EXPLANATORY MEMORANDUM TO

THE CAPITAL REQUIREMENTS (CAPITAL BUFFERS AND MACRO-PRUDENTIAL MEASURES) REGULATIONS 2014

2014 No. 894

1. This explanatory memorandum has been prepared by the Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument implements in part the provisions relating to capital buffers in Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (OJ no L176, 27 June 2013, p. 338; for corrigenda see OJ no L208, 2/8/2013, p.73) (the "capital requirements directive").

2.2 It also amends the Bank of England Act 1998 (c. 11) to specify the procedure for notifying proposed macro-prudential measures under Article 458 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (OJ no L176, 27/6/2013, p.1, for corrigenda see OJ no L208, 27/6/2013, p.68 and OJ no L321, 30/11/2013, p.6) (the "capital requirements regulation").

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 On 26th June 2013, the European Parliament and Council adopted a package of legislation known as "CRD4" which provides the framework for the authorisation and prudential supervision of banks, building societies and investment firms in the EU. The CRD4 package comprises the capital requirements directive and the capital requirements regulation. Nearly all of the capital requirements directive was required to be transposed into UK law by 31st December 2013 and to come into force on 1st January 2014. This requirement was met for most of the relevant provisions of the capital requirements directive through a range of different measures, including the Capital Requirements Regulations 2013 (S.I. 2013/3115). Nearly all of the capital requirements regulation applied from 1st January 2014.

4.2 This instrument is concerned with the provisions on capital buffers which Member States are required to implement, namely the capital conservation buffer, the countercyclical capital buffer, the global systemically important institution ("G-SII") buffer and the identification of other systemically important institutions ("O-SIIs"). These provisions are being transposed into UK law by means of:

- these Regulations; and

- rules made, and other legally binding requirements imposed, by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA").

This will complete the UK's transposition of the provisions of CRD4 which the UK is required to implement.

4.3 The Capital Requirements Regulations 2013 (S.I. 2013/3115) designates the Bank of England and the Treasury as the authorities responsible for applying Article 458 of the capital requirements regulation. These Regulations make suitable amendments to the Bank of England Act 1998 in order to specify the procedure for notifying the European Parliament, Council, Commission, the European Banking Authority and the European Systemic Risk Board of the intention to undertake national macro-prudential measures within the scope of Article 458.

4.4 The CRD4 package was submitted for scrutiny to the UK Parliament on 12th October 2011. It was cleared by the House of Commons European Scrutiny Committee on the 14th March 2012 and House of Lords European Scrutiny Committee on the 14th June 2012.

4.5 During the Financial Services and Markets debate on 27 February 2013, the Right Honourable Greg Clarke MP, the then Financial Secretary of the Treasury, stated that "the Government intend to ensure that the counter-cyclical capital buffer will be subject to the same transparency requirements as other Financial Policy Committee decisions."[1] The capital requirements directive has its own transparency requirements for the countercyclical capital buffer. This instrument implements those requirements and, by amending the Bank of England Act 1998, imposes the same transparency requirements on the countercyclical capital buffer as for other decisions taken by the Financial Policy Committee. This includes a requirement to publish decisions setting or recognising a buffer rate.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury, Sajid Javid MP, has made the following statement regarding Human Rights:

In my view the provisions of the Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014 are compatible with the Convention rights.

7. Policy background

- ***What is being done and why***

7.1 In light of the financial crisis and the pro-cyclical mechanisms that contributed to its origin and aggravated its effect, the Financial Stability Board, the Basel Committee on Banking Supervision ("BCBS"), and the G-20 made recommendations to mitigate the

[1] http://www.publications.parliament.uk/pa/cm201213/cmhansrd/cm130227/debtext/130227-0004.htm

pro-cyclical effects of financial regulation. In December 2010, the BCBS issued new global regulatory standards on bank capital adequacy (the Basel III rules), including rules requiring the maintenance of capital conservation and countercyclical capital buffers. Moreover, given the greater risk associated with global and domestic systemic institutions, further rules were designed that require the maintenance of a G-SII buffer and the identification of O-SIIs.

7.2 Specifically, this instrument implements the following:

- The countercyclical capital buffer – a buffer of capital built up and drawn down according to the designated authority's assessment of systemic risk. The Financial Policy Committee ("FPC") - a statutory sub-committee of the Court of the Bank of England - is the macro-prudential authority in the UK and it is the FPC's responsibility to oversee the system as a whole, identify potential risks to its stability and take concerted action. Therefore, the Bank of England will be made the designated authority with the FPC setting the buffer rate. The FPC will be able to use this buffer from 1st May 2014.

- The capital conservation buffer – a buffer of capital used to absorb losses in periods of economic and financial stress. The PRA will be made the designated authority for PRA-authorised institutions and the FCA will be made the designated authority for all other institutions. The buffer will apply from 1st January 2016 subject to a transitional period, and will apply fully on 1st January 2019.

- The G-SII buffer – a buffer of capital applied to institutions deemed to be globally systemic by the designated authority. The PRA, as the relevant regulator in the UK, will be made the designated authority. This buffer will also apply from 1st January 2016 subject to a transitional period, and will also apply fully on 1st January 2019.

- O-SIIs – the designated authority must identify and publish a list of institutions deemed to be systemic. The PRA, as the relevant regulator in the UK, will be made the designated authority.

7.3 Under Article 458 of the capital requirements regulation, Member States are required to notify the EU authorities mentioned in paragraph 4.3 of this Memorandum the intention to undertake a macro-prudential measure. The Commission may propose an implementing act to reject the draft national measures, which the Council may adopt acting by a qualified majority. The Bank of England will be responsible for notifying the EU authorities so far as the FPC's proposals relate to its existing macro-prudential measures, which are prescribed by order under section 9L of the Bank of England Act 1998. The Treasury will be responsible in all other cases.

- ***Consolidation***

7.4 These Regulations do not substantially amend existing enactments, so consolidation is not merited.

8. Consultation outcome

8.1 The European Commission consulted on the overall CRD4 package. The details of this consultation can be found at:

http://ec.europa.eu/internal_market/bank/regcapital/legislation_in_force_en.htm

8.2 The Government has already consulted on the FPC's macro-prudential powers when it published its consultation paper "The Financial Services Bill: the Financial Policy Committee's macro-prudential tools" on 18 September 2012.

8.3 Moreover, the Government carried out a further short informal consultation on the implementation of the countercyclical capital buffer on 21 October 2013.

9. Guidance

9.1 The Treasury is not providing any guidance in relation to these Regulations.

10. Impact

10.1 The Government has completed an impact assessment in relation to the macro-prudential measures at http://www.legislation.gov.uk/ukia/2013/1156/pdfs/ukia_20131156_en.pdf. This covers the majority of the provisions in this instrument.

10.2 The remainder of the provisions are covered in the Annex E of the following impact assessment: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223566/PU1488_Banking_reform_consultation_-_online-1.pdf.

11. Regulating small business

11.1 CRD4 covers a broad spectrum of firms, ranging from very large multi-national banks to very small investment firms. However, the G-SII buffer only applies to globally systemic institutions and therefore does not apply to SMEs by definition. The only buffers that apply to small firms are the capital conservation buffer and the countercyclical capital buffer. However, the FCA may exempt small investment firms if appropriate. Therefore, the only small firms that the capital conservation and countercyclical capital buffers will apply to are smaller banks and building societies, and those SME investment firms not exempted by the FCA. This is explained further in the impact assessment mentioned in paragraph 10.2.

12. Monitoring & review

12.1 The Treasury will monitor the practical effects of this instrument to ensure it continues to meet the policy aims.

13. Contact

13.1 Ali Uppal at Her Majesty's Treasury Tel: 020 7270 1609 or email: Ali.Uppal@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.