Opinion: Consultation stage IA
Origin: Domestic
RPC reference number: RPC15-HMT-3091(1)
Date of implementation: January 2016

The Financial Policy Committee's tools over the buy-to-let mortgage market

HM Treasury

RPC rating: fit for purpose

Description of proposal

The buy-to-let mortgage market could pose broad risks to UK financial stability. The proposal will allow the Government to grant the Bank of England's Financial Policy Committee (FPC) powers of direction over the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), with regard to the buy-to-let sector. This will allow the Bank of England to direct these regulators to require lenders to place limits on lending in the buy-to-let market. This would be with reference to setting:

- maximum loan-to-value (LTV) ratios – the ratio of the mortgage value to the property value; and
- minimum interest coverage ratios (ICRs) – the ratio of the expected rental income to the expected mortgage interest payments.

These powers would be similar to the powers of direction the FPC was granted over owner-occupied mortgage lending in April 2015.

Impacts of proposal

The only costs the department has fully monetised concern the administrative cost of the data reporting regime. The department states that the Bank of England is already developing an enhanced data reporting regime in relation to buy-to-let lending for larger lenders; this will be introduced even if the FPC is not given the new powers of direction. The data will allow the Bank to monitor compliance with the powers of direction. In order, however, to implement fully the proposal, the data collection requirements will need to be expanded to some smaller lenders. The department estimates that this will impose a one-off cost of £3.8 million on business.

The department states that wider costs and benefits of the proposal are highly uncertain. It will depend on the circumstances in which the tools are used and the level at which the LTVs and ICRs are set. It might also be the case that the power of direction is not used at all during the ten-year appraisal period. The department states that it is not possible to produce a set of monetised benefits of granting the FPC powers of direction. Instead, the department has used a number of illustrative scenarios to set out the possible impacts. Under a scenario in which the FPC implemented a policy that reduced very significantly buy-to-let mortgage lending, the department estimates that the tightening in credit supply will lead to a maximum macroeconomic cost of 0.08 per cent of GDP per annum.

The department states that the benefits of reducing the scale of a potential financial crisis could be large. The impact of a one percentage point reduction in the likelihood of a crisis is estimated to have an annualised GDP benefit of £4.5 billion. Under a severe (but plausible) scenario, the power of direction could reduce credit losses in the event of a shock by up to £7.3 billion and reduce GDP losses by up to 2 per cent.

Quality of submission

The impact of the proposal is highly uncertain and, as such, the department's conclusion that it is not possible to monetise the wider costs and benefits of this legislation, appears reasonable. The department, nonetheless, should use the consultation to gather further evidence to support its estimates of the costs and benefits.

At final stage, the department will also need to provide further evidence to support the estimates of the administrative cost of the data reporting regime. This should include:

- estimates of the number of firms affected;
- further evidence to support the assumption that only 15% of firms will incur additional costs;
- consideration of whether there will be ongoing costs, as well as one-off set-up costs; and
- a discussion of whether any additional costs incurred by the regulators will be ultimately borne by business.

The impact assessment would also have benefitted from a discussion of whether the objectives of the policy could be achieved using alternatives to regulation.

Scope

The department states that this proposal is necessary to address financial systemic risk; this appears reasonable.

Based on current working assumptions, RPC expect that this will be a non-qualifying regulatory provision that will not score under the Business Impact Target.

Small and Micro-Business Assessment

The department states that small and micro-businesses might be disproportionately affected by the proposals, but that data to assess whether these lenders would be affected is currently unavailable. For this stage of policy development, the assessment of the impact on small and micro-firms appears reasonable. The department should use the consultation to seek data on the impact on such lenders. The IA also explains that the FPC will have discretion to exclude smaller firms from the requirements if it deems them not to be systemically relevant; at final stage, the department needs to provide detail on the FPC's decision-making process regarding mitigations or exemptions for small businesses.

Initial departmental assessment

Classification	Out of scope (Financial systemic risk)
Equivalent annual net cost to business (EANCB)	£0.43 million
Business net present value	-£3.8 million
Societal net present value	-£4.0 million

RPC assessment

Classification[1]	Out of scope (Financial systemic risk)
Small and micro business assessment	Sufficient

Michael Gibbons CBE, Chairman

[1] RPC verification of the estimated EANCB and the classification that the measure is a non-qualifying regulatory provision is based on current working assumptions.