PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Sixth Delegated Legislation Committee

DRAFT CAPITAL REQUIREMENTS REGULATION (AMENDMENT) REGULATIONS 2021

Wednesday 15 September 2021

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The Committee consisted of the following Members:

Chair: Mrs Sheryll Murray

† Antoniazzi, Tonia *(Gower)* (Lab)
Bonnar, Steven *(Coatbridge, Chryston and Bellshill)* (SNP)
Carden, Dan *(Liverpool, Walton)* (Lab)
† Costa, Alberto *(South Leicestershire)* (Con)
† Coutinho, Claire *(East Surrey)* (Con)
† Crosbie, Virginia *(Ynys Môn)* (Con)
† Daby, Janet *(Lewisham East)* (Lab)
Efford, Clive *(Eltham)* (Lab)
† Glen, John *(Economic Secretary to the Treasury)*
† Jupp, Simon *(East Devon)* (Con)
† McFadden, Mr Pat *(Wolverhampton South East)* (Lab)
† Mackrory, Cherilyn *(Truro and Falmouth)* (Con)
† Mak, Alan *(Lord Commissioner of Her Majesty's Treasury)*
† Stafford, Alexander *(Rother Valley)* (Con)
† Stevenson, Jane *(Wolverhampton North East)* (Con)
† Twist, Liz *(Blaydon)* (Lab)
† Wild, James *(North West Norfolk)* (Con)

Peter Stam, *Committee Clerk*

† attended the Committee

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Wednesday 15 September 2021

[MRS SHERYLL MURRAY *in the Chair*]

Draft Capital Requirements Regulation (Amendment) Regulations 2021

2.30 pm

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

That the Committee has considered the draft Capital Requirements Regulation (Amendment) Regulations 2021.

It is a pleasure to serve under your chairmanship, Mrs Murray. The regulations, among other things, support the implementation of the Basel III standards in the United Kingdom. This is yet another statutory instrument that I bring to the Committee, and I am delighted to do so.

I want to begin by reminding the Committee of the background to this issue. After the financial crisis, the international community came together to rectify major deficiencies in financial regulation and created new banking standards, known as the Basel III accords. As a member of the G20 the UK is committed to implementing these standards, but now we have left the EU, we have the opportunity to do so in our own way, enabling our expert regulators to apply international standards in a way that is most fitting to the UK's individual circumstances. The instrument therefore exercises the powers contained in section 3 of the Financial Services Act 2021, to revoke elements of the UK's capital requirements—the CRR, or capital requirements regulation—so the Prudential Regulation Authority can update the current regime to account for the Basel III standards.

Let me turn to some of the detail. The Financial Services Act restricts the ability of Ministers to only revoking those parts of the CRR that need to be updated to reflect the new Basel standards, and anything that is connected to, or consequential to, those standards. When it makes CRR rules under the new regime, the PRA is subject to an accountability framework under which it must consider the impact of its rules on a number of areas. These are: the relative standing of the UK compared to other jurisdictions, lending to the real economy and the Basel standards themselves. In addition, the PRA must consult the Treasury on the potential impacts of any rule changes on equivalence.

The instrument also contains additional EU exit-related amendments to the CRR. It makes an amendment to article 497 of the CRR, allowing for the Treasury to extend a transitional provision that allows for certain foreign central counterparties, or CCPs, to retain temporary qualifying status. Qualifying status allows UK firms to have exposures to these CCPs without being subject to higher capital requirements. This amendment will allow for the transitional period to be extended by regulations one year at a time. These extensions are required as there may be non-UK CCPs that will be unable to receive qualifying status through recognition for a prolonged period. However, the Treasury still considers it beneficial that they retain qualifying status. The Treasury will keep these arrangements under review to ensure they are fit for purpose.

Additionally, under article 391 of the CRR, the Treasury may determine that an overseas jurisdiction applies prudential requirements to the same standard as those applied in the UK and grant it equivalence. Smaller UK banks in particular benefit from that article as it allows them to lend more as a single loan to overseas firms. However, the UK's only equivalence decision in this area is with respect to EEA member states. That is because, at the end of the transition period, the EU had not made any equivalence decisions under the article and the European Banking Authority had issued guidance allowing EU firms, including those in the UK, to use equivalence decisions under a different article—107—as a proxy for article 391 equivalence. However, this is, in effect, regulatory guidance overruling legislation.

The Government and the UK's regulators consider that guidance inappropriate and therefore do not intend to replicate it in the UK. It is also impractical to undertake the equivalence assessments in such short timescales. The Treasury is therefore, through this statutory instrument, using section 8 powers under the European Union (Withdrawal) Act 2018 to put in place transitional arrangements. In parallel, the Treasury will seek a legislative opportunity to streamline the system by linking the equivalence regime in article 391 to that in article 107, providing certainty to firms.

The Treasury has worked closely with the PRA in drafting the instrument. We also engaged with industry throughout the process, including through a public consultation. The Government have updated their approach in line with the points raised in the consultation.

I hope I have given Members a comprehensive overview of the measure, and I urge colleagues to join me in supporting the regulations. In short, the measure will enable the implementation of Basel III—regulation that is key to the UK's international standing. In addition, it will iron out some of the wrinkles in existing EU regulation. Together, the proposals will give UK firms certainty, and therefore help them to flourish. I commend the regulations to the Committee.

2.35 pm

Mr Pat McFadden (Wolverhampton South East) (Lab): Thank you for chairing the sitting, Mrs Murray.

Just before I came here, I saw media reports that there is a Government reshuffle under way. There is an old Glasgow phrase referring to job insecurity. It talks about somebody's jacket hanging on a shoogly nail. I genuinely hope that the Minister's jacket is not hanging on a shoogly nail, and wish him well in whatever transpires over the rest of the day.

The statutory instrument before us, as the Minister explained, is the legislative child of section 3 of the Financial Services Act, which we debated in the House last year. Under that Act, powers under certain EU directives were onshored to be allocated to UK-based regulators. Some of those powers related to the capital requirements regulation, which was the EU's instrument for implementing the Basel standards agreed in the wake of the financial crash of 2007 and 2008.

Those Basel standards are important, because they required financial institutions to hold particular levels of capital buffer; stick to, at the very least, a minimum

overall leverage requirement below which they could not fall; and have particular liquidity requirements. All that was designed to avoid a repeat of the financial crisis, when globally and systemically important banks were found to be holding too little capital, and to be overstretched when it came to leverage, and therefore to be unable to fund themselves when the crisis came.

That scenario left Governments and taxpayers—not only in this country, but in the United States, Ireland and a number of European countries—in the invidious position of having to bail out banks deemed too big to fail. The Basel rules were designed to avoid a repeat of that situation, make financial institutions more resilient and get taxpayers off the hook of bailing those institutions out, or to put it another way, and perhaps more bluntly, to deal with the problem of privatising the profits and nationalising the risks.

As the Minister and I have often discussed in such debates, there is particular onus on the UK to have resilient institutions and good regulation in this sphere, because our banking and financial services sector is so large relative to the rest of our economy. That in many ways is a great strength, but it can be a vulnerability if the UK taxpayer is the ultimate backstop for the system.

My first question to the Minister, therefore, is about whether, in giving these powers to the PRA, there is any policy intent to reduce the capital requirements on institutions. Banks will not openly lobby to put greater risk in the system. Instead, when they come knocking on the Minister's door, they talk about competitiveness and say, "Can we just have this change? It would make us more internationally competitive. We could lend a bit more if only we didn't have to hold all this capital against our balance sheet."

How alive is the Treasury to that kind of lobbying and how determined is the Treasury to resist it, particularly given the number of consultations going on in the financial sector, on all sorts of subjects, asking the sector what it would like to be changed in the wake of our withdrawal from the EU? Really, my question is about whether this is a purely technical transfer of administrative responsibility, or does it open the door to lower capital requirements and greater leverage, and therefore greater risk, for UK-regulated financial institutions?

The second issue in the regulations is clearing services and the recognition of overseas central counterparties, known as CCPs, by the Bank of England. Clearing is very important; it is a firebreak in the system when large transactions take place. It is very important for the UK financial services sector and allows huge volumes of transactions to take place in this country. A temporary agreement on clearing was reached with the EU in the absence of any wider equivalence recognition on financial services last year. This instrument allows the Treasury to extend the transitional period for recognition of overseas CCPs indefinitely, but one year at a time. The reason for that is explained in paragraph 7.11 of the explanatory notes, which say that

"because there are some CCPs, who submitted applications for recognition…that will likely be unable to receive equivalence and recognition under EMIR"—

the relevant directive—

"for a prolonged period".

In other words, "We need to have this rollover because we can't process the paperwork."

That is the financial equivalent of Lord Frost's announcement yesterday of the unilateral setting aside of border controls on incoming goods. What the Government are doing through this instrument, and a number of similar ones, is empowering themselves in legislation to carry on what went before even in the absence of mutual agreements in the other direction and in recognition that their institutions do not yet have the capacity to consider the individual applications and approvals that would be necessary to do this one clearing house at a time. In the absence of that capacity, we have this catch-all rollover of the status quo, because we are openly admitting that cannot process the paperwork. Can the Minister explain why this power for endless rollover has been deemed necessary? Why, five years after the referendum, does the UK not have the necessary systems in place? How often does he expect to see this annual extension power used?

As I said, this aspect of the statutory instrument is part of a pattern. I have stood in this room and similar rooms on this Corridor debating the same thing with regard to customs procedures, and we also saw it yesterday with regard to the clearance of goods. At what point did taking back control morph into not having controls at all, and not being able to consider applications? When will we ultimately get out of this holding pattern of the rollover of the status quo and actually put in place the controls that were envisaged five years ago when the country took this decision?

2.42 pm

John Glen: I am grateful to the right hon. Gentleman, as ever, for his constructive scrutiny of the statutory instrument. He always provides succinct summaries of complex matters. They are often full of wisdom, and always courteous, and I am very happy to try to address the points that he made.

The right hon. Gentleman referred to the anxiety that exists in his mind concerning the Government's intentions with respect to standards, competitiveness, what the PRA will be subject to and what we may wish to do to encourage it to succumb to such covert lobbying. As I have always tried to stress in our encounters, this Government wish to retain the highest possible standards. Of course, having regard to our situation in the global financial services industry will always be important, but we are united, in terms of the Treasury, the PRA and the FCA, on the need to hold to the highest international standards, which give us a baseline of resilience. As the right hon. Gentleman will know, the UK was extremely influential in both shaping the Basel accords and pushing for their implementation. We remain committed to their effective implementation.

As the right hon. Gentleman will know, as part of the Financial Services Act, the PRA is required to have regard to the effect of its rules on international standards, including Basel. As was demonstrated in the publicly available analysis, which I think was published in July, the PRA considers all its rules as achieving the same outcomes: a safe and sound prudential regime to the Basel standards and EU equivalent legislation.

The second issue that the right hon. Gentleman raised was around the CCPs and the transitional rollover concept. He asked about that provision. I would want to say to him that while a foreign firm or jurisdiction

[John Glen]

can express an interest in receiving equivalence or recognition, it will be for the Treasury to decide whether to initiate consideration of an EU equivalence decision for a foreign jurisdiction and the appropriate timescales. As with all equivalence decisions, the UK authorities will need to ensure that granting equivalence is compatible with the UK's policy priorities, including those relating to the rule of law, international standards, human rights and efforts to combat money laundering.

Let me turn to the retention of that transitional status without, I think the right hon. Gentleman said, all the forms being processed. Letting that transition fall away might create disruption for the UK firms with exposures to the relevant CCPs. That is not something we would wish to have. The market access provided by qualifying central counterparty status is more limited than that provided by full recognition status, with QCCP firms unable to provide clearing services directly to UK clients. Therefore, it is appropriate that firms may continue to benefit from QCCP status while awaiting the result of their application for recognition.

On any Government intention to extend the transition indefinitely, that is not the case. The Treasury will keep those arrangements under review to ensure they are fit for purpose while a permanent solution is considered. Obviously, I am engaged in discussions with colleagues about legislation in the next Session.

May I conclude by reminding members of the Committee of the key purposes of the statutory instrument? The legislation revokes a number of provisions in the UK's capital requirements regulations. By doing so, it will enable regulators to make rules in these areas reflecting Basel III international standards. The PRA has consulted on those rules, and in July it published a near-final version of the rules alongside an accompanying policy statement. That set out how the regulator had taken into account public policy factors set out in legislation.

I hope that the Committee has found today's sitting informative, and that its members will join me in supporting the regulations, which I commend to the Committee.

Question put and agreed to.

2.47 pm

Committee rose.