

FSA Basel 2/CRD

Implementation Timetable

1. This note sets out for discussion purposes the FSA's current timetable for implementing the Basel 2 framework via the Capital Requirements Directive (CRD). The attached chart gives a high-level overview of the FSA's implementation timetable. Key issues regarding the consultation process, parallel running, and Pillar 2 are discussed below. Detail on the Application Process for IRB/AMA is provided in a separate paper submitted to this meeting (AG/23.09.04/02).

Capital Requirements Directive

2. The timetable has been revised to take into account the split implementation date outlined in the European Commission's proposal for the CRD. The CRD comes into force on 31 December 2006, and all firms must apply either the standardised approaches or the intermediate approaches for Pillar 1. At this point, firms will have two options under the standardised approaches: a) firms may move to the standardised approach under Basel 2; or b) firms may elect to remain on Basel 1 until end-2007 (as per the option given in CRD Article 152.7). From end-2007, Basel 1 will no longer suffice and all firms will need to be applying the (Basel 2) standardised, intermediate, or advanced approaches for Pillar 1.

Prudential Sourcebook

3. As discussed at the last meeting, the FSA will publish a consultation paper (CP) in January 2005, describing the main changes we expect the CRD to introduce in the UK and focusing on the aspects on which the FSA has choice to exercise. A second CP with a full set of draft rules is scheduled for publication in September 2005, following (and dependent on) agreement of the CRD in Brussels. We plan to publish near final rules in Q1 2006, following the three month consultation period on the second CP, and final rules in October 2006.
4. The consultation process is only one part of our dialogue with the industry on the UK's implementation of the CRD. Throughout the period between now and implementation we will continue to communicate with the industry through our industry standing groups, firm and industry feedback from thematic visits, and publication of FAQs and other relevant documentation on our website.

Quantitative Impact Study (QIS) & Parallel Running

5. At the last meeting of the Advisory Group, we briefly discussed the possibility of conducting a fourth Quantitative Impact Study (QIS4). Since then, the FSA has been considering how best to collect data from the industry between now and end-2007, to assess the impact of implementation as well as for recalibration purposes. The CRD is silent on this issue, whilst the Basel framework suggests that firms undertake either parallel running or impact studies during 2006, and parallel running during 2007. Having considered the options, we intend to adopt the following approach.

6. **QIS4** During 2005, we propose to conduct QIS4. Participation in the impact study would be voluntary. The information collected from this exercise will inform the negotiation of the overall recalibration of Basel. QIS4 will also give information relevant to our implementation dialogue with the industry, and we will be able to discuss any firm-specific issues arising with participating firms. For a small subset of participating firms, we may explore the possibility of undertaking a pilot run of the application process.
7. **Parallel Running** All firms applying to adopt the IRB and AMA approaches are required to undertake a minimum of 12 months parallel running prior to use in capital calculations. The period of parallel running must commence one year prior to the first intended use of the approach or three months prior to the FSA's decision on a firm's approach, whichever is the earlier. For example, if a firm wants to use a Retail IRB approach from end-2006, then it should start its parallel running no later than end-2005. Alternatively, if a firm chooses to apply in September 2005 to use a Retail IRB approach from end-2007 (i.e. more than a year before the date from which it intends to make use of the approach in capital calculations), it should start its parallel running no later than June 2006. (The separate application process timetable shows the FSA decision periods.) This will allow FSA staff to review firms' approaches in situ before a decision is made. The intention is that no decisions on IRB or AMA applications will be taken without a period of parallel running being conducted.
8. However, these principles need to be modified somewhat for the particular cohort of firms applying in Q4 2006 to adopt an IRB or AMA approach from end-2007. For these firms, we have considered the following options for data collection during 2006: parallel running; impact study; or a choice of either parallel running or an impact study. In terms of collecting information for calibration purposes, whilst it would be possible to collect information from the estimates provided by an impact study, it would of course be more desirable to collect the actual system data provided by parallel running. Parallel running data would also be more beneficial than impact study data as an input into our firm-specific implementation decision-making. At this stage, we favour the parallel running option. However, we welcome any views on this.