

A response to the PRA CP16/22 Implementation of the Basel 3.1 standards Executive summary

Introduction

UK Finance is the collective voice for the banking and finance industry. Representing around 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

We are pleased to respond to the PRA's [CP16/22](#) which proposes changes to the PRA's Rulebook to implement the finalised Basel 3 standards ('Basel 3.1') in the UK. Other sections of our response provide our views on each of the substantive 12 chapters of the CP and make recommendations.

Subject matter experts from many of our member banks and building societies have contributed to this response so it reflects the views of a range of different firms - UK and foreign systemically important firms, simpler-regime firms, intermediate firms and smaller domestic and foreign firms. They have a variety of business models providing finance and risk management services to owner-occupied and buy-to-let mortgage customers, corporate borrowers, large and small, users of trade finance and wholesale market participants accessing the international capital markets in London.

The following key recommendations are particularly important to our members and are broadly supported across UK Finance's different member cohorts. The appendix contains the full suite of recommendations and individual chapter response provide rationale and details.

Key recommendations

SME supporting factor

Our members do not support the **withdrawal of the SME supporting factor**. Without it the cost of lending to a critical component of the UK economy will increase and lending appetite reduce.

Should the PRA decide to remove the SME supporting factor:

- it should be maintained for existing lending
- the counter-intuitive higher 100% risk weighting for secured lending to corporates should be reduced to 75%/85%
- a transitional phase-out period should be introduced

Residential mortgages

Embedding **valuation at origination** will have unintended consequences, including an ever-increasing impact on long term fixed rate lending as the true property value deviates further away from the original value making the approach non-risk sensitive. It should be revisited to avoid such unintended consequences.

Automated Valuation Methodologies should continue to be eligible for LTV assessment purposes.

The continued use of **indexation for SA firms** should be permitted to align with the IRB approach.

A **10% standardised risk-weight** should be applied to mortgages with an LTV of up to 55% to promote convergence between standardised and IRB mortgages.

Unhedged retail exposures

The **risk weight multiplier for unhedged retail exposures** should not be applied to wealth management revolving credit facilities.

Buy-to-let

The buy-to-let sector is a significant provider of homes in the UK yet exposures outside of the **'three property limit'** are penalised by unduly high-risk weights compared to owner occupied, which does not recognise the strong and more stringent BTL underwriting standards and low loss data experienced by our members, both unique to the UK.

We propose the PRA **align BTL risk weight proposals** with current requirements set out in the existing CRR. If the final standard remains similar to that in the CP, we would propose greater risk sensitivity across the $60\% < \text{LTV} \leq 80\%$ RWA segment and that the increase in BTL capital requirements should only apply to new mortgage loans booked from the implementation date.

Unrated corporates

Create a new corporate exposure category appropriate to the characteristics of **funds and other regulated financial corporates** to address risk sensitivity gaps in both credit and counterparty credit risk frameworks.

The PRA should promote discussion of **a more risk-sensitive approach to the risk weighting of unrated corporates** in the Basel Committee, given the low level of rating coverage for corporate exposures.

Infrastructure Supporting Factor ('IFS')

Our members do not support the **removal of the IFS**. Its removal would limit UK banks' ability to efficiently support key UK growth industries and the environmental objectives specified in the ISF criteria including climate change mitigation, sustainability and energy transition.

Should the PRA decide to remove the IFS:

- it should be maintained for existing lending
- a transitional period phase-out period should be introduced

Pillar 2

We look forward to continuing to work with the PRA as it refines the Pillar 2 framework which should be completed swiftly, to:

- ensure **elimination of double counting** between Pillar 1 and 2
- enable firms' **capital planning** to incorporate Pillar 2 changes
- **avoid capital increases** from interaction between the output floor and Pillar 2

Output floor

UK authorities should implement an **equivalence regime** to ensure UK and third country firms operate on a level playing field.

An RWA equivalent of the **excess EL deduction should be added back** to IRB RWAs for the purposes of the floor calculation

The PRA should engage with industry on the **impact of the output floor on significant risk transfer** transactions and a transitional measure introduced to **adjust the p-factor** during the UK's review of the **Securitisation Regulation**.

Simpler-regime

We support the PRA's continued progress towards creating a Simpler-regime for firms whose failure would not pose a significant risk to the UK's financial system but encourage it to consider each element of the Basel 3.1 regime carefully to **consider where to align** its implementation **with Basel 3.1** and **where it would make sense to deviate for simplicity and proportionality reasons**.

The PRA should **simplify the Pillar 2 approach** by aligning timing of full ICAAP requirement with C-SREP cycle.

Alignment with Basel

UK Finance members support the PRA's approach of seeking close alignment to the Basel 3.1 framework. This supports those with international activities and the UK's standing as an international financial centre. But it should **avoid super-equivalent implementation and adopt more National Discretions** where reasonable. For instance:

- the application of a *50% CCF to all 'other retail'* categories should just be restricted to mortgages.
- the super-equivalent *100% floor for commercial real estate exposures* that are not materially dependent on property cash flows should be removed.
- exposures such as trade finance, receivables finance and equipment finance, and other products where firms have *significant control over drawings should be exempted from the definition of commitment*.
- the eligibility of financial instruments and commodities as *collateral in trading book securities financing transactions should be linked to the ability of a firm to trade the instrument* based on specific criteria, not holding it outright.
- allow firms to *substitute an IRB risk weight for a standardised risk weight* where the underlying exposure is on standardised and the guarantor is on IRB, consistent with our reading of Basel.

- firms should be able to treat *second charge mortgages as secured loans* and either allow them to choose between the two Basel approaches or allow firms to adopt the whole loan approach for regulatory real estate.
- align the *SME definition* to the Basel definition.
- ECAs, which would fall into a category of *public sector entities*, should be treated as central government and central bank category where there are no differences in risk between the central government and the PSE-ECA.
- *inter-bank deposits and nostro accounts* should be exempt from the *one-year floor requirement*.

Operational considerations:

IRB and FRTB model approval process

The PRA should work with industry to ensure firms can meet the **demanding timelines** for application of credit and market risk model approvals, by clarifying its expectations on material compliance, governance requirements and timelines.

The UK's **FRTB implementation** should be internationally aligned.

The PRA should permit firms to **incorporate all types of parental support arrangements in their IRB models**.

Robust implementation

Firms ask the PRA to **share the final rules, taxonomy, tabulated disclosure and reporting templates and instructions, and mapping tools, at least a year prior to the implementation date**, to ensure consistent and good quality implementation by firms.

Historic operational losses

The PRA should **remove the disclosure and reporting requirements for historic operational losses**, given its decision to set ILM to 1, which we support.

Q&A process

We ask the PRA to provide a **mechanism** which allows firms **to address issues of interpretation and operationalisation** of its requirements via a Q&As process, for example a **Wiki-style approach**, a subject matter expert forum or an embedded EBA-style Q&A model.

We look forward to discussing our response with the PRA and working together as it finalises the Rule book to ensure its proposals can be operationalised as smoothly as possible and in a timely fashion.

Responsible executives



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