

Consequences for UK implementation plans of delay in EU agreement of the Capital Requirements Directive (CRD)

1. The latest indications from Brussels suggest that delays in the European Parliament's consideration of the draft CRD may postpone the Council's agreement of the final text until November this year. The purpose of this note is to set out the likely implications for the production of our second CP and our firm-specific work on applications. The views of the Advisory Group are sought on our proposed contingency planning and the suggested new timetable for our implementation programme.
2. The prospect of such a delay raises the question of whether the start date of 1 January 2007 for the simpler approaches to credit and operational risk would still be feasible. While the UK preference remains a 'big bang' date of 1 January 2008 for the full range of approaches, we must continue to plan for the two separate start dates. The anticipated delay has immediate and significant consequences for the production of our second CP and for our firm-specific work on applications for the advanced approaches.

Second CP timetable

3. We stated in our Business Plan that the second CP would be produced in Q4 2005. Since the CP cannot be published before we have seen the agreed text of the CRD, we need to devise a credible new timetable for this work. Following the planned ECOFIN discussion in November and circulation of relevant texts, we will need to allow a full two months for whatever work remains to be done, including compliance with our formal legal processes, in the light of the agreed EU text. This argues for a revised publication date for the second CP of mid-February 2006. Work on scoping the second CP and drafting has already begun. If, in due course, we have substantive reasons for believing that the changes made to the text after the Parliaments' plenary vote, expected in September, will be minor, we may well be able to publish earlier and would certainly want to do so. But at this stage, it would not be sensible to commit to this. There is also a good deal to be said for being able to take account of as much CEBS advice as possible. And while we see merit in being one of the first Member States to publish a full set of implementing proposals, there is a risk in being too far ahead of the majority, especially in areas of remaining national discretion.
4. This delay in the publication of the CP has an immediate knock-on effect for firms' submission and our assessment of their applications to use the advanced approaches. One way of giving a little time back to this crucial part of the process would be to limit the consultation period for the second CP to two months. This would also mean that the Policy Statement giving feedback on firms' comments on the second CP, and 'near final' rules could be published about six months before the 1/1/07 implementation date. The key elements of this timetable are set out in the box below.

The papers and meetings of the group are intended to encourage useful discussion of the issues rather than to present a comprehensive account of the matters concerned or a set of agreed conclusions. The minutes of the meetings report the discussions of the group, but neither the papers or minutes nor any reported remarks by anyone present at one of those meetings should be read as representing formal positions of the institutions represented or of the FSA. The FSA's Handbook proposals will be subject to consultation in the normal way.

First CP – January 2005

- 3 month consultation period

Interim policy statement – June/July 2005

Finalisation of EU text – November 2005

Second CP – February 2006

- 2 month consultation period

Policy statement (including 'near' final rules) – June/July 2006

FSA makes final rules – October 2006

Rules come into force – December 2006, to take effect from 1 January 2007

5. Our preliminary thinking is that it would be a mistake to postpone the serious dialogue needed between firms and supervisors to assess firms' level of preparedness for the advanced approaches. Even if we do not have the final text until late 2005, we feel it is better to press on with our review of applications so that firms can be in business from 1 January 2007, if that is their wish. Our initial view is therefore that we should still proceed to open our application period on 1 July this year and close it on 31 December 2005 for the firms seeking to use Foundation and Retail IRB from the earliest opportunity, ie 1 January 2007.
6. To make this possible we would need to construct a current policy "baseline" using the material set out in the January CP and taking account also of FAQs, as we continue to issue them, together with points emerging from our review of responses to the CP. The agreement of the final CRD text and publication of our second CP will inevitably include some changes to this. Once these are known, we will need to determine what further adjustments to our approach are appropriate eg. an additional self-assessment (see paragraph 8). The only alternative to this approach would be to put up our shutters until well into 2006, which would be unhelpful for all of us.
7. Using the revised planning assumptions as set out above, we have prepared a revised implementation time-line for the approvals process. The revised timeline is attached to this note as Annex A. For comparison, the timeline on which we are consulting in CP 05/03 is attached as Annex B. The key changes to the various application waves are as follows:

Wave 1

- Wave 1 continues to apply to applications for first use in calendar year 2007 and is the only Wave that will guarantee a decision in time for first use on 1/1/2007.
- The start and end of the application window remain 1 July 2005 and 31 December 2005 respectively. The consequence of retaining an unchanged end date is that firms wanting to be in the first wave will make applications without sight of the second CP. A key part of the application pack is the section on self-assessment against relevant standards. So, for firms applying in Wave 1, the initial self-assessment will be performed against the baseline of CP 05/03 together with any FAQs and substantive points emerging from our review of responses to CP05/3.
- The decision-making window remains Q3 2006.

Wave 2

- There is no separate Wave 2.

Wave 3

- Wave 3 is revised.

- The application window for Wave 3 opens on 1 January 2006 and closes on 30 June 2006. The opening date is three months earlier than that announced for Wave 3 in CP 05/03; the closing date is unchanged.
- Conceivably a firm might submit an application early in the window, before the second CP is published. As with Wave 1, the firm's initial self assessment will need to be against the baseline of CP05/03, FAQs and substantive points in our feedback on CP05/3.
- Decisions for Wave 3 would be taken on or before 31 December 2006.
- This will allow firms a six month period between decision making and making first use of the chosen approach intended from 1 July 2007.

Waves 4 to 8

- No alterations have been made to these waves.

Early applications and second self-assessments

8. As explained, firms may submit applications prior to publication of the second CP under Waves 1 and 3; the same could be true for early applications in Waves 7 and 8. Assuming that the second CP introduces new policy rules, firms that apply before the second CP is published will not be able to perform a self-assessment against those new rules that apply to them until after the CP is published. So the FSA will reserve the right to require a second self-assessment from firms against the Handbook text attached to the second CP. But it may be that this review only takes the form of an identification of changes and an analysis of their impact by those firms that have submitted early applications or an update to the self-assessment section of the application pack. Current thinking is that, if needed, the second self-assessment would have to be submitted to the FSA on or before 1 May 2006.
9. It is a possibility that further changes may be introduced between the text of the second CP and the FSA's final rules. While we will seek to avoid this, if amendments do prove necessary, a further update to the self-assessment may be required.

Risks

10. There will be a number of risks for the FSA and for firms attached to the proposed new timeline.

First, there will be additional work involved in Wave 1: if a second self-assessment is required it will need to be reviewed and acted on in short order. If substantial work needs to be taken as a result, it may be difficult to reach a decision by 30 September 2006.

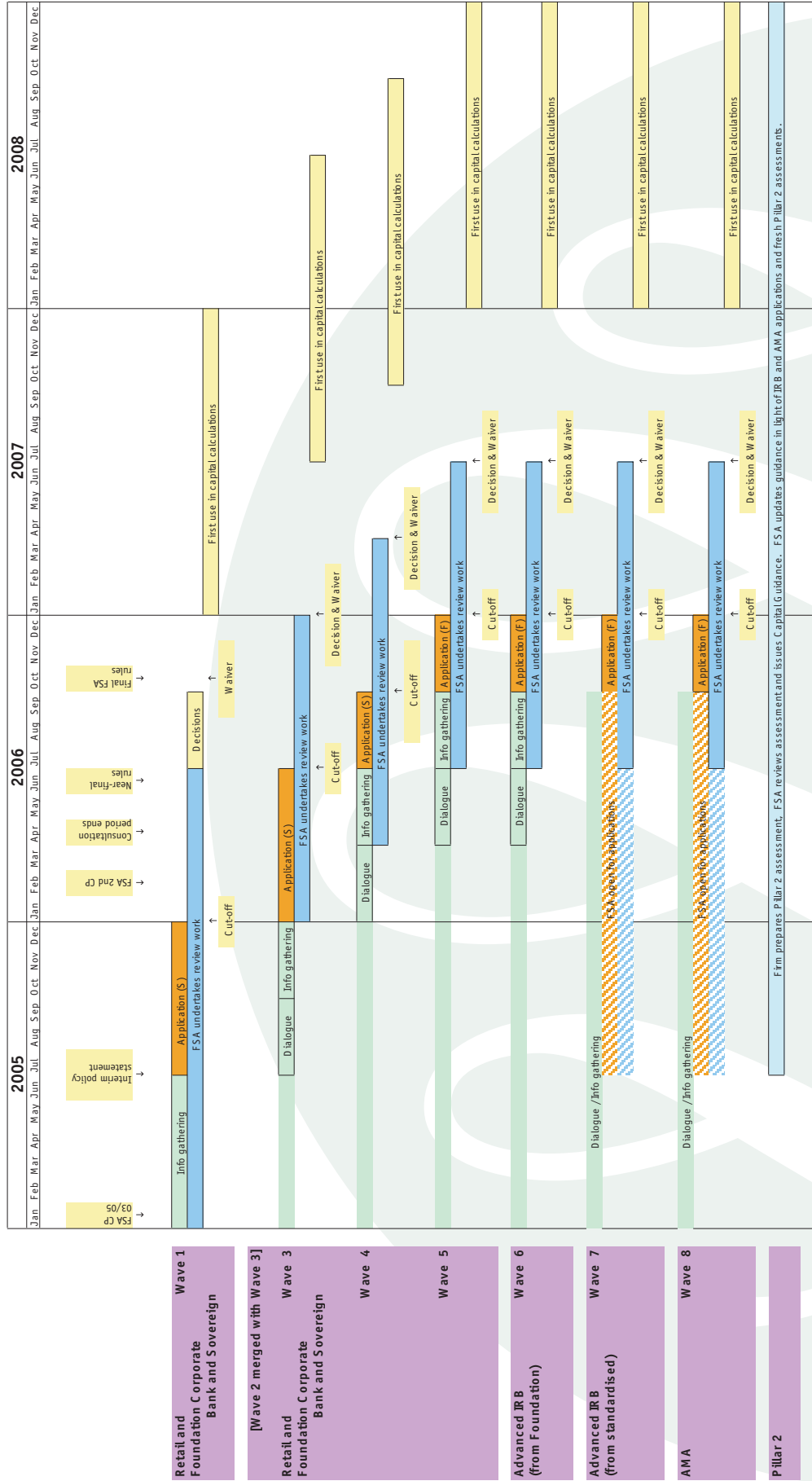
Second, in the light of the new timetable for the production of the second CP, firms may change their intentions regarding the timing of submission of an application. This may result in a bunching of applications in the later waves.

Third, FSA may face requests for feedback on firms' plans prior to completion of the second self-assessment, if one is required. FSA is unlikely to have the resources to undertake this work and even if it did, this could result in a weakening of the application discipline on firms for Wave 1.

The Advisory Group is invited to discuss this note and provide views on our proposed revisions to the timeline for production of the second CP and submission of firms' applications for use of the advanced approaches.

Annex A: Revised Timeline

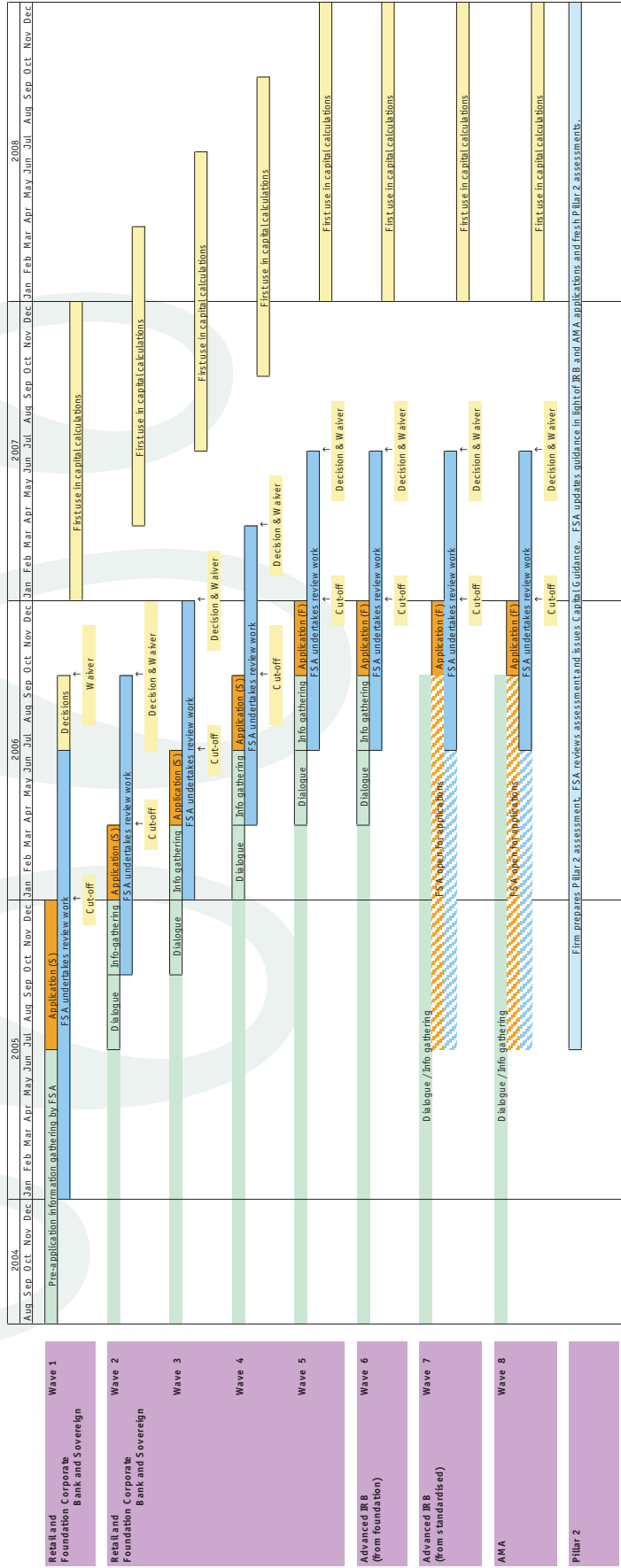
DIAGRAM 1: BASEL 2 /CRD APPROVALS PROCESS - IMPLEMENTATION TIMELINES FOR PILLAR 1 AND 2
(Based on planning assumption of 2nd CP in February 2006 & unchanged implementation dates)



Application (S) = Shadow Application, i.e. application made prior to making of final FSA rules. An application fee will be payable at this point.
 Application (F) = Formal Application, i.e. application made after making of FSA rules. An application fee will be payable at this point.

Annex B: Timeline CP05/3 version

DIAGRAM 1: BASEL 2/CRD APPROVALS PROCESS - IMPLEMENTATION TIMELINES FOR PILLAR 1 AND 2



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