

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

First Delegated Legislation Committee

DRAFT BANK RECOVERY AND RESOLUTION
ORDER 2016

DRAFT BANK OF ENGLAND ACT 1998 (MACRO-
PRUDENTIAL MEASURES) ORDER 2016

Monday 5 December 2016

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The Committee consisted of the following Members:

Chair: MARK PRITCHARD

- | | |
|---|--|
| † Allan, Lucy (<i>Telford</i>) (Con) | † Miller, Mrs Maria (<i>Basingstoke</i>) (Con) |
| † Ansell, Caroline (<i>Eastbourne</i>) (Con) | † Mullin, Roger (<i>Kirkcaldy and Cowdenbeath</i>) (SNP) |
| † Barclay, Stephen (<i>Lord Commissioner of Her Majesty's Treasury</i>) | † Reynolds, Jonathan (<i>Stalybridge and Hyde</i>) (Lab/Co-op) |
| † Beckett, Margaret (<i>Derby South</i>) (Lab) | † Shelbrooke, Alec (<i>Elmet and Rothwell</i>) (Con) |
| † Blackman, Kirsty (<i>Aberdeen North</i>) (SNP) | † Smith, Jeff (<i>Manchester, Withington</i>) (Lab) |
| Clwyd, Ann (<i>Cynon Valley</i>) (Lab) | Woodcock, John (<i>Barrow and Furness</i>) (Lab/Co-op) |
| † Glen, John (<i>Salisbury</i>) (Con) | † Wragg, William (<i>Hazel Grove</i>) (Con) |
| † Kirby, Simon (<i>Economic Secretary to the Treasury</i>) | |
| † Letwin, Sir Oliver (<i>West Dorset</i>) (Con) | Clementine Brown, <i>Committee Clerk</i> |
| † Mactaggart, Fiona (<i>Slough</i>) (Lab) | |
| † Menzies, Mark (<i>Fylde</i>) (Con) | † attended the Committee |

First Delegated Legislation Committee

Monday 5 December 2016

[MARK PRITCHARD *in the Chair*]

Draft Bank Recovery and Resolution Order 2016

4.30 pm

The Economic Secretary to the Treasury (Simon Kirby): I beg to move,

That the Committee has considered the draft Bank Recovery and Resolution Order 2016.

The Chair: With this it will be convenient to consider the draft Bank of England Act 1998 (Macro-prudential Measures) Order 2016.

Simon Kirby: It is a pleasure to serve under your chairmanship this afternoon, Mr Pritchard.

Since the financial crisis, the Government have implemented significant reforms to address the problems of the past and make the financial sector safer and more stable. In addition, these reforms have ensured that a bank failure can be managed in a way that protects the wider economy and financial sector without relying on taxpayer bail-outs. I will speak to both orders, which concern two key planks of these reforms: macro-prudential regulation and resolution.

I will begin with the Bank of England Act 1998 (Macro-prudential Measures) Order 2016. The Government have reformed our financial regulation so that risks to the whole system are identified and addressed. The Financial Policy Committee addresses macro-prudential risks through its powers to issue recommendations and, importantly, directions.

Mortgages are the single largest asset class held by UK banks, which makes them sensitive to the performance of the housing market and exposes them to direct risks when borrowers struggle to pay back their loans. Work done by the Bank of England suggests that buy-to-let mortgage lending can amplify the housing cycle. As house prices go up, buy-to-let investors are incentivised to enter the market and accrue capital gains, which pushes prices up for all homebuyers. As prices fall, buy-to-let investors are incentivised to sell their properties, which can drive prices down further.

The lessons of the recent financial crisis are still fresh in our memory, and we all know that the costs of financial instability are huge. That is why, in his Mansion House speech on 12 June 2014, the then Chancellor committed to ensuring that the FPC has

“all the weapons it needs to guard against risks in the housing market.”

In 2014, the FPC recommended that its powers of direction be expanded so that it could effectively tackle the systemic risks in the UK housing market. The Government agree with those recommendations and have, indeed, already legislated to grant the requested

powers regarding owner-occupied mortgages. Today's order will provide similar powers over buy-to-let mortgages. It will allow the FPC to direct the financial regulators—the Prudential Regulation Authority and the Financial Conduct Authority—to require regulated lenders to place limits on buy-to-let mortgage lending in relation to loan-to-value ratio and interest coverage ratio. This instrument is another step taken by this Government to ensure that our financial system is resilient and supports the wider economy.

I will now turn to the Bank Recovery and Resolution Order 2016. The UK's special resolution regime provides the authorities with the tools to manage the failure of financial sector firms without relying on taxpayer bail-outs. The EU bank recovery and resolution directive established a common approach across the EU to the recovery and resolution of banks and drew on key aspects of the UK's existing resolution regime. Since the transposition of the BRRD in January 2015, industry and the regulators have had time to digest the new rules, and they have uncovered a small number of areas where the UK's special resolution regime could be improved. This order therefore makes changes to strengthen the UK's special resolution regime so it works more smoothly and effectively. The Government have consulted extensively on the draft legislation through both public consultation and close engagement with the banking liaison panel. The changes have the support of industry.

The Bank Recovery and Resolution Order 2016 makes changes in three key areas. First, it makes amendments to allow the Bank of England or the Treasury to activate contractual default event provisions where they would assist a resolution. That will support the Bank of England's efforts to resolve a failing firm and maintain financial stability.

Secondly, the order introduces new stand-alone early intervention powers for the PRA and the FCA, which could be used when an institution's position is deteriorating to try to prevent it from failing or requiring resolution. The stand-alone powers, which include the power to require the removal of senior management, clarify the scope of the existing powers.

Thirdly, the order provides new backstop powers for the Bank of England to resolve branches of third-country institutions operating in the UK, independently of the third-country resolution authority. The circumstances in which those independent powers would be used are exceptional. The preference of UK authorities is for co-operation between authorities.

The order also addresses a couple of other issues. First, it introduces powers to enable the bridge bank tool to be applied through a share-transfer scheme for building societies. Secondly, it introduces powers for the Treasury and the Bank of England to recover bail-in expenses. As I said earlier, the changes will strengthen the UK's resolution regime. I hope hon. Members will support both orders.

4.37 pm

Jonathan Reynolds (Stalybridge and Hyde) (Lab/Co-op): What a pleasure it is to see you in the Chair, Mr Pritchard. I thank the Minister for his introductory remarks.

The Opposition support measures to protect and enhance the stability of the financial system, including plans to avoid another banking crisis. Recent history

has unfortunately revealed that the insolvency rules and legislative framework that applied to all companies were highly unsuited to the particular circumstances of bank failure. As the Minister said, this bank recovery order follows on from the Banking Act 2009. It is absolutely vital that we as legislators get this right. There is simply no room for error. These are measures that will be used only once in the event of a bank failure. There is an incredible duty on our shoulders to protect the people we serve—indeed, the Labour party takes that responsibility with the seriousness it commands.

In that light, we have concerns that the guidance for these orders is not as accessible and transparent as it might be. Not only does that make it challenging for the Opposition to provide effective scrutiny, but it raises questions about how usable the regulations will be by the industry itself and, indeed, the wider public.

Article 15 of the banking recovery order amends section 48Z of the 2009 Act to allow the Bank of England or the Treasury to activate default event provisions. The order states that the

“Bank of England...or the Treasury (in the case of a share transfer order)”

need to

“consider that such provision would advance one or more of the special resolution objectives.”

We have previously raised concerns that that will give considerable discretion to the relevant authorities. In a letter to my Front-Bench colleague in the other place dated 24 November 2016, the Government promised further guidance on the types of contracts, which could include clauses that are activated by the use of a crisis prevention or management measure. Will the Minister update us on whether any progress has been made in that regard?

Given that the power to remove directors is significant, we would want some oversight of a kind not covered by this provision of the people chosen by the regulator to serve as replacement directors. We would also like clarity about the tribunal under proposed new section 71G, which will presumably sit under the FCA. Are we to understand that it is to be a police force, a judge and a jury in all cases? I wonder whether anyone might claim it is unlawful, either via a judicial review or a human rights appeal, for the regulator to be able to make all those decisions using its own people when taking a bank from its shareholders.

What consideration have the Government given to providing for a periodic report back to Parliament or a review by an outside oversight committee to see what the regulator has done? More generally, we would like a clear assurance from the Government that the measures do not represent the risk of a spaghetti of committees—perhaps the FCA, the PRA, the FPC—making decisions in various contexts.

Moving on to the shorter macro-prudential measures order, I want to probe concerns about the power that the FPC will gain. If I understand the Minister's remarks correctly, the FPC now has the ability to interfere with mortgage business on the basis of a cost-benefit analysis. Will he elaborate on this, as some fear that article 3 is somewhat vague? Is the idea to empower the FPC to constrict the buy-to-let mortgage market as much as possible? Although we support restricting that market, we have concerns about a committee of the Bank of England doing so without external oversight and without

parliamentary referral. It would therefore be helpful to have assurances that any oversight is transparent, meaningful and democratic.

We are all aware that the issues raised by the orders have a topical significance. The decisive victory of the no side against proposed constitutional changes in the Italian referendum followed by the resignation of Prime Minister Matteo Renzi represents a challenge to ongoing efforts to break Europe's economic malaise. Despite major changes for the better, there are those who fear that the European banking system remains one with large and unresolved problems. As the Bank of England UK bank stress tests last week emphasised, Government and financial authorities must ensure that precautionary measures are ready for use if needed to prevent contagion and to protect depositors and taxpayers.

We know that people and society want and need banks in which they can safely deposit their money and savings, which lend responsibly and provide credit to finance investment and growth across the country. We will support financial services where they deliver a clear benefit to the whole community and we will work with the finance sector and the Government to develop this new deal with finance for the British people.

4.41 pm

Sir Oliver Letwin (West Dorset) (Con): I am aware that the Committee is not able to propose amendments. I will certainly want to support the orders, but can I induce the Minister to make a comment, which might be useful for the purposes of subsequent legislation and perhaps any subsequent court actions, in relation to article 32, particularly the removal of directors and senior executives under section 71B? May I draw his attention to an oddity of drafting? He will see that under section 71H the regulator can impose the requirements for a new temporary manager only if he reasonably considers that it is necessary for the requirement to take immediate effect. That seems to be proper drafting. However, under 71B, bizarrely and very unusually in this kind of illustration, there is no reference to reasonableness as a test. It states,

“If the appropriate regulator is satisfied that the conditions in section 71D(1) and (2) are met”—

essentially, if there is significant deterioration in the bank's solidity, the appropriate regulator may require the firm to remove the person who is a director or senior executive, so there is no reasonableness test there. I think that is an oversight in the drafting, but we cannot change the drafting. Is the Minister therefore willing to put on the record what I think must be the intent of the Government, namely that 71B would apply only where the regulator is reasonably satisfied that the conditions are as such? I take it that that is the way the court would then read it and I think the possibility for mischief would be removed.

4.44 pm

Roger Mullin (Kirkcaldy and Cowdenbeath) (SNP): I shall be brief. I have just a couple of questions for the Minister. I will say at the outset, however, that if the risks of failure are to be mitigated, the key issue to address is the culture in the institutions, as we have argued for a long time, and that cannot be addressed by regulation alone.

[Roger Mullin]

I want to come back to the opening remarks of the Minister when he talked about macro-prudential regulation and risks. Will he clarify exactly what assessment of risk has been taken post-Brexit? There are two components of risk that I am particularly interested in. First, what is the estimate of the probability of increased risk of failure? Secondly, what would the nature of that failure look like post-Brexit?

I support what the hon. Member for Stalybridge and Hyde said about the need for oversight of the appointment of directors, and I would like to know more about the Government's thinking in that regard.

4.45 pm

Simon Kirby: I thank right hon. and hon. Members for their contributions. These are important instruments and it is right that they are debated properly and that questions about them are answered properly.

The Government continue to learn the lessons of the financial crisis and take action to strengthen financial stability. The instruments will enable the authorities to take action to address and mitigate systemic risks in the UK's housing market and to improve the functioning of its resolution regime. These powers are another important step in making the UK's financial system resilient so that it works for everyone.

The Opposition spokesperson, the hon. Member for Stalybridge and Hyde, mentioned that oversight of the new directors could create problems. In answer, I can say that anyone chosen to act as a director in place of an existing board will have to satisfy the same standards and be approved by the regulations.

The hon. Gentleman said that the amendments were not clear and were hard to understand. The Government

acknowledge the technical nature of the changes; HM Treasury's special code of practice and the Bank of England's guidance document should be helpful in increasing understanding, but these are technical measures and we have done our very best. He also mentioned that the requirements were unclear. The Bank of England Act requires the FPC to act proportionately, to publish guidance on how it will use the powers and to publish an explanation, including a cost-benefit analysis, when using those powers.

My right hon. Friend the Member for West Dorset asked about the difference between proposed new sections 71B and 71H and about the concept of reasonableness. The regulators will exercise their powers under section 71B reasonably, and they can be challenged if they act unreasonably. I hope that that is very clear.

The hon. Member for Kirkcaldy and Cowdenbeath mentioned risk assessment. The FPC has published two financial stability reports since the referendum, which make interesting reading.

I hope that right hon. and hon. Members on the Committee will support both measures.

Question put and agreed to.

**DRAFT BANK OF ENGLAND ACT 1998
(MACRO-PRUDENTIAL MEASURES)
ORDER 2016**

Resolved,

That the Committee has considered the draft Bank of England Act 1998 (Macro-prudential Measures) Order 2016.—(*Simon Kirby.*)

4.49 pm

Committee rose.