

EXPLANATORY MEMORANDUM TO
THE PRUDENTIAL REGULATION OF CREDIT INSTITUTIONS (MEANING OF
CRR RULES AND RECOGNISED EXCHANGE) (AMENDMENT) REGULATIONS
2024

2024 No. 1200

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Tulip Siddiq MP, Economic Secretary to the Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 Fayyaz Muneer, Deputy Director responsible for Prudential policy at HM Treasury confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Jeanie Watson at HM Treasury email: Jeanie.Watson@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This legislation will do two things:

- (i) Regulations 2 and 3 make amendments to primary legislation in connection with the revocation by the Financial Services and Markets Act 2023 (FSMA 2023) of the UK Capital Requirements Regulation (CRR), which currently forms part of assimilated law on financial services. Regulation 2 amends the definition of "CRR rules" in the Financial Services and Markets Act 2000 (FSMA 2000) to include rules made by the Prudential Regulation Authority as part of Basel 3.1 implementation to replace CRR provisions revoked under FSMA 2023. Regulation 3 makes a related amendment to section 5 of the Financial Services Act 2021 to ensure that certain requirements apply to those rules.
- (ii) Regulation 4 amends the definition of "recognised exchange" as contained in the CRR. This will support an expansion of investment exchanges that fall within the definition of a "recognised exchange". The instrument does this by specifying that investment exchanges can qualify as a 'recognised exchange' if they are: a) UK-based investment exchanges that are considered to be regulated markets; b) in the register of Recognised Overseas Investment Exchanges (ROIEs), a regime owned by the Financial Conduct Authority (FCA); or c) an investment exchange, which meets certain conditions as set out in the PRA's rulebook. For this purpose, the PRA expects to make rules on the proposed "conditions", which will help firms identify a "recognised exchange". The PRA plans to consult on its conditions shortly.

Where does the legislation extend to, and apply?

- 4.2 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England and Wales, Scotland and Northern Ireland.
- 4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales, Scotland and Northern Ireland.

5. Policy Context

What is being done and why?

CRR rules

- 5.1 The UK authorities are currently implementing Basel 3.1. Basel 3.1 is the final round of post-Global Financial Crisis reforms to banks' capital requirements. In the UK, Basel 3.1 implementation is being delegated to the PRA in line with the government's Smarter Regulatory Framework (SRF) programme for financial services.
- 5.2 In 2020 the government began setting out its approach for adapting the financial services regulatory framework to the UK's new position outside of the EU. Following two consultations, the SRF approach was finalised in 2022 with Parliament approving a comprehensive set of legislative tools to deliver the SRF in the Financial Services and Markets Act 2023 (FSMA 2023). In the meantime, the government needed to put interim arrangements in place for implementation of Basel 3.1 so that the UK would meet its international banking standards commitments on time. The Financial Services Act 2021 (FSA21) included provision for Basel 3.1 implementation to commence, consistent with the government's overall SRF approach which was then going through the final stages of public consultation.
- 5.3 Both Basel 3.1 implementation and the government's broader SRF programme involve the revocation of assimilated law on financial services which can then be replaced by regulator rules, in line with the UK's established model of regulation under FSMA 2000. To implement the changes under Basel 3.1, HM Treasury will need to revoke provisions currently legislated for in the CRR and the PRA will need to make rules to replace those provisions, as appropriate. A power for HM Treasury to make the necessary CRR revocations was originally provided for in FSA21. Since then, Parliament has approved a final set of legislative tools for dealing with all assimilated law on financial services, including the CRR. The CRR is revoked by Section 1 of FSMA 2023, subject to commencement of that revocation by HM Treasury. The government therefore intends to complete Basel 3.1 implementation under the most recent legislative mechanism approved by Parliament for revocation of assimilated law, as set out in FSMA 2023.
- 5.4 The rules that the PRA will need to make to replace revoked CRR provisions are defined in FSMA 2000 as "CRR rules". Rules that fall within this definition are subject to an accountability framework under which the PRA must have regard to specific policy considerations set by Parliament for implementation of Basel 3.1, as set out in Part 9D FSMA 2000. This instrument amends the definition of CRR rules to ensure that the Part 9D accountability framework will continue to apply to PRA rules implementing Basel 3.1, including where those rules replace CRR provisions revoked under FSMA 2023. This instrument also makes a related amendment to section 5 of FSA21. In accordance with section 5, references in legislation to revoked CRR provisions are to be treated as references to the PRA rules which have replaced the revoked CRR provisions. This instrument ensures that section 5 will continue to operate as intended in relation to CRR provisions which are revoked by FSMA 2023.

In summary, these amendments ensure revocation of CRR provisions under FSMA 2023 will not alter the approach to Basel 3.1 implementation, which will be completed in accordance with the policy approach set out by the government in 2021 and under the SRF.

Recognised Exchanges

- 5.5 Assets issued or traded on a “recognised exchange” receive a preferential capital treatment under the CRR.
- 5.6 Financial instruments (stocks and shares) are often used as a form of collateral to secure financial services from banks. Certain instruments, where they are traded on a “recognised exchange” can be considered as “eligible collateral” for other activities under the CRR whereas those traded on a non-recognised exchange cannot.
- 5.7 Through the process of assimilating EU law set out in the CRR, the effect of this definition became narrower and only allowed certain UK-based investment exchanges to be considered as a “recognised exchange”.
- 5.8 This instrument is expanding the definition of a “recognised exchange” so a wider range of instruments can benefit from preferential capital treatment under the CRR. It does this by allowing overseas investment exchanges to be brought into the definition. This will include those exchanges on the ROIEs register and eventually it will also include exchanges where they meet conditions set by the PRA, which will be consulted on shortly.
- 5.9 This instrument will come into force on the day after the day on which it is made. This early commencement is appropriate as it will allow firms to benefit from changes being made to the definition of “recognised exchange” as swiftly as possible. It will not reduce the rights of, or impose new onerous duties on, firms affected by the instrument.

What was the previous policy, how is this different?

CRR rules

- 5.10 The definition of “CRR rules” as set out in FSMA 2000 did not explicitly include rules the PRA might make to replace provisions of the CRR that have been revoked by FSMA 2023.
- 5.11 This instrument expands this definition to include these rules as “CRR rules”.

Recognised Exchanges

- 5.12 The previous definition meant that no overseas investment exchanges could be considered as a “recognised exchange” and only certain UK-based investment exchanges could be. This legislation will facilitate an expansion of the CRR definition so that overseas investment exchanges can be included.

6. Legislative and Legal Context

How has the law changed?

CRR rules

- 6.1 Regulation 2 amends the definition of "CRR rules" in section 144A of FSMA 2000 to include rules made by the Prudential Regulation Authority to replace provisions of the CRR revoked under FSMA 2023. Regulation 3 amends section 5 of the Financial

Services Act 2021, which makes provision relating to CRR rules replacing provisions of the CRR.

Recognised Exchanges

- 6.2 This instrument amends the definition of “recognised exchange” as contained in article 4(1)(72) of the CRR.
- 6.3 Part (a) of the amended definition aims to preserve the link to domestic investment exchanges. Part (b) and (c) expands the definition to include overseas investment exchanges.
- 6.4 Until the PRA makes rules relevant for part c) of the definition, the only investment exchanges that fall within the definition of “recognised exchange” are those falling within part a) and b) of article 4(1)(72) of the CRR.

Why was this approach taken to change the law?

- 6.5 This is the only possible approach to make the necessary changes.

7. Consultation

Summary of consultation outcome and methodology

CRR rules

- 7.1 The amended definition of CRR rules does not alter the policy approach to implementation of Basel 3.1 on which the government has consulted and therefore has no impact on the PRA's responsibility for implementing Basel 3.1 or how implementation will affect regulated firms. As such, no consultation on the amended definition of CRR rules has been necessary.

Recognised Exchanges

- 7.2 HM Treasury consulted on the definition of a “recognised exchange” as part of a wider consultation on Basel 3.1, which was published in November 2022 and ran until 30 March 2023.
- 7.3 The consultation proposed to amend the definition of “recognised exchange”, linking it to the ROIEs regime and to “exchanges” detailed in the PRA’s regulatory technical standards.
- 7.4 The government’s response to this part of the consultation is being published alongside this legislation¹. In summary, responses suggested the link to the ROIEs regime and the PRA’s technical standards would be insufficient. This is because the existing list of investment exchanges on the ROIEs register and the PRA’s technical standards, whilst still an expansion, would not be as wide as that preferred by firms.
- 7.5 The government has considered these responses and has amended its initial proposal as a result. The main change is that instead of referencing the PRA’s technical standards, the legislation will refer to a set of conditions that can be used to identify investment exchanges. The PRA are expected to consult and make rules on this area in due course. We expect this will meet firms’ preferences.

8. Applicable Guidance

- 8.1 No guidance accompanies this instrument.

¹ <https://www.gov.uk/government/publications/treatment-of-overseas-investment-exchanges-for-the-purposes-of-the-capital-requirements-regulation>

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

- 9.1 A full Impact Assessment has not been prepared for this instrument because the impact of this SI is small (the cost to business is expected to be <£10m per year).
- 9.2 A de minimis Impact Assessment is published alongside the Explanatory Memorandum on the legislation.gov.uk website.
- 9.3 We expect the PRA to publish a full cost-benefit analysis alongside any new policy proposals they take forward, including on their forthcoming proposals on recognised exchanges.

Impact on businesses, charities and voluntary bodies

- 9.4 There is no, or no significant, impact on business, charities or voluntary bodies because this instrument is making minor amendments to existing legislation. The amendment to the definition contained in article 4(1)(72) of the CRR is the only part that will affect credit institutions. The benefits of this amendment will be delivered through forthcoming proposals from the PRA.
- 9.5 The legislation does not impact small or micro businesses.
- 9.6 There is no, or no significant, impact on the public sector because the amendments do not affect public sector activities.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

- 10.1 The approach to monitoring this legislation will consist of engagement with industry to understand its initial and ongoing impact.
- 10.2 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, the Right Honourable Tulip Siddiq M.P., has made the following statement: “It is not proportionate to include a review clause in this instrument because the estimated annual net direct cost to business is less than £10 million.”.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Economic Secretary to the Treasury, Tulip Siddiq MP, has made the following statement regarding Human Rights:

“In my view the provisions of the Prudential Regulation of Credit Institutions (Meaning of CRR Rules and Recognised Exchange) (Amendment) Regulations 2024 are compatible with the Convention rights.”

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 (“relevant European Union Acts”). It does however relate to the withdrawal of the United Kingdom from the European Union because it amends assimilated EU law contained in the CRR.