PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Tenth Delegated Legislation Committee

CAPITAL REQUIREMENTS (AMENDMENT) (EU EXIT) REGULATIONS 2019

Monday 7 October 2019

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not later than

Friday 11 October 2019

The Committee consisted of the following Members:

Chair: Mr Adrian Bailey

† Baldwin, Harriett *(West Worcestershire)* (Con)
† Campbell, Mr Ronnie *(Blyth Valley)* (Lab)
† Duffield, Rosie *(Canterbury)* (Lab)
† Freer, Mike *(Lord Commissioner of Her Majesty's Treasury)*
† Glen, John *(Economic Secretary to the Treasury)*
† Howell, John *(Henley)* (Con)
† Kyle, Peter *(Hove)* (Lab)
† Lammy, Mr David *(Tottenham)* (Lab)
† Maclean, Rachel *(Redditch)* (Con)
† Moore, Damien *(Southport)* (Con)
† Morden, Jessica *(Newport East)* (Lab)
† Pearce, Teresa *(Erith and Thamesmead)* (Lab)
† Poulter, Dr Dan *(Central Suffolk and North Ipswich)* (Con)
† Reynolds, Jonathan *(Stalybridge and Hyde)* (Lab/Co-op)
† Seely, Mr Bob *(Isle of Wight)* (Con)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Whittingdale, Mr John *(Maldon)* (Con)

Sarah Rees, *Committee Clerk*

† attended the Committee

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[MR ADRIAN BAILEY *in the Chair*]

Capital Requirements (Amendment) (EU Exit) Regulations 2019

4.30 pm

The Economic Secretary to the Treasury (John Glen): I beg to move,

That the Committee has considered the Capital Requirements (Amendment) (EU Exit) Regulations 2019 (S.I. 2019, No. 1232).

It is a pleasure to serve under your chairmanship, Mr Bailey. As the Committee will be aware, the Government had made all the necessary legislation under the European Union (Withdrawal) Act 2018 to ensure that in the event of a no-deal exit on 29 March 2019, there was a functioning legal and regulatory regime for financial services from exit day. Following the extension to the article 50 process, new EU legislation will become applicable before 31 October. Under the 2018 Act, that new legislation will form part of UK law at exit; further deficiency fixes are therefore necessary to ensure that the UK's regulatory regime remains prepared for exit.

The regulations deal with one of the new pieces of EU legislation that has recently become applicable. They resolve deficiencies in the EU's prudential regime that will be retained in UK law at exit. The regime sets out how much capital credit institutions such as banks and investment firms need to hold; these rules are currently set in the EU capital requirements regulation, as well as in UK secondary legislation to implement the fourth capital requirements directive. The CRR is a directly applicable EU regulation that has applied since 2013. A statutory instrument to correct the deficiencies in this retained law was laid before and approved by Parliament last year: the Capital Requirements (Amendment) (EU Exit) Regulations 2018.

Earlier this year, the European Council and European Parliament finalised a revised banking package, which included several amendments to the capital requirements regulation made by an amending instrument known as CRR II. This gives effect to some of the internationally agreed Basel reforms, which are the centrepiece of the post-crisis reforms aimed at making banking safer. Similar changes are expected in all G20 economies that follow the Basel guidelines. Through the UK's membership of the G20 and the Financial Stability Board, we have committed to the full, timely and consistent implementation of the Basel III reforms.

Several of the amendments made by CRR II are already in force and will therefore become retained EU law on exit day. This retained EU law will contain deficiencies that need to be fixed and that have not been addressed by the 2018 SI because they relate to changes that have come into effect since it was made. There are three main areas in which fixes are required.

The first area is third-country treatment. Consistent with the approach taken in the 2018 SI to amend the CRR, the regulations remove the preferential treatment given to the largest banks and investment firms in the EU27 to reflect the fact that the EU and the UK will treat each other as third countries after exit. It must be stressed that this is not about the ability of EU firms to carry on doing business here after the UK has left the single market; through comprehensive temporary permissions and transitional regimes, we have done everything we can to support EU firms that already have business here to continue with that business while they become UK-authorised.

The second area is transfer of functions. In line with the Government's approach to all onshored financial services legislation, the regulations transfer a number of functions currently within the remit of EU authorities to the appropriate UK bodies. Such functions, such as the development of detailed technical rules on certain provisions of the regulations, will now be carried out by the Financial Conduct Authority, the Prudential Regulation Authority or the Bank of England. That is appropriate, given the regulators' responsibilities for prudential and resolution policy and the supervision of global firms, and the major role that they have already played in the EU to develop CRR technical standards. Where CRR II confers delegated legislation-making powers on the Commission, those powers are converted into regulation-making powers conferred on the Treasury. Their use by the Treasury will need the approval of Parliament.

The final area is updates to definitions. CRR II amended some definitions used in the CRR; the regulations correct those updated definitions so that they can operate in a UK-only context. Here, too, the approach is consistent with fixes that Parliament has already approved in the previous CRR SI.

In drafting the SI, the Treasury worked closely with the financial services regulators, and we have engaged extensively with the financial services industry, incorporating feedback from industry players that will be significantly affected.

Before I conclude, it is important to address the procedure under which the SI has been made. Along with three other financial services SIs, the SI was made and laid before Parliament under the made affirmative procedure provided for in the European Union (Withdrawal) Act. It is an urgent procedure that brings an affirmative instrument into law immediately, before Parliament has considered the legislation, but it also requires that Parliament must consider and approve a made affirmative SI if it is to remain in law.

The Government have not used that procedure lightly, and it must be remembered that, across Departments, we have laid more than 600 exit SIs under the usual secondary legislation procedures. As we draw near to exit day, however, it is vital that all critical exit legislation is in place, including legislation necessary to ensure that our financial services regulatory regime continues to function effectively from exit. It would have been reckless to leave that until the last minute. Industry and our financial regulators need—and needed—legal certainty on the regime that will apply from exit. Without addressing the deficiencies in the new CRR rules, there would be significant legal uncertainty, disruption for firms and increased risk to financial stability.

The SI is essential to ensure that the prudential regime applying to credit institutions and investment firms works effectively if the UK leaves the EU without a deal on 31 October. I hope that colleagues will join me in supporting the regulations, which I commend to the Committee.

4.36 pm

Jonathan Reynolds (Stalybridge and Hyde) (Lab/Co-op): May I, too, say what a pleasure it is to see you in the Chair, Mr Bailey?

The statutory instrument returns the Minister and I to our preparations for the country's potential exit from the European Union without a deal. For the avoidance of any doubt, let me state that the Opposition believe that a no-deal Brexit would be extremely damaging and grossly irresponsible, and would return the Brexit process to square one rather than be the clean break that some would, erroneously, have us believe. However, we acknowledge, as we always have, the need for a functional regulatory regime in the eventuality that we have to fall back on it.

The issue relating to the capital requirements regulation was first addressed by the Minister and me in Committee on 12 December 2018. The Opposition retain our concerns about one of the central tenets of the instrument, which is the removal of the preferential treatment for EU sovereign debt. That raises the risk of a potentially costly, disruptive and unnecessary sale and repurchase of assets immediately upon a no-deal Brexit. The trade publication *GlobalCapital* expressed it succinctly last year as proposing

"a hit to UK bank capital ratios at the worst time imaginable."

However, I am mindful that we have had that substantive debate before, and the Government and Opposition do not agree. Hopefully we will never have to find out who is correct on that point.

The explanatory memorandum highlights that the reason we are going round this matter again today is to account for changes that have occurred between the original proposed EU exit date of 29 March and the revised exit date of 31 October. However, that seems to be a convenient means of avoiding the resurrection of the Financial Services (Implementation of Legislation) Bill on in-flight files. To remind colleagues, the Opposition were put under significant time pressure on the in-flight Bill in March. We were given very short notice to scrutinise and table amendments to that piece of primary legislation. When it became apparent that the Bill would not be passed by Parliament unless it was amended to strengthen money laundering and anti-corruption provisions, the Government withdrew it.

Today's instrument will seemingly implement some of those in-flight changes. The capital requirements regulation was named as one of the relevant files in scope of that original Bill. I ask the Minister whether he can clarify that point and, if so, how it can be that those changes have been demoted in importance from primary to secondary legislation. Is it the intention that the entire in-flight Bill will be broken up across several statutory instruments to conceal the fact that it cannot be passed on the Floor of the House of Commons?

The changes contained in the statutory instrument again give new responsibilities to UK regulators. The capital requirements regulation is an important part of the post-financial crisis regulatory regime, and I am sure that we all wish never to find ourselves in a repeat of the circumstances of 2008. Yet new requirements are being loaded on to UK regulators regarding macro-supervisory obligations that have previously been conducted at an EU level. Will the Minister assure the Committee that that is the right supervisory model?

Furthermore, in almost all the substantive changes to the capital requirements regulation—for example on internal modelling, reporting requirements and reporting on prudential requirements—there has been an important change of language. Where the original EU legislation states that the European Banking Authority "shall" make standards, that has become,

"The FCA and PRA may…make",

on pages 11, 13, 15, 17 and so on.

I read that as a shift from mandatory action to optional action by the regulator. Why has that new distinction been made? The argument has always been that this process simply transfers responsibilities, with no policy decisions being taken, but surely this decision could lead to a change of regulation. Will the Minister elaborate on why that change of language was made, and on the Treasury's intentions behind it?

4.40 pm

Alison Thewliss (Glasgow Central) (SNP): It is a pleasure to see you in the Chair, Mr Bailey. I very much agree with what the hon. Member for Stalybridge and Hyde said; the SNP shares the official Opposition's suspicions about areas related to the Financial Services (Implementation of Legislation) Bill, which—as hon. Members will remember—did not even reach Report.

The regulations flag up the fact that this will be an ongoing issue. As the EU continues to make changes, we will have to make changes here to get any type of equivalence with it. I remind the Minister that equivalence determinations are akin to building a house on sand: they are very much at the discretion of the Commission and can be withdrawn at very short notice. If we do not match the EU's regulations, that equivalence may end up being withdrawn, to the detriment of our financial services industry in the UK—particularly in Scotland, which did not vote for this but is being left to deal with the consequences and chaos that result from it. The Minister said that the regulations reflect a new piece of EU legislation that has recently become applicable. I suppose that that is part of the chaos that we now face: the EU is moving on without us, and we are left picking up the pieces.

On the financial services Bill and the suspicions of the hon. Gentleman, I must ask the Minister: are the regulations a workaround for the Bill? Are they a means of escaping the scrutiny and the amendments that I supported for the greater regulation that we need?

Will the Minister tell us more about the powers that are going to the FCA and the PRA and away from this House? How will the House maintain scrutiny of those institutions and of the rules and regulations? There will be a need for adaptation and change; how will he make sure that the House is given a full part to play—not just a statement or an update—in administering the regulations in the years ahead?

This all highlights our lack of voice and influence in future EU reforms. We will be abiding by the rules, because otherwise we will lose the opportunities for our financial services market, but we will not necessarily have influence in making them—in areas in which for

[Alison Thewliss]

many years we have had the advantage because we have a large majority in the types of industry that will be affected. We will end up in a weaker situation than we are in at the moment, particularly in a no-deal Brexit in which we cannot guarantee that we will have the equivalence or access to markets that we require.

Further to that sense of weakness, we have yet to see from this Government a full picture of what the financial services framework will look like. I have asked for that on all the Committees that I have been on, because we need to know what the framework will look like. This is being done with a hasty, piecemeal approach. We are being asked to come here not quite at the last minute, as the Minister pointed out, but with 24 days to go till Brexit, when we may end up with no deal. There are Committees sitting all the way along this corridor this afternoon and later this evening to get these last-minute preparations done, but we do not know what the picture will look like in the year ahead.

To give some degree of stability in planning to the organisations, institutions and people in the financial services industry, I urge the Minister to bring forward some kind of clear framework so that we can see where we are going. This piecemeal approach, this last-minute chaos of bringing things forward, this move towards more Brexit red tape rather than less, as I am sure the Brexiteers would want—none of it is adequate or particularly seemly. I urge the Minister to do a lot better on this, because it is absolute chaos.

4.44 pm

John Glen: I will endeavour to address the points raised by the hon. Members for Stalybridge and Hyde and for Glasgow Central. The hon. Gentleman referred to our conversation on 12 December regarding preferential sovereign debt and preferential capital treatment. In the circumstances of no deal, the consequences will be the inevitable result of leaving the EU: the UK and the EU27 will no longer be part of the same overriding legal infrastructure.

It is Government policy not to provide unilateral preferential treatment, but the hon. Gentleman made a reasonable point about different scenarios that might ensue. In practice, the impact would be largely mitigated by the transitional powers that we have given through this process to regulators, enabling them to phase in the new requirements between now and 31 December 2020.

The hon. Gentleman asked about the provision of the changes with respect to the in-flight files Bill. Only legislation under the European Union (Withdrawal) Act can onshore legislation before exit. The IFF Bill would have been for new files after exit, but we are dealing with all the immediate risks prior to exit. Given that there was an evolution in the corpus of EU material and directives over the summer, it is within scope of this mechanism.

The hon. Gentleman asked about the "shall" versus "may" language, and whether action is optional for regulators. That fits with the UK's existing regulatory framework. Parliament has already delegated responsibility to our regulators for technical rules. That approach has been accepted in the UK and is supported by industry. I am happy to look carefully at what he said and see whether there is an issue. I will write to him, but I do not think that we have changed anything from previous approaches.

Like the hon. Gentleman, the hon. Member for Glasgow Central made a number of wider political points that I will resist responding to now. However, I will try to address the specific points regarding the use of SIs. Again, it is completely consistent with the approach approved by Parliament, and it would not be feasible to use primary legislation for onshoring.

The hon. Lady asked about the future regulatory framework, and made some wider observations about the potential diminution of UK influence. Obviously, we will always be part of wider bodies globally in terms of regulation in this area, but the aim of the onshoring legislation for financial services has always been to ensure that we are at a base point in terms of a functioning regime in all scenarios. Onshoring is designed to provide continuity and to minimise disruption, as well as to provide time for the Government and Parliament to design a regulatory framework fit for the future.

The first step in that has already taken place with the call for evidence document of 19 July, which set out the context of a long-term review of the regulatory framework and the key issues that we will need to consider for a regime that operates outside the EU. The document also requests views for the Treasury and the regulators in terms of short-term changes, and how the co-ordination of UK regulatory activity can be improved to manage the combined impact of regulatory change on firms and their customers. The call for evidence ends on 18 October and is the first stage of a longer review. Obviously, the nature of our exit from the EU will determine the way that evolves in subsequent stages.

I hope that that addresses the substantive points that were raised. The Government believe that the SI is essential to ensure that prudential regulation of credit institutions and investment firms continues to work safely and effectively if the UK leaves the EU without a deal. I hope that the Committee has found the sitting informative and will join me in supporting the regulations.

Question put and agreed to.

4.49 pm

Committee rose.