# EXPLANATORY MEMORANDUM TO

# THE CAPITAL REQUIREMENTS (CAPITAL BUFFERS AND MACRO-PRUDENTIAL MEASURES) (AMENDMENT) REGULATIONS 2015

**2015 No. 19**

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

This memorandum contains information for the Joint Committee on Statutory Instruments.

## 2. Purpose of the instrument

2.1 These Regulations introduce a capital buffer called the "systemic risk buffer" for banks, building societies and investment firms. This buffer is intended to make these firms more resilient to certain long-term systemic risks in the economy. The Regulations should be read with rules made, and individually binding requirements imposed, by the Prudential Regulation Authority and Financial Conduct Authority in relation to the systemic risk buffer.

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

3.1 None

## 4. Legislative Context

4.1 These Regulations implement Articles 133 and 134 of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms. This Directive is part of a package of legislation known as the Capital Requirements Directive IV ('CRD4'), which provides the framework for the authorisation and prudential supervision of banks, building societies and investment firms in the EU. 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.

4.2 Following recommendations made by the Independent Commission on Banking (ICB) in 2011, and the Government's White Paper on Bank Reform in 2012, the Government gave effect to its ring-fencing policy for banks in the Financial Services (Banking Reform) Act 2013. The additional capital buffer element of the ring-fencing policy recommended by the ICB and agreed by the Government remains outstanding. These Regulations, together with rules and individual requirements imposed by the

Prudential Regulation Authority and Financial Conduct Authority, implement this capital buffer.

## 5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

## 6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

## 7. Policy background

7.1 CRD4 sets out the EU's implementation of the Basel III macro-prudential framework. This consists of capital buffers and other macro-prudential tools which aim to address system-wide risks which may materialise.

7.2 Capital buffers, which are additional amounts of capital which firms should hold on top of their minimum capital requirements, should be maintained in normal times. They can then be depleted when firms face losses. This should help to mitigate the impact on the wider economy when a firm is in distress or facing failure - the purpose of the buffers is to increase the likelihood that the firms themselves absorb losses and not the taxpayer.

7.3 The UK has implemented all the capital buffers in CRD4, except the systemic risk buffer and OSII buffer, by means of the Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014 (S.I. 2014/894) (the "2014 Regulations") and rules and individual requirements imposed by the Prudential Regulation Authority and Financial Conduct Authority. These Regulations amend the 2014 Regulations to implement the systemic risk buffer.

7.4 The systemic risk buffer is an additional capital buffer which can apply to firms which are deemed to be systemic. Recital 85 of Directive 2013/36/EU provides that the buffer should '*prevent and mitigate long-term non-cyclical systemic or macro-prudential risks not covered by Regulation (EU) 575/2013, where there is a risk of disruption in the financial system with the potential to have serious negative consequences for the financial system and the real economy in a specific Member State*'.

7.5 There is a degree of flexibility in applying this buffer. Member States can decide which firms should meet this buffer. However, there should be notification outlining the reasons for the use of the systemic risk buffer to the European Commission, the European Systemic Risk Board, the European Banking Authority and the competent and designated authorities of the Member States where this may have impact.

7.6 The UK intends to use the systemic risk buffer to implement the recommendation made by the Independent Commission on Banking in 2011, and subsequently agreed by HM Treasury in its 2012 White Paper, that ring-fenced banks and large building societies hold additional capital due to their relative importance to the UK economy. This will help achieve the policy objective of ensuring that the ring-fenced banks and building societies are able to carry out their core activities in times of distress, with an overall aim of helping to tackle the 'too big to fail' problem. The systemic risk buffer will apply to all the exposures of these firms.

7.7 The UK's systemic risk buffer will effectively apply to large banks with "core" deposits of more than £25bn. Large building societies are also subject to the systemic risk buffer, but as they will not be ring-fenced since they are not permitted by law to conduct high-risk activity, the principle of "core" deposits does not apply to them. An equivalent threshold is applicable to building societies to determine whether they are in scope.

7.8 The Bank of England's Financial Policy Committee (FPC) will be responsible for setting out the framework for determining which institutions should hold the buffer and, if so, how large the buffer should be. So capital buffers of 0-3% of firms' risk-weighted assets will apply to firms under scope, depending on the FPC's criteria. The FPC will need to publish this methodology by 31st May 2016. The Prudential Regulation Authority will be responsible for applying the framework and will have ultimate discretion over which firms must hold the buffer and its size - as this is a firm specific decision to be decided on an entity by entity basis.

7.9 The systemic risk buffer is applicable from 1 January 2019.

7.10 Other EEA states may also introduce systemic risk buffers, which may apply to a wider range of firms than the UK's systemic risk buffer. There are reciprocity provisions in Article 134 of Directive 2013/36/EU, which are implemented in these Regulations. The Prudential Regulation Authority will have the discretion to decide whether such a rate is recognised in the United Kingdom. Where it is recognised, the Prudential Regulation Authority and the Financial Conduct Authority will decide which of the UK entities they regulate must apply the rate in the calculation of their systemic risk buffers. Where a firm is required to apply such a rate, the rate will apply only to exposures located in the EEA state concerned.

- Consolidation

7.11 The Government does not currently intend to consolidate the Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014.

## 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 consulted on its response to the policy proposals made by the Independent Commission on Banking's proposals in its 2012 White Paper on banking reform. The Government agreed with the recommendation that ring-fenced banks and large building societies should meet an additional capital buffer. This can be found at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223566/PU1488_Banking_reform_consultation_-_online-1.pdf

8.3 The UK Treasury informally consulted on how to replicate for large building societies the way ring-fenced banks are brought within scope of the systemic risk buffer. Banks which come under scope of the ring-fence rules need to have at least £25bn of 'core' deposits. However, as large building societies are not being ring-fenced, an equivalent threshold was needed to determine which building societies would come under scope.

## 9. Guidance

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

## 10. Impact

10.1 The Government completed an impact assessment on the application of the systemic risk buffer for ring-fenced banks and large building societies, which can be found at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223566/PU1488_Banking_reform_consultation_-_online-1.pdf

10.2 The impact assessment showed that the ongoing annual private costs of the entirety of the ring-fencing proposals to UK banks would be £1.7 bn- £4.4 bn, with a cost of £0.4 bn - £1.9 bn to the UK's annual GDP. The annual gross domestic product benefit would be an increase of £7.1bn (in 2011-2012 terms).

10.3 An Impact Assessment has not been prepared for this instrument.

## 11. Regulating small business

11.1 The UK's systemic risk buffer is designed so that only the largest firms (those with retail deposits of more than £25bn, or equivalent) will be required to meet higher capital buffer requirements. Where an EEA rate is recognised by the Prudential Conduct Authority, it may be applied to smaller firms. The Prudential Regulation Authority and the Financial Conduct Authority will decide which small firms should apply EEA rates which have been recognised in the UK. The Financial Conduct Authority regulates many such small firms and is expected to consult on their approach.

## 12. Monitoring & review

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

## 13. Contact

Aisha Khalid at HM Treasury (telephone 020 7270 6955 or email: Aisha.Khalid@hmtreasury.gsi.gov.uk) can answer any queries regarding the instrument.