Title: Amendments to the Financial Policy Committee's Powers of Direction	De minimis assessment
SI No: 2021/869	**Date:** **08/06/2021**
Other departments or agencies: **Bank of England**	**Type of regulation:** **Domestic**
Contact for enquiries: **Will Crabtree**	**Date measure comes into force:** **21/07/2021**
Cost of Preferred (or more likely) Option **One-off familiarisation costs totalling £20,600 for all businesses we expect to be affected**	**Net cost to business per year** (EANDCB in 2019 prices) **N/A**

1. What is the problem under consideration? Why is government intervention necessary? (Maximum 5 lines)

The Financial Policy Committee (FPC) may give a direction to the Financial Conduct Authority (FCA) or the Prudential Regulation Authority (PRA) to act to implement certain macro-prudential measures, as set out in the Bank of England Act 1998; four such measures are currently set out in secondary legislation (listed below).

- The Bank of England Act 1998 (Macro-prudential Measures) Order 2013/644
- The Bank of England Act 1998 (Macro-prudential Measures) (No.2) Order 2015/905
- The Bank of England Act 1998 (Macro-prudential Measures) Order 2015/909
- The Bank of England Act 1998 (Macro-prudential Measures) Order 2016/1240

The FPC also has the power to make recommendations to the PRA and FCA, including on a 'comply or explain' basis.

The FPC currently has no outstanding directions under the above instruments.

The Financial Services Act 2021 (FS Act) granted the PRA new regulatory powers in relation to holding companies that have been designated or approved by the PRA. To reflect this the FS Act therefore extends the FPC's power of direction and recommendation to include approved or designated holding companies. However, without amendment, this will not apply to the existing powers of direction which parliament has granted to the Committee in relation to Sectoral Capital Requirements and the leverage ratio.

It is necessary for the government to make a small number of amendments to the four macro-prudential measure Orders referenced above to ensure the macro-prudential measures prescribed within them can be used as intended and reflect the enactment of the FS Act.

In addition, within the macro-prudential measure setting out the FPC's powers of direction over the leverage ratio, the term "total exposure measure" (TEM) is defined by reference to the Capital Requirements Regulations (CRR). In effect, the current definition of the TEM prevents the FPC from using its power of direction if it wishes to implement a leverage ratio with an alternative definition of the TEM. In 2016, the FPC recommended excluding central bank exposures from the UK TEM. Since then, the UK leverage ratio has been specified through the FPC's power of recommendation rather than its powers of direction.

2. What are the policy objectives and the intended effects? (Maximum 5 lines)

The core policy objective of these regulations is to ensure the FPC can use its powers of direction as originally intended by:

- Removing the reference to Capital Requirements Regulation in the definition of the TEM and instead defining this by reference to the PRA rules. This is because the original reference is outdated and prevents the effective use of this macro-prudential measure.
- Reflecting that the TEM will no longer be prescribed by EU law, granting the FPC the power to direct the PRA in how it calculates the TEM when it judges this is necessary for macro-prudential purposes.
- Reflecting the fact that holding companies designated by the PRA will become responsible for meeting group consolidated and sub-consolidated requirements. It will do this by allowing the FPC to direct the PRA to exercise its functions over those holding companies to implement leverage and sectoral capital requirements.

3. What policy options have been considered, including any alternatives to regulation? Please justify preferred option (Maximum 5 lines)

The main alternative policy option considered was to not make these changes.

If no changes were made the FPC would still be able to use its power of recommendation and would accordingly continue to set the UK leverage ratio framework by making recommendations to the PRA. Similarly, it could make recommendations to the PRA in relation to how it exercised its functions over holding companies following the enactment of the FS Act.

However, this option would mean that the FPC's powers of direction would not be consistent with recent legislative developments, such as the enactment of the FS Act. In practice this would make it challenging for the FPC to use its powers of direction which the government does not consider consistent with the original intent of the FS Act. It would also mean the FPC's powers over the leverage ratio become effectively inoperable.

The relative costs and benefits of the policy option have been agreed with the Bank of England. The FPC were also consulted and agreed with the preferred option.

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

One off costs: One-off familiarisation costs totalling £20,600 for all firms we expect to be affected

Overall, the government expects these changes to have a negligible impact on firms. This broadly reflects that the macro-prudential measures can already be implemented as proposed via the FPC's powers of recommendation so we would not expect this to lead to a substantive change from the status quo for firms. Whilst in theory the PRA could refuse to implement a recommendation, this has not happened since the FPC was created and the PRA currently follow the FPC's existing recommendations over the leverage ratio.

However, each change is addressed in greater detail below.

We also anticipate familiarisation costs for compliance officers to be low. Whilst compliance officers will predominately need to familiarise themselves with PRA rules, which should be unaffected by this change, we recognise that they will want to:

- familiarise themselves with how the macro-prudential measures have been amended; and
- familiarise themselves with any amendments that the FPC makes to its policy statement on how it intends to use its powers of direction.

The assumed costs are summarised in the table below. At a conservative estimate we do not anticipate the changes to the regulations and policy statements to total more than 10 pages. Taking 10 pages at 500 words per page = 5000 words. The mean hourly wages of in-house compliance staff are expected to be £40 per hour. These wage costs are inflated by 30% to reflect non-wage labour costs.

Reading speed declines with text complexity. An assessment of the complexity of this information yields a Flesch-Kinkaid readability score that suggests a reading speed of 80 words per minute. At 5000 words, this suggests a reading time of 1 hour. The familiarisation costs to each financial institution in scope will therefore be £54, assuming the cost of one compliance officer.

Therefore, taking an average cost of £54 and multiplying it by 380 (the approximate number of firms we expect to be affected) leads to an upper estimate for total up-front cost to firms of £20,600.

Length of changes to regulations and policy statements	10 pages (5000 words)
Mean hourly wage costs of in-house compliance costs	£40 per hour
Reading time	1.0 hours
Familiarisation cost per institution	£54
Anticipated number of firms we expect to be affected	380
Total familiarisation costs	**£20 600**

<u>Changes to the definition of total exposure measure and the FPC's powers over how it is defined</u>
The change will give the TEM in the FPC's power of direction the same meaning as it has in the PRA rules, rather than the CRR.

The FPC already has the ability to recommend to the PRA that it implements a leverage ratio with a definition of total exposure which is different to that contained in the CRR. In fact, since 2016 the UK leverage ratio has been implemented this way and affects major UK banks with retail deposits greater than £50bn. The PRA separately sets a supervisory expectation for all firms to 'consider whether their degree of leverage is appropriate against the internationally agreed measure of leverage'. Therefore, there should be no significant incremental costs to businesses from defining total exposure by reference to PRA rules, given this occurs in practice already.

Similarly, we do not anticipate significant incremental costs to affording the FPC the power to prescribe conditions for how the PRA defines the TEM when implementing a macro-prudential measure in relation to leverage. As stated above, the PRA have already complied with FPC recommendations in relation to how this is defined, and it is impossible to predict how policy over the leverage ratio would differ if the FPC can require (rather than recommend) the PRA to alter the definition.

It is difficult to disaggregate the impact that an amendment to how the total exposure measure is calculated could have from any potential future changes to the broader leverage ratio framework (which it can already issue directions over). For example, when the FPC recommended that central bank reserves were excluded from the total exposure measure in 2016, it recalibrated the minimum leverage ratio from 3.0% to 3.25% to broadly maintain the same levels of aggregate capital required by UK banks.

The FPC and PRA have jointly stated their intention to review the UK leverage ratio framework, but the government cannot anticipate these changes, and in any case does not believe there are any incremental costs from implementing any changes via either a recommendation or a direction.

<u>Changes relating to holding companies</u>
The FS Act will ensure that holding companies are responsible for group consolidated and sub-consolidated requirements once they have been approved/designated by the PRA. Equally the FS Act will allow the FPC to make recommendations to the PRA in relation to PRA-approved/designated holding companies. Therefore, we do not anticipate that extending the FPC's powers of direction to reflect these changes will bring any incremental costs to these firms.

Ongoing costs: N/A
We do not anticipate these amendments will create ongoing costs for firms. As stated above, these changes do not change the powers of the PRA, they simply allow the FPC to prescribe that the PRA implement these measures as proposed here as opposed to recommending them. Furthermore:

- Any directions issued to the PRA by the FPC will be a matter for the FPC. The FPC must prepare and maintain a written statement of the general policy that it proposes to follow in relation to the exercise of its power of direction so far as it relates to that particular measure.
- In the exercise of its functions, the FPC must also have regard to the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction.
- Under section 9S of the Bank of England Act 1998, when issuing a recommendation or direction the FPC must publish an estimate of the costs and benefits that would arise from compliance with the direction or recommendation in question (if it is reasonably practical to do so).
- Similarly, any future amendments to the definition of the TEM will be a matter for the PRA (and subject to any directions or recommendations made by the FPC). Any major deviations from their current approach and the associated costs/benefits to firms will be caused by their rules. Furthermore, the PRA will be required to do their own cost benefit analysis (CBA) and this will be made publicly available. Therefore, it is not required for HM Treasury to do its own CBA on the impact of potential future changes in PRA rules.

Review

Order 2013/644 and Order 2016/1240 already include provisions requiring the regulations to be reviewed every 5 years. These regulations will introduce equivalent requirements for Order 2015/905 and Order 2016/1240. The Orders (as amended) will therefore be reviewed in 2026.

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**
No, as outlined above we do not expect these amendments to lead to a substantive change in the status-quo for businesses and familiarisation costs are low so small businesses will not face disproportionate burdens.
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 Financial Stability Group

Signed: **Lowri Khan** Date: 14/04/2021

SCS of Better Regulation Unit

Signed: **Linda Timson** Date: 21/04/2021

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*** Date: 08/06/2021