Regulatory Policy Committee	**Opinion**	
Impact Assessment (IA)	Amendment to the Financial Services (Banking Reform) Bill – introducing a bail-in power	
Lead Department/Agency	HM Treasury	
Stage	Final	
IA number	Not Provided	
Origin	Domestic	
Expected date of implementation (and SNR number)	SNR 8	
Date submitted to RPC	15/10/2013	
RPC Opinion date and reference	30/10/2013	RPC13-HMT-1931
Overall Assessment	**GREEN**	

RPC comments

The IA is fit for purpose. HM Treasury explain the proposal is out of scope of One-In, Two-Out (OITO) as it is specifically intended to reduce systemic risk in the UK banking sector.

The opinion highlights some analytical issues with the evidence presented. Addressing these would improve the overall quality of the IA, including further discussion for early implementation of the anticipated European Banking Recovery and Resolution Directive.

Background (extracts from IA)

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

"The financial crisis exposed problems in the global financial system where regulators were unable to effectively deal with institutions in serious difficulty. When large, systemic banks failed, they could not be allowed to enter insolvency due to the effect that would have on those who relied on the critical services provided by the bank, and the wider impact on financial stability. This meant that the losses of failing banks were not borne by creditors, as they would have been if the failing banks had entered insolvency, but by the taxpayer, who was called upon for billions of pounds to bail-out failing banks. This highlighted the need for more effective methods of dealing with failing banks."

What are the policy objectives and the intended effects?

"The policy objective is to be able to resolve banks more easily if they fail, by providing a mechanism by which losses can fall on creditors of the failing bank without the bank first entering an insolvency process. This will allow failing banks to be resolved in a manner that does not threaten the provision of essential services to the real economy and without requiring a public "bail out", reducing the cost to Government finances. It will also help to curb excessive risk taking in financial markets and curtail the implicit government guarantee that large banks are seen to benefit from. Meeting these objectives will reduce the probability and

severity of future financial crises, leading to greater financial stability."

Comments on the robustness of the OITO assessment

The IA says *"This measure specifically intends to reduce the systemic risk in the UK banking sector by increasing financial stability."* (paragraph 47 of the IA). While the Department has provided limited explanation to support this assessment, the conclusion appears reasonable and is consistent with current One-in, Two-out Methodology (paragraph 1.9.8 v. "Financial systemic risk" of the Better Regulation Framework Manual).

Comments on the robustness of the Small & Micro Business Assessment (SaMBA)

The proposals regulate business and are intended to come into force after 1 April 2014. Therefore the SaMBA is applicable.

The SaMBA is sufficient. The Department explains that *"…there will be no impact on small or micro businesses as even the smallest banks will not be either small or micro businesses. Even if there were such small banks, the Government anticipates that it will not meet the statutory test for use of the* [bail-in] *tool…"* The Department adds that *"…there is no expected impact on SME lending rates."* (Paragraph 40 of the IA.)

However, the SaMBA could be improved by providing further discussion and analysis of the potential scale and cost to small and micro-businesses as customers of banks, in particular if banks do decide to pass on any increase in costs**.** While these costs are indirect, they represent a potential impact on small and micro-businesses as a result of the policy.

Quality of the analysis and evidence presented in the IA

HM Treasury explains in its IA that the proposal is intended to give regulatory authorities the power to 'bail-in' a failing financial institution with the aim of curtailing the perceived implicit government guarantee (page 4 of the IA).

Wider economic impact of the proposal. The Department sets out that there could be a potential impact on the economy through increased lending rates to the real economy. The Department considers this cost to be negligible as the order of magnitude is smaller than usual changes in the Base Rate made by the Bank of England (paragraph 26 of the IA). However, given the large numbers involved, even a very small change would result in a large total cost. The Department should consider the potential size of this impact.

Quantification of benefits. The Department has not monetised any of the benefits in the IA. Even if monetisation is not possible, the Department should attempt to provide a fuller discussion of the potential benefits of the preferred policy option to assist decision-makers when considering whether the benefits justify the costs.

Range of costs of the proposal on business. While the estimate of the impact of the proposal (paragraph 22 of the IA) is wide-ranging – between £75m and £220m - it is not clear if it reflects the extent of the uncertainty. The IA states that estimates of the cost of the introduction of a bail-in regime range from "minimal" to an increase of 87 basis points on borrowing costs (paragraph 13). HMT has used a 50 basis point increase as the upper bound estimate on the basis that the 'No Creditor Worse Off' principle provides reassurance to creditors, which *"should result in a reduced impact in banks' funding costs. The Commission's analysis suggests this may reduce the funding cost increase by around 50%"*. Given the uncertainty associated with the level of basis point increases, the Department should have considered a wider range of possible estimates.

Early implementation of the European Banking Recovery and Resolution Directive (BRRD) – 'gold-plating'. The Department explains that the preferred policy objective is to introduce a bail-in tool earlier than envisaged under the current EU timeline for a Directive in this area (page 1 of the IA). The justification to do so now is on the basis that negotiations at the European level *"…have now progressed to a sufficiently advanced state that we can now respond positively to* [the recommendation of the Parliamentary Commission on Banking Standards], *by bringing in bail-in powers domestically without risking having to adapt to a radically different regime when the BRRD is implemented."* (paragraph 4 of the IA). The Department has indicated that early implementation represents going beyond minimum EU requirements. The IA would benefit from providing further discussion of the need to implement in advance of the transposition deadline. In so doing, the Department should also explain more fully why it has not been considered necessary to put in place domestically derived bail-in powers until now.

Time period covered by the IA. The assessment of impact is based on a 1 year timescale at which point EU provisions are expected to come into force in the UK. However, the Directive is likely to offer flexibility to permit transposition of this provision as late as January 2018 (paragraph 7 of the IA). The IA should reflect what steps:

(a) the Department proposes to take to identify and account for any ongoing costs and benefits of the proposal if adoption of the Directive at the European level is delayed, or transposition into UK is later than envisaged; and

(b) account for the costs and benefits of the proposal for the period from early implementation up to January 2018, if such flexibility is built into the BRRD.

Signed		**Michael Gibbons,** Chairman