

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Second Delegated Legislation Committee

DRAFT FINANCIAL SERVICES ACT 2021
(PRUDENTIAL REGULATION OF CREDIT
INSTITUTIONS AND INVESTMENT FIRMS)
(CONSEQUENTIAL AMENDMENTS
AND MISCELLANEOUS PROVISIONS)
REGULATIONS 2022

Tuesday 12 July 2022

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Saturday 16 July 2022

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The Committee consisted of the following Members:

Chair: DR RUPA HUQ

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|---|---|
| † Bacon, Gareth (<i>Orpington</i>) (Con) | † Siddiq, Tulip (<i>Hampstead and Kilburn</i>) (Lab) |
| † Benn, Hilary (<i>Leeds Central</i>) (Lab) | † Smith, Nick (<i>Blaenau Gwent</i>) (Lab) |
| † Buchan, Felicity (<i>Kensington</i>) (Con) | † Tomlinson, Justin (<i>North Swindon</i>) (Con) |
| † Davies, David T. C. (<i>Parliamentary Under-Secretary of State for Wales</i>) | † Turner, Karl (<i>Kingston upon Hull East</i>) (Lab) |
| Day, Martyn (<i>Linlithgow and East Falkirk</i>) (SNP) | † Twist, Liz (<i>Blaydon</i>) (Lab) |
| † Fuller, Richard (<i>Economic Secretary to the Treasury</i>) | † Wild, James (<i>North West Norfolk</i>) (Con) |
| † Hardy, Emma (<i>Kingston upon Hull West and Hessle</i>) (Lab) | † Williams, Craig (<i>Montgomeryshire</i>) (Con) |
| † Howell, Paul (<i>Sedgefield</i>) (Con) | † Young, Jacob (<i>Redcar</i>) (Con) |
| † Longhi, Marco (<i>Dudley North</i>) (Con) | |
| | Rebecca Lees, Beth Goodwin, <i>Committee Clerks</i> |
| | † attended the Committee |

Second Delegated Legislation Committee

Tuesday 12 July 2022

[DR RUPA HUQ *in the Chair*]

Draft Financial Services Act 2021 (Prudential Regulation of Credit Institutions and Investment Firms) (Consequential Amendments and Miscellaneous Provisions) Regulations 2022

2.30 pm

The Chair: May I just say, before I call the Minister to move the motion, people have asked if they can remove my jacket? The heat is getting to me already; I should have said, people have asked if they can remove their jackets, which I think it is customary to do. I am happy to give blanket permission; you can all have it off, as it were. Anyway, for the first outing, I believe, in his new post, I ask the Minister to move the motion.

The Economic Secretary to the Treasury (Richard Fuller): I beg to move,

That the Committee has considered the draft Financial Services Act 2021 (Prudential Regulation of Credit Institutions and Investment Firms) (Consequential Amendments and Miscellaneous Provisions) Regulations 2022.

It is a pleasure to serve under your chairmanship in these very warm afternoon conditions, Dr Huq. The regulations tidy up some final aspects of the statute book following the implementation of the remaining Basel III standards and the investment firms prudential regime on 1 Jan 2022.

The Government's vision is one of an open, green and technologically advanced financial services sector—a sector that is globally competitive and acts in the interests of communities and citizens, creating jobs, supporting businesses and powering growth throughout the UK. At the heart of that is the approach proposed under the future regulatory framework review, which delegates responsibility for firm-facing rules to the regulators, subject to enhanced accountability. As Members may recall, in the Financial Services Act 2021 the Government introduced a similar model to enable the Prudential Regulation Authority to update the UK's capital requirements regime to implement the remaining Basel standards. The Act also enabled the Financial Conduct Authority to implement the IFPR. Both those regimes devolved the detailed firm requirements to the relevant financial services regulator.

In September and December 2021, the House approved two instruments made under the Financial Services Act 2021 to implement those regimes. Cumulatively the two instruments revoked relevant sections of the capital requirements regulation and introduced consequential amendments to make the regimes function effectively. This instrument makes further consequential changes to provide a complete, functioning legal regime for firms.

This instrument adds and updates cross-references to regulator rules to link the legislation and the new rules together effectively, and to ensure effective transitional arrangements for certain requirements related to securitisation.

Finally, this instrument further addresses a small number of deficiencies arising from the withdrawal of the UK from the EU that have been identified during the development of the above amendments.

I hope that I have shed some light on some of the main elements of the instrument, and that hon. Members have found the explanation helpful.

Nick Smith (Blaenau Gwent) (Lab): I have been looking at the explanatory memorandum. On page 7, in paragraph 10.2, it states that Her Majesty's Treasury ran a public consultation on one of the amendments to the Banking Act 2009 relating to these changes. Can the Minister say how many people responded, and what the results of the consultation were?

Richard Fuller: I am grateful to the hon. Gentleman for his question, to which, in a moment, I shall be inspired to respond. He will be aware of some of the limitations on consultations, in terms of the ways in which they are handled; having been a Member of Parliament for a number of years, he will be aware how frequently they are run and how often people participate. As I do not yet have inspiration to answer, perhaps I may respond to that question in my summing up.

These changes are simple, yet play an important part in our work to build a financial system that is both responsive to the UK's specific needs and mindful of our responsibilities to the wider world. I therefore commend them to the Committee.

2.35 pm

Tulip Siddiq (Hampstead and Kilburn) (Lab): It is a pleasure to serve under you in the Chair, Dr Huq. The Opposition recognise that regulatory divergence with the European Union will provide opportunities for our financial services sector, whether that is through Solvency II reform or creating a more favourable environment for the UK's vibrant fintech industry. However, financial stability must remain the priority for regulators as we diverge from the EU, as I am sure the Minister will agree.

A race to the bottom in regulation is not the way to build a strong future for our financial services outside of the EU. The protections that were put in place following the 2008 crisis must not be undermined. Never again should the public be expected to bail out our financial institutions or the health of our economy be put at risk because of lax regulation. That is why we will support the Government's draft regulations today, which are largely technical amendments to ensure that IFPR, Basel III, bail-in procedures and securitisation regulations operate within the specificities of the UK's financial services sector.

The UK was heavily involved and influential in the design of those policies at EU level, which all contribute to a strong prudential regime that upholds financial stability and promotes competition, and help to ensure that the mistakes that led up to 2008 are not repeated. We therefore support the Government's aim of creating

similar outcomes by tailoring the policies to ensure they function effectively in the UK context now that we have left the EU, so the Minister may be pleased to know that I will not be on the attack today. However, I do have a series of questions about how he expects the draft regulations to operate in the UK market. I am aware that he has not been in his position very long and if he would like to write with information later, I would be happy for him to do that, but I would like the answers, even if that is in written form.

First, I would like to touch on the implementation of the capital requirements regulation and IFPR—the penultimate phase of the Basel III reforms, which only became effective on 1 January 2022. Any significant issues with the regime are likely to surface after the first full year of operation. Will the Minister tell me how he will work with the regulators to assess the effectiveness of the regime and whether the regulators will report annually on the impact on investment firms?

I also understand that the Bank of England is planning to consult on the final phase of the Basel III framework—Basel 3.1—later this year, with implementation planned for January 2025. Will the Minister confirm whether the implementation dates for Basel III will align with other major jurisdictions, particularly the European Commission, should the implementation dates get postponed beyond 2025, to ensure a level playing field for the UK banking industry? Does the Treasury anticipate that the UK's implementation of Basel III will result in capital regulations for larger, mid-tier and challenger banks to diverge from the EU? If so, what assessment has the Minister made of the risks, both to competitiveness and financial stability, of such divergence?

I turn briefly to the bail-in procedures. We welcome that the draft regulations will ensure that investment firms regulated solely by the Financial Conduct Authority, under the IFPR, will continue to benefit from the exemption to the bail-in scheme for short-term liabilities owed to investment firms. That will help to reduce the risk of system contagion in the case of a bank failure. However, as I am sure the Minister is aware, some in the sector have questions about the proportionality of the bail-in procedures for mid-tier and challenger banks. For example, UK Finance has stated that the lower end of the current bail-in threshold range of £15 billion, above which firms must start issuing MREL capital—the minimum requirements for own funds and eligible liabilities—as part of bail-in procedures, is set too low.

What are the Minister's thoughts on UK Finance's suggestions that the MREL requirements be introduced on a sliding scale from £25 billion to £50 billion of total assets excluding central bank deposits, which it argues would create greater competition in the banking sector? I would be interested to hear the Minister's assessment of the impact of bail-in procedures on the competitiveness of mid-tier and challenger firms, and the risks to financial stability of introducing lower capital requirements for smaller banks.

I have some questions about the draft regulations' implications for securitisation. Poor regulations played a catastrophic role in the US subprime mortgage scandal, which ultimately triggered the 2008 global financial crisis, so I am sure the Minister will agree that it is incredibly important that the UK gets this right. As he is aware, some of the rule changes brought in by the

IFPR following our exit from the EU narrowed the scope of the group risk retention requirements for some investment firms.

We fully support the Government's attempts to rectify that in the draft regulations by requiring that the originator of the securitisation assumes the risk, but firms must be deterred from packaging unreliable assets or loans. Can the Minister assure me that the Treasury will keep the new measures under review to ensure that the risk retention requirements work as intended?

We welcome the draft regulations because we believe they will help to protect financial stability, economic growth and the taxpayer. The success of the City depends on the UK's reputation for strong regulatory standards. We will continue to scrutinise the Government closely in the coming months as the UK presses forward in shaping our regulatory framework outside the EU. We must ensure there is no unnecessary trade-off between competitiveness and the public interest. I would like some clarity on the points that I have raised. I know there were a lot, but I am also happy to have some written answers.

2.42 pm

Richard Fuller: I thank the hon. Member for Hampstead and Kilburn for her kind words and her barrage of questions to test my mettle. I genuinely appreciate them. I particularly appreciated her opening point about the importance of stability in our financial services. I assure her that she and I are in lockstep: that is the absolute priority for UK financial services.

The hon. Lady asked about the implementation of parts of the capital requirements—the penultimate phase of Basel—and said there will be significant issues after the first year. She is absolutely right that there will be significant issues, but it is up to the Prudential Regulation Authority and the Financial Conduct Authority to consider whether there should be any further tweaks or changes to the regime once it is fully in force.

The hon. Lady asked whether we will align with the EU institutions on the timing and dates for January 2025. I do not have a full answer to that now, but what is important is that we are protecting the UK financial system from international and domestic risks. That goes to the crucial point of stability. One of the benefits of taking back control is that we can assess those risks ourselves and do not necessarily have to walk in lockstep with other jurisdictions, including the EU. There are international considerations that matter, but it is not an absolute requirement for the UK to move in lockstep on that issue.

Tulip Siddiq: I hear what the Minister says, but my question was more about the implementation dates for Basel III. I am saying that they should be in line with the European Commission, but if its dates get postponed, I am worried about a level playing field for the UK banking industry. Does he share my concerns about that?

Richard Fuller: The phrase “a level playing field” has within it a whole set of issues that may be beneficial to the UK, the population and our financial services. What is important is not necessarily achieving a level playing field but achieving that crucial point of stability and at the same time ensuring that we have an economically competitive financial system in the United Kingdom.

[Richard Fuller]

For me, those are the absolute priorities, rather than the determination that lockstep with the European Union or other states is the most important aspect.

The hon. Lady asked whether UK implementation would include divergence from the EU Basel 3.1 standards. I do not have an answer to that, but I am happy to write to her about it.

The hon. Lady rightly moved on to challenger banks and how the regulations will affect competition in that very difficult sector. She was right to raise the point about the barrier for the low end of deregulation. I think she referred to some recommendations for a sliding scale from £15 billion to £25 billion; I have not yet seen those recommendations, but I will bear them in mind and come back to her with a response.

Finally, on the issue of sub-prime loans and their effect on the United States and, consequently, financial systems around the world, the hon. Lady is right to talk about the minimum requirement. The Treasury has worked closely with the Bank on its MREL—minimum requirement for own funds and eligible liabilities—and I am content that its proposed change to the framework that sets MREL should ensure that the policy continues to provide an appropriate degree of protection for the financial stability of public funds, while ensuring a proportionate approach. I hope that those answers address some of her questions, but I will review and come back to her with any additional points, should they be required.

Hilary Benn (Leeds Central) (Lab): I seek a point of clarification. Part of the measure seeks to amend retained direct EU legislation. The Government recently published their dashboard where we can go and see retained EU law. Assuming that the changes are agreed by the Committee, will the text of the retained EU law on the dashboard be subsequently amended to reflect them?

Richard Fuller: As the right hon. Gentleman will be aware, it is up to the relevant Minister to decide what he includes on his dashboard. I recommend that the right hon. Gentleman speaks to him directly on that specific point, as I have not had a chance to do so in the last day.

Hilary Benn: It is really about general policy, not the specific Department. If we go to the dashboard, do we assume that it shows the most up-to-date version of retained EU law, which would include any changes made today in Committee?

Richard Fuller: The right hon. Gentleman makes a logical argument with which there is little to argue. The policy implementation of that point is not up to me, however, because it is not within my responsibilities. He has put his point on the record and I am sure that the relevant Minister will look at it directly.

The Chair: Perhaps that could go in the letter, along with the answer to Nick Smith's point.

Richard Fuller: Of course; I can answer that point now. In addition to perspiration, I have received inspiration, so I can say to the hon. Member for Blaenau Gwent that there were two responses to the consultation and both agreed with the Government's suggested approach.

Tulip Siddiq: I would like to clarify my question. The suggestion was that MREL requirements be included on a sliding scale from £25 billion to £50 billion of total assets, excluding central Bank deposits. UK Finance is arguing that that would create greater competition in the banking sector. When the Minister writes to me, can he take that into account? I am not quite sure I made that point, so I am clarifying it for when he writes to me. That is coming up when we are speaking to stakeholders and people in the City.

Richard Fuller: I am happy to address that issue as well.

If there are no further questions, I will conclude by reminding Members of the instrument's key purposes. It makes further consequential amendments following the implementation of Basel III standards and IFPR by updating or adding references to regulatory rules—regulation that is key to the UK's international standing. It makes transitional provision in respect of risk-retention requirements for certain securitisations following the implementation of the IFPR. Finally, it irons out some of the wrinkles left in EU regulation to reflect the fact that the UK has now left the EU. Together, the measures ensure the coherence of the UK's regulatory regimes and give UK firms certainty over the Basel III standards and IFPR regimes. I commend these regulations to the Committee.

Question put and agreed to.

2.50 pm

Committee rose.

