

Cabinet News and Views

Informed analysis for the financial services industry



The UK's PRA Publishes Consultation on Basel 3.1



By **Alix Prentice**
Partner | Financial Regulation

In CP16/22 (published on 30 November 2022), the UK's Prudential Regulation Authority ("PRA") sets out plans for implementing the Basel 3.1 standards for calculating risk-weighted assets ("RWA"). Concerned that downward movement in average risk weights (measured by the ratio of RWA to assets) over the last 10 years is due to fairly pervasive underestimation in internally-modelled risk, the PRA is proposing to align with international standards and implement the final Basel 3 package of significant changes to the way firms calculate RWA. The PRA's aim is to mitigate the threats to confidence caused by degrees of variability in calculation of risk weights and resultant inconsistencies in capital ratios and difficulties in comparing like-for-like.

Basel 3.1 standards include revised standard and internal ratings-based approaches for credit risk, revisions to the use of credit risk mitigation techniques, a revised approach to market risk, the removal of the use of internal models for operational risk capital requirements and for credit valuation adjustment and their replacement with new standard and basic approaches, and the introduction of an aggregate "output floor" to ensure that total RWAs using internal models cannot fall below 72.5% of RWAs derived under standard approaches. This means a more granular set of standard approaches for assessing risk exposures and the removal of some internal model approaches, as well a new modelling approach for internal ratings-based assessments, alongside improvements to the trading book/non-trading book boundary.

Implementation is due on 1 January 2025, with a transition period of five years from that date for most provisions.
