This part of the guidance covers the interaction between the transitional direction, the CRR and the Securitisation Regulation. 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 the onshored Securitisation Regulation are eligible for differentiated capital treatment where the other criteria in Article 243 CRR 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 during the TTP period. 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 (see Regulation 42 of the Securitisation Regulation EU Exit SI)
 - 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).
- d. Where the transitional measures listed in Article 2 of Regulation (EU) 2017/2401 (Amendments to the CRR) and Article 43 of the Securitisation Regulation apply, firms may continue to recognise preferential treatments afforded to EU assets and exposures which existed in the CRR as it applied at 31 December 2018. This includes:
 - i. In the circumstances specified in Article 405(2) CRR, the risk retention requirements outlined in 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 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.

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- 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 during the TTP period. 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 during the TTP period. 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 during the TTP period.
- b. Reporting requirements on material losses stemming from operational risk events as set out in ITS 680/2014 Article 5(b)(2) will apply during the TTP period as they applied at the end of the transition period. 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. During the TTP period, firms should continue to report and disclose data according to the same methodology that they used for reporting and disclosure before the end of the transition period. The PRA has set out expectations for how firms should interpret EU references in reporting and disclosure requirements after the end of the transition period 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 a firm 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, and doing so would change how an obligation applies in that firm's case, the firm should comply with that obligation as it applied before the end of the transition period.
 - ii. Where the guidance in SS 2/19 expects a firm to refer to nationalised (i.e. onshored) legislation to interpret a reporting or disclosure definition that is based on a CRR or Solvency II requirement, and doing so would change how an obligation applies in that firm's case, the firm should comply with that obligation as it applied before the end of the transition period.

17. Own funds requirements for exposures to CCPs

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- 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 Capital Requirements Directive. Many binding technical standards made under the CRR are onshored without any significant amendment and will continue to operate as before the end of transition period.

SUPERSEDED