EXPLANATORY MEMORANDUM TO

THE CAPITAL REQUIREMENTS (AMENDMENT) REGULATIONS 2010

2010 No. 2628

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

2. Purpose of the instrument

2.1 These Regulations implement, in part, Directive 2009/111/EC of the European Parliament and of the Council amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements and crisis management ("CRD2"). The Regulations impose new requirements on the Financial Services Authority ("FSA") in relation to its supervision of cross-border banking and investment firms.

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

3.1 None.

4. Legislative Context

4.1. The Capital Requirements Directive ("CRD"), which comprises Directive 2006/48/EC (the recast Banking Consolidation Directive) and 2006/49/EC (the recast Capital Adequacy Directive), provides the framework for the supervision of banks and certain investment firms in the EU. The CRD was implemented in the UK partly by the Capital Requirements Regulations 2006 (S.I. 2006/3221 – the "2006 Regulations") and partly by rules made by the FSA. CRD2 amends several aspects of the CRD, including the provisions dealing with supervisory arrangements and crisis management, which were originally implemented by the 2006 Regulations. These Regulations implement those changes by way of amendments to the 2006 Regulations. Other changes made by CRD2 are being implemented by the FSA by way of amendments to its rules. CRD2 is the first in a series of three Directives making changes to the CRD.

Scrutiny Committee History

4.2. The Treasury submitted explanatory memorandum 13713/08 (dated 21 October 2008) to Parliament in relation the proposal for CRD2. The House of Commons European Scrutiny Committee reported on the proposal in its Thirty-Eighth Report (2007-08) and its First Report (2008-09) chapter 1,

clearing it on 26 November 2008 following debate[1]. The House of Lords European Union Select Committee cleared the document from scrutiny on 25 November 2008 following correspondence with Ian Pearson MP (letter dated 13 November 2008) as reported in its Seventeenth Report (2007/08)[2]. Ian Pearson wrote a further letter to update both Committees on negotiations on 22 April 2009.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 Mark Hoban MP, the Financial Secretary to the Treasury, has made the following statement regarding Human Rights:

"In my view the provisions of the Capital Requirements (Amendment) Regulations 2010 are compatible with the Convention rights".

7. Policy background

What is being done and why

7.1 The CRD sets out the EU framework for the prudential supervision of banks, building societies and certain investment firms by setting minimum rules on capital requirements (in line with internationally agreed standards known as "Basel II"), providing a framework for supervision by national supervisors and establishing a information disclosure regime. CRD2 contains a package of reforms to the CRD dealing in particular with improvements to the quality of capital, the management of large exposures, and improving supervisory arrangements in particular for firms operating cross-border. These form part of the Commission's response to the financial crisis.

7.2 These Regulations are necessary in order to implement in the UK those amendments concerning the supervisory arrangements. The amendments aim, in particular, to strengthen the EU supervisory framework for cross-border banking and investment groups by ensuring more effective co-operation and coordination between national supervisors, by:
- requiring the FSA to reach a joint decision with other EU supervisors on the consolidated level of capital to be held by a cross-border group which contains an entity established in the UK;

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[1] http://www.publications.parliament.uk/pa/cm200708/cmselect/cmeuleg/16-xxxiv/16xxxi10.htm

http://www.publications.parliament.uk/pa/cm200708/cmselect/cmeuleg/16-xxxv/16-xxxv.pdf

[2] http://www.publications.parliament.uk/pa/ld200708/ldselect/ldeucom/17/1712.htm

- requiring a college of supervisors to be established for all cross-border groups to improve the exchange of information and the planning of supervisory activities by the relevant national supervisors;
- enabling better access for the FSA to information about "significant" UK branches of foreign firms;
- requiring the FSA to have regard to the implications of its decisions on financial stability in other EEA states;
- improving information sharing between the FSA, Bank of England and other EEA central banks and supervisors, in particular in emergency situations.

There are also amendments to the provisions in the 2006 Regulations on recognition of external credit assessment institutions, which take into account the new EC Regulation on Credit Ratings Agencies (EC Regulation 1060/2009).

7.3 The changes to the supervisory framework are intended to reduce the likelihood and impact of any further financial crises and the associated economic and social costs. Improving the coordination of supervisory activity will also bring a general reduction in the compliance burden on firms.

Consolidation

7.4 There are no current plans to consolidate these amendments to the 2006 Regulations. It is likely that further amendments will be required to the 2006 Regulations when the other Directives amending the CRD have been finalised and further consideration will be given at that time to consolidation.

8. Consultation outcome

8.1 The European Commission undertook a public consultation on its proposed changes to the CRD from 16 April to 16 June 2008, prior to issuing its formal proposal for CRD2. There was general support for the changes relating to the supervisory arrangements. Further details of the responses, including those from businesses in the UK, are available at http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm#amendments.

8.2 The Treasury undertook a 12-week consultation from 5th January to 30th March 2010 on the approach towards implementing CRD2, which included a draft of the Regulations. Views were sought, in particular, on whether the draft Regulations implemented CRD2 in a clear and appropriate manner without introducing superequivalence. A copy of the consultation document is available at http://www.hm-treasury.gov.uk/consult_capital_requirements_directive.htm.

8.3 Only one response was received to the consultation. This supported the Treasury's approach to drafting the Regulations and raised no other issues directly concerning the proposed approach to implementation.

9. Guidance

9.1 The Treasury is not planning to issue any guidance on the Regulations.

10. Impact

10.1 The Regulations are not expected to have any material impact on charities or voluntary bodies. There is no direct impact on business, as the Regulations only impose obligations directly on the FSA and the Bank of England. However, there will be an indirect impact on UK banks and investment firms which are members of cross-border groups or which constitute significant UK branches of foreign firms. These firms will be subject to the new supervisory arrangements which are expected to reduce the compliance burden on firms.

10.2 In relation to the public sector, the Regulations have a direct impact on the FSA and the Bank of England. The new requirements will improve supervisory co-ordination across the EEA.

10.3 An impact assessment is attached to this memorandum.

11. Regulating small business

11.1 The Regulations place no direct obligations on business, in particular smaller firms. As indicated above, there may be an indirect impact on UK branches of foreign banking or investment firms or members of cross-border banking or investment groups, but these are unlikely to constitute small businesses.

12. Monitoring & review

12.1 CRD2 requires the European Commission to continue to monitor the effectiveness of the CRD as a whole, and provides for the Commission to review and report on specific provisions by certain deadlines over the next two years. This may result in further amendments to the CRD.

13. Contact

Conor Macmanus at HM Treasury Tel: 020 7270 5593 or email: Conor.Macmanus@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.

Title: **Impact Assessment of CRD 2 regulations** **Lead department or agency:** HM Treasury **Other departments or agencies:**	**Impact Assessment (IA)** **IA No:** **Date:** 01/09/2009 **Stage:** Enactment **Source of intervention:** EU **Type of measure:** Secondary legislation **Contact for enquiries:** Conor MacManus

Summary: Intervention and Options

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

The financial crisis revealed demonstrable short comings in the regulatory framework with regards to cross-border supervisory arrangements.

In response to this, in September 2009 the European Parliament and Council adopted a Directive (CRD 2) aimed at improving cross-border supervisiory cooperation. The UK is obliged to transpose CRD2 by 31 October 2010 and this requires amendments to be made by HMT to the Capital Requirements Regulations 2006, which implement the existing CRD provisions on supervisory arrangements. HMT is required to transpose the regulations related to supervision whilst the revisions related to securitisations and risk management will be implemented through the FSA rule book.

What are the policy objectives and the intended effects?

The policy objective and intended effect of those amendments to the CRD are to strengthen the supervisory framework for cross-border banking and investment groups by establishing colleges of supervisors to foster stronger co-operation between supervisors of cross border groups. CRD 2 intends to reduce the likelihood and impact of any further financial crises and the associated economic and social costs, which are typically loss of GDP resulting from a constriction of credit conditions and the resulting impacts on businesses. The objective of the Regulation is to create an requirement for the FSA to co-operate with superviors in other EEA states, and to meet the obligation on Member States to transpose CRD 2 by 31 October 2010 and to apply those provisions from 31 December 2010.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

As CRD2 is an EU directive, the UK is under a legal obligation to implement it in accordance with the timelimits prescribed. CRD2 amends the CRD, which was implemented in the UK, in part, by way of Regulations made in 2006. As such, the most sensible approach to implementation is to amend those 2006 Regulations and there is limited scope for different options in the way the amendments are made. The amending Regulations follow the "copy out approach" to transposition. We have not identified any areas where it is desirable to implement further legislation over and above the minimum requirements of the Directive. The only plausible alternative would be to create new regulations rather than amending the 2006 regulations, however amending the regulations is the more efficient and time effective approach.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	It will be reviewed 01/2012
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

SELECT SIGNATORY Sign-off For enactment stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible SELECT SIGNATORY: ..... Date: 9/10/10

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Summary: Analysis and Evidence

Policy Option

Description:

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Marginal		Marginal	**Marginal**
High	Marginal		Marginal	**Marginal**
Best Estimate	Marginal		Marginal	**Marginal**

Description and scale of key monetised costs by 'main affected groups'

The FSA, together with other national regulators, will have to establish supervisory colleges to deal with the regulation of cross-border groups that operate in a number EEA juristictions.
The net impact of the additional supervisory obligations resulting from the establishment of supervisory colleges on the Financial Services Authority is expected to be marginal as cooperation and sharing of information is already largely undertaken by the FSA as a matter of best practice.

Other key non-monetised costs by 'main affected groups'

Zero

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A		N/A	**N/A**
High	N/A		N/A	**N/A**
Best Estimate	N/A		N/A	**N/A**

Description and scale of key monetised benefits by 'main affected groups'

We expect an overall reduction in industry compliance costs as a result of greater efficiency of supervision and a reduction in the number of overlapping and conflicting regulatory requirements. This is not quantifiable as it is not possible to determine in advance the extent of changes in supervisory behaviour.

Other key non-monetised benefits by 'main affected groups'

The amendments will increase the efficiency of supervision through greater cooperation which would lead to reduced competitive distortions arising from differential approaches to supervision, enhanced financial stability, increased access to information for host supervisors; and improved crisis management solutions for cross-border groups. In aggregate, the amendments will reduce the potential economic and social crisis related costs for both investors and creditors.

Key assumptions/sensitivities/risks **Discount rate (%)**

The key assumption that informs this impact assessment is that greater supervisory cooperation and information sharing will ensure more effective regulation of cross-border groups. CRD 2 will ensure that these practices applied across the EU. The key risk is that supervisory cooperation could become obstructed by overly bureaucratic processes in the supervisory colleges. To mitigate this risk the FSA will engage with CEBS.

Impact on admin burden (AB) (£m):			Impact on policy cost savings (£m):	In scope
New AB:	**AB savings:**	**Net:**	**Policy cost savings:**	No

nforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			Other		
From what date will the policy be implemented?			31/12/2010		
Which organisation(s) will enforce the policy?			HMT		
What is the annual change in enforcement cost (£m)?			Marginal		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			No		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** Zero	**Non-traded:** Zero	
Does the proposal have an impact on competition?			Yes		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:**	**Benefits:**	
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	**Impact**	**Page ref within IA**
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	6
Small firms Small Firms Impact Test guidance	Yes	7
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

[1] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
1	http://ec.europa.eu/internal_market/bank/docs/regcapital/resume_impact_assessment_en.pdf
2	http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0602:FIN:EN:PDF
3	
4	

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs										
Annual recurring cost										
Total annual costs										
Transition benefits										
Annual recurring benefits										
Total annual benefits										

* For non-monetised benefits please see summary pages and main evidence base section

Evidence Base (for summary sheets)

Addressing market failures

Significant progress has been made in developing a single market in financial services across the EU. However, while many areas of the supervisory requirements have been harmonised, supervision takes place on a national basis. Therefore a key component of harmonising standards and facilitating greater cross-border competition is the effective coordination of supervisory activity between national supervisors. Where this coordination is sub-optimal there will be increased compliance burden on cross-border firms that have to deal with multiple national regulators.

Changes introduced to the CRD make explicit the obligations on the consolidating supervisor of a cross-border group. This will reduce the level of conflict and overlap in supervisory activity between national supervisors by improving the level of coordination that occurs. More efficient supervision will reduce the compliance burden, which in turn should lead to greater cross-border competition. The Committee of European Banking Supervisors ("CEBs") will help ensure this outcome by promoting convergence and monitoring the activities of supervisory colleges to aid consistency.

Improving the effectiveness of colleges should also lead to better detection of the early signs of stress, as a wider range of information will be assessed on a timely basis by a broader group of supervisors, who will each benefit from seeing a fuller picture. The ability to create more coordinated contingency plans will lessen the tendency for national interests to result in suboptimal decision-making that could have an adverse outcome for the UK. It is also apparent that there may currently be legal impediments to the sharing of information between supervisors, central banks and finance ministries in crisis situations, which these amendments will force Member States to address. Taken together, these improvements will improve financial stability and lessen the social and economic costs arising from banking crises.

For host supervisors there are significant benefits arising from these amendments. Currently a host supervisor is not entitled to receive specific prudential information relating to a branch operating in their jurisdiction. The UK hosts a large number of branches, and where a branch is large enough to pose a threat to financial stability, the FSA may be left with inadequate information to match up to their responsibilities. By allowing the FSA to designate certain branches as 'significant', and therefore to participate in that supervisory college, they will gain access to the information that is appropriate to their obligations and will be better able to ensure financial stability.

As part of supervisory best practice the FSA is already involved in supervisory colleges at an international level and regularly shares information with other supervisors. Therefore the additional cost to them as a result of this regulation should be marginal. The key risk relating to the impact of CRD 2 is that the requirements are placed on the FSA in a overly bureaucratic manner. This risk will be mitigated through FSA engagement with CEBs.

Overall, the amendments should lead to a reduction in the compliance costs experienced by cross-border firms, by reducing multiple and conflicting data requests. For supervisors the incremental costs will be marginal as the financial crisis has already driven improved supervisory cooperation and in several areas these amendments merely formalise existing requirements. To the extent that more robust supervisory arrangements minimise both the frequency and severity of future crises, there will be a reduction in the associated social and economic costs.

Hampton principles

The provisions largely facilitate, but place no direct burdens, on businesses, as they enable the FSA to take part in a system of enhanced supervisory cooperation. The FSA has been assessed as complying well with Hampton principles: the activities of the FSA are risk-based, principles-based and proportionate. No new information burdens will be placed on new businesses.

Super-equivalence

Implementation will be delivered using a copy-out approach and does not add to the minimum EU requirements.

Competition

Having assessed this legislation against the OFT's criteria on competition impacts, we believe these proposals raise no significant competition concerns. Rather, there are several ways in which the legislation may facilitate greater cross-border trade and reduce competitive distortions. We therefore expect the legislation to have a positive impact on competition.

Small firm impact test

The Government is required to examine the impact on businesses with fewer than 50 employees and to quantify the annual costs placed on micro, small and medium size businesses. The legislation places no direct obligations on firms. The obligations placed on the FSA by this legislation are targeted at larger cross-border firms. A small firm is not likely to meet the criteria to be designated as a significant branch. Further, the FSA operates a risk-based approach, focusing more supervisory resources on higher impact, higher risk firms, and ensuring regulation is proportionate to the size of the firm. This legislation will therefore have no materially adverse impact on small firms.

The following has also been considered in this assessment:

- legal aid;
- sustainable development;
- carbon assessment and other environment;
- health;
- race, disability, gender equality;
- human rights; and
- rural proofs.

There is no material impact on these areas of consideration

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review]; N/A
Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?] N/A
Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach] N/A
Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured] N/A
Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives] N/A
Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review] N/A
Reasons for not planning a PIR: [If there is no plan to do a PIR please provide reasons here] There is no plan to undertake a PIR because the costs of CRD 2 on the public, private and third sector is marginal.

Add annexes here.