

Pillar 2

Framework for Pillar 2 Implementation

1. We are in the process of integrating Pillar 2 work into the overall Basel2/CRD implementation project. The work on Pillar 2 is led by a Programme Manager supported by a Programme Group comprising key internal stakeholders spanning Policy, Risk Review Department, Supervision and General Counsel. It sets the way forward on an end-to-end basis, including:
 - policy discussions in the Basel Accord Implementation Group;
 - evolution of the relevant CRD provisions and related policy considerations;
 - development of a practical intra-EEA approach to Pillar 2 and home/host responsibilities, through CEBS; and
 - development of the FSA's approach both in the Handbook and implementation and roll-out by supervisors in dialogue with firms.
2. The objective is to define a framework which incorporates the key elements of the Supervisory Review Process under Pillar 2, the relationship with the firms' internal capital processes and the translation of these into prudential outcomes, including Individual Capital Guidance.
3. The work needs to take account of the continuing discussions at the Basel level through the AIG, and of parallel work in the Committee of European Banking Supervisors (in which the FSA is playing an active role) on related convergence of supervisory practice, especially in relation to home-host cooperation/responsibilities. CEBS's proposals are expected to be issued for consultation in January 2005.
4. Current work on Pillar 2, both domestically and at international level recognises the need for close engagement with the industry – via the Capital and Groups Standing Group and otherwise – to discuss how the concepts can best be implemented in a practically-focused way.

Pillar 2 and Staggered Implementation Dates for Pillar 1

5. The requirements of Pillar 2 have to be met across-the-board as from 31 December 2006 whereas implementation of Pillar 1 is staggered, with some approaches to take effect on 31 December 2006 and others on 31 December 2007 (with the option as applicable to continue the use of the Basel 1 approach until the second date).
6. As from the effective date for Pillar 2, credit institutions and investment firms will have to have in place an internal capital process (Article 123) and the FSA will be required to perform a supervisory review and evaluate the firms' internal capital processes (Article 124).
7. The FSA will set individual capital guidance (ICG) by reference to its supervisory review, taking into account its evaluation of the firm's internal capital process. This will mean in practice:

- setting revised ICGs for firms which implement both Pillar 1 and Pillar 2 from 31 December 2006;
- retaining the existing Individual Capital Requirement set for credit institutions which opt to stay on Basel 1 or a combination thereof until 31 December 2007 – unless there is any material change in circumstances during this interim period or the evaluation of the internal capital process identifies material risks which had not previously been reflected in the ICR; and
- reviewing the internal capital processes of investment firms which opt to go straight to advanced approaches on 31 December 2007, to assess whether any additional capital requirement should be set for the interim period.

Within CEBS we are working to establish a pan-EEA approach that will enable us to proceed accordingly.