Title: THE FINANCIAL SERVICES ACT 2021 (PRUDENTIAL REGULATION OF CREDIT INSTITUTIONS AND INVESTMENT FIRMS) (CONSEQUENTIAL AMENDMENTS AND MISCELLANEOUS PROVISIONS) REGULATIONS 2021	De minimis assessment
SI No: 838	**Date: 25/10/2021**
Other departments or agencies: **N/A**	**Type of regulation: Domestic**
Contact for enquiries: **toby.coaker@hmtreasury.gov.uk**	**Date measure comes into force:** **01/01/2022**
Cost of Preferred (or more likely) Option	**Equivalent Annual Net Direct Cost to Business per year** (EANDCB in 2019 prices) **£0.9m**

1. What is the problem under consideration? Why is government intervention necessary?

Background

This instrument will support the implementation of the remaining aspects of the Third Basel Accord (otherwise known as the "Basel 3 Standards"). These international standards – agreed by the Basel Committee on Banking Supervision (BCBS) - were developed in response to the financial crisis. The UK played an active role in negotiating and agreeing these standards and has always been committed to their full, timely and consistent implementation.

These standards sought to strengthen the existing prudential framework, notably by improving the quality and quantity of financial resources credit institutions (banks) are required to maintain and extending the requirements to cover a wide variety of risks that banks are exposed to.

Basel (Basel 3 and NPL securitisation) Implementation

Prior to the end of the EU exit implementation period, the UK had implemented the majority of the earlier Basel Standards through EU regulations, which were directly applicable to the UK as a member of the EU or transposed Directives.

The most recent EU legislation, which implemented some of the Basel standards, was the 2nd Capital Requirements Regulation (CRR2) and the 5th Capital Requirements Directive (CRDV). Some aspects of CRR2, however, came into application in the EU following Implementation Period Completion Day (IPCD) and therefore do not form part of retained EU law in the UK.

The UK, as a member of the G20, is committed to the implementation of the remaining Basel standards on banking. HM Treasury through this instrument is updating the UK's prudential regime to reflect the updated Basel 3 standards.

This is being done through the powers in the Financial Services Act 2021 (the "FS Act") and regulations made under it. The FS Act facilitates the transfer of certain prudential regulation matters into PRA rules.

It is intended, given that the majority of the prudential requirements contained in CRR2 are highly technical in nature, that these will be implemented by the Prudential Regulation Authority (PRA) through its rules rather than through legislation. This will ensure that the UK's prudential regime remains agile and responsive to market developments by allowing the PRA to make rules in such matters.

To enable the PRA to make these rules, HM Treasury revoked provisions of the Capital Requirements Regulation (CRR) through the Capital Requirements Regulation (Amendment) Regulations 2021(SI 2021 No. 1078). The PRA has replaced the revoked provisions with rules using its rule-making powers in the Financial Services and Markets Act 2000.

This instrument ensures that consequential amendments to primary and secondary legislation, and retained EU law, are made as a result of the revocations in the Capital Requirements Regulation

(Amendment) Regulations 2021 (SI 2021 No. 1078). For example, this instrument changes or replaces references in relevant legislation, to reflect the new rules set by the PRA.

Investment Firms Prudential Regime (IFPR)

This instrument will also support the effective implementation of the Investment Firms Prudential Regime (IFPR), the framework for which was introduced by the FS Act. The IFPR framework aims to introduce a proportionate and tailored prudential regime for non-systemic investment firms ('FCA investment firms'). This will take into consideration differences in business model and the size of these firms, while ensuring they are subject to appropriate prudential requirements. This new regime will be delivered by the Financial Conduct Authority (FCA) using its rule-making powers in the Financial Services and Markets Act 2000.

2. What are the policy objectives and the intended effects?

Basel changes (Basel 3 and NPL securitisation) and IFPR

Basel 3 and IFPR

The amendments in this instrument for Basel 3 implementation and IFPR introduction largely fall into three categories:

- further revocations of provisions in the Capital Requirements Regulation (Regulation (EU) No.575/2013) (CRR) which will either be adequately replaced with rules made by the PRA or which do not need to be replaced;
- consequential amendments made to the CRR and elsewhere as a result of the revocation of provisions in the CRR contained in the Capital Requirements Regulation (Amendment) Regulations 2021 and their replacement with PRA rules; and
- definitional changes and consequential amendments to legislation resulting from the introduction of IFPR.

Non-performing loans

This instrument also inserts a new article into the CRR as a result of the PRA's implementation of updated Basel standards for the securitisation of Non-Performing Loans (NPLs). The PRA's rules in this space can allow firms to gain additional certainty on their balance sheets where they hold exposures to NPL securitisations. Ultimately, this is expected to have a positive net effect on industry and should support lending to the real economy.

Application of the UK resolution regime to FCA investment firms

This instrument also removes FCA investment firms from the provisions related to the resolution regime in the Banking Act 2009 and makes subsequent amendments to other legislation.

HM Treasury are taking FCA investment firms out of the scope of the resolution regime, as the impact from the failure of these firms differs from those of credit institutions (banks) and PRA-designated systematic investment firms. FCA investment firms will remain subject to relevant legislation and the FCA's existing rules and processes in place to facilitate the orderly wind-down of FCA investment firms. In addition, the Investment Bank Special Administration Regime (IBSAR) will be available to use to manage the failure of some investment firms. The FCA will also put in place through the IFPR new rules and guidance around winddown planning.

The PRA is also able to designate any investment firm as systemic in future if necessary, bringing these firms within the scope of the resolution regime.

Securitisation Regulation

This instrument also amends Securitisation Regulation (Regulation (EU) 2017/2402) references to FCA investment firms and groups, which previously relied on definitions in the CRR which have been amended by the FS Act to introduce the IFPR. The objectives of these definitional amendments are to maintain consistency with the IFPR, ensure that relevant professional investors in securitisations are

subject to the Securitisation Regulation's due diligence requirements (amendment to Article 2(12)) and ensure that the risk from securitisation positions is held by the correct financial entity (amendment to Article 6(4)).

Achieving these objectives will have the effect of supporting the effective implementation of the IFPR from 1 January 2022 and clarifying the application of the Securitisation Regulation's rules around appropriately accounting for and holding risk. Ultimately, this will better support the growth of a robust securitisation market in the UK.

Macro-prudential measures order

This instrument includes a minor change to The Bank of England Act 1998 (Macro-prudential Measures) Order 2013, such that the definition of "financial institution" is coherent with changes to the prudential framework which have been made since the Order was first introduced.

Fixing EU Exit deficiencies

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

3. What policy options have been considered, including any alternatives to regulation? Please justify preferred option

Basel changes (Basel 3 and NPL securitisation) and IFPR

For both regimes, the option of "do nothing" was considered. This was rejected as it would result in significant incoherence across the statute book. Such a result would not only be confusing for firms, but it could also lead to quite significant unintended consequences, such as the CRR regime becoming unusable, or all investment firms being scoped out of an existing piece of legislation e.g. because the term that refers to them will no longer exist.

No alternatives to legislation were considered given requirements currently sit in legislation and guidance/non-legislative measures cannot override legislation.

Application of the UK resolution regime to FCA investment firms

We considered alternative policy options that would keep some FCA investment firms in scope of the resolution regime. However, these options were not considered appropriate as we consider there to be limited additional benefit to keeping FCA investment firms in the UK resolution regime. Furthermore, there are high resource burdens of maintaining resolution plans and the FCA already has suitable processes in place to manage the failure of one of these firms.

Securitisation Regulation

We considered one alternative policy option, which was to keep the scope of the definition of 'institutional investor' the same as before the FS Act and the associated introduction of the IFPR. This would result in certain types of FCA investment firms staying out of the scope of the definition and therefore not subject to the Securitisation Regulation's due diligence requirements. These requirements are important for assessing the risk of a securitisation position.

However, this option would be problematic because it could result in some securitisation investors being exempt from scrutinising a securitisation position (e.g. by verifying that an investor has access to relevant disclosure information). This could potentially result in an investor taking a securitisation position without being subject to the Securitisation Regulation's due diligence

requirements and it could, consequently, increase risk in the UK securitisation market. Therefore, HM Treasury and the FCA agree that this option is not desirable.

Fixing EU Exit deficiencies

The powers in the EU (Withdrawal) Act 2018 are limited to fixing deficiencies and cannot be used to develop new policy beyond what is appropriate to address the deficiencies. The aim is to limit the disruption to, and burden on, firms by maintaining the status quo as far as possible. Most of the changes to retained EU law are functional changes and therefore there are no costs to businesses.

4. Please justify why the net impacts (i.e. net costs or benefits) to business will be less than £5 million a year.

Familiarisation costs

Basel changes (Basel 3 and NPL securitisation), IFPR and application of the UK resolution regime to FCA investment firms

The primary purpose of this instrument is to make consequential amendments to legislation following the making of the FS Act 2021, The Capital Requirements Regulation (Amendment) Regulations 2021 (SI 2021 No. 1078) and rules made by the PRA and FCA. These changes are to amend cross references, update language and to ensure coherence of the prudential legislative framework, following the implementation of the Basel standards and IFPR.

We expect that firms will need to understand the changes being made by familiarising themselves with the relevant legislation and these costs are likely to be absorbed into business-as-usual activities for compliance officers.

This instrument also provides for saving provisions for permissions which were granted to firms under the CRR. These provisions will save the effect of permissions granted to firms under the CRR where those articles are being revoked and replaced with CRR rules. This ensures that firms will not have to reapply for their permissions simply because the article in the CRR has been replaced by CRR rules. We anticipate that this will save firms from having to pay a very small, immaterial fee to the regulators for these permissions.

The PRA have already carried out a full consultation on their rules, impact assessment and cost benefit analysis on these rules and **therefore the impacts to business from the Basel and IFPR implementation have not been included in this Impact Assessment as these have been assessed through regulator consultation and cost benefit analysis**(bar those which affect the securitisation regulation which are detailed below).

These can be found at:

Basel 3: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2021/february/cp521.pdf?la=en&hash=430FBE3BF2D03AC61F86794BD9F09CDAE031E0E8

Non-performing loan securitisations: https://www.bankofengland.co.uk/prudential-regulation/publication/2021/june/implementation-of-basel-standards-non-performing-loan-securitisations

Leverage ratio: CP14/21 'Consultations by the FPC and PRA on changes to the UK leverage ratio framework' (bankofengland.co.uk)

The FCA have also carried out a full consultation, and cost benefit analysis on their rules to implement IFPR.

These can be found at:

IFPR and resolution: https://www.fca.org.uk/firms/investment-firms-prudential-regime-ifpr

As with the above, the impacts to business from removing FCA investment firms from the resolution regime have not been included in this Impact Assessment as these have been assessed through regulator consultation and cost benefit analysis.

These can be found at:

https://www.fca.org.uk/publication/consultation/cp21-26.pdf

Securitisation Regulation

Regarding the amendment to Article 6(4) (on ensuring that the correct entity holds the risk), after engaging industry stakeholders HMT did not identify any firms impacted by this amendment. Therefore, we estimate the net impact on investment firms is zero.

Regarding the amendment to Article 2(12)(g) (clarifying the types of investment firms in scope of the regulation and therefore subject to the due diligence requirement), the net impact to firms is expected to be £900,000 pa, based on the relevant firms investing in 20 securitisation positions per year. This figure represents the aggregate costs for firms to comply with the due diligence requirement when investing in securitisations. This figure has been calculated from information provided by the FCA and industry. The calculation is based on the type of investment firms impacted by the amendment (i.e. BIPRU and IPRU firms), the estimated number of these firms and the estimated cost of complying with the due diligence requirements.

Type of investment firm

As mentioned in section two, this instrument amends the Securitisation Regulation as a result of changes to the scope of definitions that will be brought about by the IFPR. The IFPR will impact FCA-regulated investment firms (previously categorised as IFPRU, IPRU and BIPRU).

IFPRU firms were already subject to the Securitisation Regulation and are therefore not considered in the calculations below. Instead, the calculations account for the number of, and costs incurred by, both IPRU and BIPRU firms that were not subject to the Securitisation Regulation (although they were subject to some due diligence requirements in other sectoral regulations). Not all previously exempt investment firms are expected to invest in securitisations and therefore be impacted by this amendment.

Number of investment firms

The number of investment firms that are expected to be impacted by this change is estimated to be 60. This is based on the estimated 3000 firms that will be brought into the scope of ‘institutional investor’ by the IFPR (see table below). In the past, however, the FCA has reported that only a very small fraction of those types of firms have reported holding a securitisation position (0.5% of those IPRU and BIPRU firms, or 15 firms).

The number of 15 firms has been increased fourfold to account for the possibility that the number of previously exempt investment firms holding securitisation positions has increased.

Firm category	%	Number	Included in Securitisation Regulation pre-IFPR	Included in Securitisation Regulation post-IFPR
IFPRU	18.9	700	Yes	Yes
BIPRU	46.1	1705	No	Yes
IPRU	34.9	1291	No	Yes
Total	**100**	**3700**	**N/A**	**N/A**

Estimated cost

The estimated cost of this amendment is £900,000 pa. This is based on the expectation that BIPRU or IPRU (see sensitivity analysis) firms invest in between 10-25 securitisations a year, with 25 being very much the upper limit. The estimated cost is based on these firms investing in 20 securitisation positions, which is both towards the upper limit and is considered a realistic estimate of the number of investments.

Each investment is expected to take approximately one hour of an analyst's time to analyse and document regulatory compliance. There are often quarterly monitoring meetings too, which are estimated to total two hours, including preparatory time, which are expected to involve one analyst and two senior managers. Therefore, the time taken on securitisation transactions per year is estimated to be 44 hours (1 hour x 20 transactions + 2 hours x 3 people x 4 quarterly meetings).

Based on industry intelligence, the estimated cost of one analyst and two senior managers' time is £10,000. It is also expected that these firms will spend approximately £2,500-£5,000 per year on legal advice, which could either be deal-specific or more general.

Therefore, the estimated overall cost is £15,000 pa (cost of time spent by one analyst + two senior managers + legal advice) multiplied by 60 firms (totalling £900,000).

Realistic estimate of no. of securitisation investments	Quarterly meetings	Number of hours work	Typical cost of 44 hours of 1 analyst and 2 senior manager's time (NB this time could be split in different ways)	Cost of legal advice	Total maximum cost per firm	Number of firms impacted
20 (requiring 1 hour of an analyst's time) – **total 20 hours**	4 (6 hours each for meeting and prep time, because of 1 analyst and 2 senior managers taking 2 hours each) – **total 24 hours**	20+24 **=44 hours**	£10,000	£2,500-5,000	**£15,000**	**60**
					Total maximum EANDCB	**£15,000 x 60 = £900,000**

<u>Sensitivity analysis</u>

As referenced in the 'Number of firms' subheading, the £900,000 pa figure has involved increasing the estimated number of firms impacted by this measure fourfold, from 15 to 60. Therefore, this figure can be considered the veritable upper bound and is still more than five times below the de minimis threshold.

EU Exit deficiencies

The powers in the EU (Withdrawal) Act 2018 are limited to fixing deficiencies and cannot be used to develop new policy beyond what is appropriate to address the deficiencies. The aim is to limit the disruption to and burden on firms by maintaining the status quo as far as possible. Most of the changes to retained EU retained law are functional changes to reflect that the UK has now left

the EU and therefore there are no costs to businesses arising from fixes from EU Exit deficiencies.

5. Please confirm whether your measure could be subject to call-in by BRE under the following criteria. If yes, please provide a justification of why a full impact assessment is not appropriate:

a) **Significant distributional impacts (such as significant transfers between different businesses or sectors)**
No

b) **Disproportionate burdens on small businesses**
There are a very limited number (if any) of small firms in scope of the changes applying to banks/systemic investment firms (i.e. the Basel 3 changes). For the IFPR there are small businesses in scope but, as explained above, these regulations will have no or limited direct impacts on the firms in scope. In the case of the amendments to the Securitisation Regulation, the impact on all investment firms, including those that classify as small businesses, are under the de minimis threshold.

c) **Significant gross effects despite small net impacts**
No

d) **Significant wider social, environmental, financial or economic impacts**
No

e) **Significant novel or contentious elements**
No

Sign-off for de minimis assessment: SCS

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

SCS of Green and Prudential Team

Signed: ***Fayyaz Muneer*** Date: 25/10/2021

SCS of Better Regulation Unit

Signed: ***Linda Timson*** Date: 21/10/2021

Sign-off for de minimis assessment: Minister

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

Signed: ***John Glen, Economic Secretary*** Date: 25/10/2021

Further information sheet

Please provide additional evidence in subsequent sheets, as required.