

HOUSE OF LORDS

Secondary Legislation Scrutiny Committee

16th Report of Session 2016–17

**Draft Bank of England Act
1998 (Macro-prudential
Measures) Order 2016**

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Secondary Legislation Scrutiny Committee

The Committee was established on 17 December 2003 as the Merits of Statutory Instruments Committee. It was renamed in 2012 to reflect the widening of its responsibilities to include the scrutiny of Orders laid under the Public Bodies Act 2011.

The Committee's terms of reference are set out in full on the website but are, broadly, to scrutinise —

(a) every instrument (whether or not a statutory instrument), or draft of an instrument, which is laid before each House of Parliament and upon which proceedings may be, or might have been, taken in either House of Parliament under an Act of Parliament;

(b) every proposal which is in the form of a draft of such an instrument and is laid before each House of Parliament under an Act of Parliament,

with a view to determining whether or not the special attention of the House should be drawn to it on any of these specified grounds:

(a) that it is politically or legally important or gives rise to issues of public policy likely to be of interest to the House;

(b) that it may be inappropriate in view of changed circumstances since the enactment of the parent Act;

(c) that it may inappropriately implement European Union legislation;

(d) that it may imperfectly achieve its policy objectives;

(e) that the explanatory material laid in support provides insufficient information to gain a clear understanding about the instrument's policy objective and intended implementation;

(f) that there appear to be inadequacies in the consultation process which relates to the instrument.

The Committee may also consider such other general matters relating to the effective scrutiny of secondary legislation as the Committee considers appropriate, except matters within the orders of reference of the Joint Committee on Statutory Instruments.

Members

Baroness Andrews	Lord Hodgson of Astley Abbots	Lord Rowlands
Lord Bowness	Baroness Humphreys	Baroness Stern
Lord Goddard of Stockport	Rt Hon. Lord Janvrin	Rt Hon. Lord Trefgarne (<i>Chairman</i>)
Lord Haskel	Baroness O'Loan	

Registered interests

Information about interests of Committee Members can be found in the last Appendix to this report.

Publications

The Committee's Reports are published on the internet at www.parliament.uk/seclegpublications

The National Archives publish statutory instruments with a plain English explanatory memorandum on the internet at <http://www.legislation.gov.uk/uksi>

Information and Contacts

Any query about the Committee or its work, or opinions on any new item of secondary legislation, should be directed to the Clerk to the Secondary Legislation Scrutiny Committee, Legislation Office, House of Lords, London SW1A 0PW. The telephone number is 020 7219 8821 and the email address is hseclegscrutiny@parliament.uk.

Sixteenth Report

INSTRUMENTS DRAWN TO THE SPECIAL ATTENTION OF THE HOUSE

Draft Bank of England Act 1998 (Macro-prudential Measures) Order 2016

Date laid: 16 November 2016

Parliamentary procedure: affirmative

The Order proposes to give powers to the Financial Policy Committee of the Bank of England to direct the Prudential Regulation Authority and the Financial Conduct Authority to take action to deal with financial stability risks from the buy-to-let market. HM Treasury has offered a detailed explanation of the rationale for the instrument which, while operating in a complex area of policy, is of potentially major significance for the future health of the economy.

We draw this Order to the special attention of the House on the ground that it gives rise to issues of public policy likely to be of interest to the House.

1. HM Treasury (HMT) has laid this draft Order with an Explanatory Memorandum (EM) and Impact Assessment. It gives powers to the Financial Policy Committee (FPC)—an independent committee of the Bank of England—to direct the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA)¹ to take action with respect to loan-to-value (LTV) ratios² and interest coverage ratios (ICRs)³ for buy-to-let mortgages. The FPC will be able to limit the proportion of new mortgages extended at LTV ratios above, or ICRs below, a level which it has specified.
2. In the EM, HMT says that the primary objective of the FPC is to contribute to the achievement by the Bank of England of its financial stability objective; that it does this by identifying, monitoring and addressing risks to the financial system as a whole; and that this role complements the responsibilities of the PRA and FCA. The FPC acts to address systemic risk—in pursuance of what is known macro-prudential policy—through its powers of recommendation and its powers of direction. Its powers of direction are limited to specified macro-prudential tools that are set out in secondary legislation.
FPC recommendation on powers of direction
3. HMT says that in September 2014 the FPC made a recommendation regarding the powers of direction that, in its view, it needed to address systemic risks in the UK housing market, including the buy-to-let market. The FPC recommended that it be granted powers of direction over residential mortgages with reference to loan-to-value (LTV) ratios and debt-to-income (DTI) ratios, including Interest Coverage Ratios (ICRs), in respect of buy-

1 The PRA regulates individual firms for soundness, while the FCA regulates individual firms for conduct of business.

2 The “loan-to-value ratio” means the ratio of the amount borrowed to the value of the property.

3 “Interest coverage ratio” means the ratio of the expected rental income to the interest payments on the mortgage.

to-let mortgages. The powers relating to owner-occupied mortgages were granted in 2015, through the Bank of England Act 1998 (Macro-prudential Measures) Order 2015 (SI 2015/909: “the 2015 Order”).⁴

4. In line with the FPC’s recommendation, the draft Order proposes to grant the FPC the ability to set limits on the proportion of new buy-to-let mortgages that are extended above a specified loan-to-value (LTV) ratio and/or below a specified Interest Coverage Ratio (ICR). HMT says that the FPC could use these powers, for example, to require the PRA and FCA to ensure that no more than 15% of new buy-to-let mortgages (either by volume or by value) were at LTVs above 95%. If the FPC were indeed to use these powers, the impact must surely be expected to vary widely, both as regards different socio-economic groups as well as different geographic areas of the country. We consider that it would have been helpful if this varying impact could have been exemplified more fully in the information provided in support of the Order.

Financial stability risks from the buy-to-let market

5. In the EM, HMT explains the risks that may be posed to financial stability by the buy-to-let market. It says that the main channels are:
 - credit risk, in view of the adverse impact that losses arising from buy-to-let lending could have on the balance-sheets of banks;
 - the risk of amplification of the house price cycle, given that housing is the main source of collateral for the real economy, and so can give rise to a “self-reinforcing loop” of rising house prices and over-extension of credit growth; and
 - the possible interaction of high indebtedness with these two channels: in an environment of falling house prices, buy-to-let borrowers could exacerbate the scale of house price falls if they chose to exit from the market and sell their investments.

Consultation

6. In the EM, HMT explains that it carried out consultation from December 2015 to March 2016. There were 20 responses to the consultation: 11 from lenders, seven from associations or trade bodies, one charity, and one joint response from two professors. Almost three-quarters of respondents agreed that buy-to-let lending does or could carry risks to the stability of the UK financial system; and nearly three-quarters of respondents agreed that the powers of direction should be granted to the FPC. In November 2016, HMT published a more detailed summary of the responses.⁵

FPC policy statement

7. The FPC is required to prepare a written statement of the general policy that it proposes to follow in relation to the exercise of its powers of direction. In November of this year, it published a draft policy statement on its powers over housing policy instruments, in time to be considered alongside Parliament’s

4 We published information about this statutory instrument, which was laid as an affirmative (the Draft Bank of England Act 1998 (Macro-prudential Measures) Order 2015) in our [28th Report](#) of Session 2014–15 (HL Paper 128).

5 See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/568504/buy_to_let_consultation_response_final.pdf

scrutiny of the secondary legislation.⁶ The draft statement describes: the housing policy instruments⁷ and the proposed scope of their coverage; the FPC's current view of the possible impact of the policy instruments on financial stability and growth; and the indicators that the FPC will look at, among other information, in making its judgement on when to use the policy instruments. While the draft statement accords with HMT's explanation that the FPC's primary objective is to support financial stability, it makes it clear that "the FPC's task is not to achieve resilience at any cost"; and that, subject to achieving its primary objective, "the FPC must support 'the economic policy of Her Majesty's Government, including its objectives for growth and employment'".

Conclusion

8. We commend HMT on its efforts to explain the purpose and effects of the draft Order, and to set out details of the consultation, in the Explanatory Memorandum. When we published information about the 2015 Order, we commented that the EM which accompanied it failed to provide any qualitative assessment of consultation responses. In the debate on 19 March 2015 on the 2015 Order,⁸ Lord Tunncliffe referred to our report and emphasised the difficulty of gaining an understanding of that Order through the EM: he said that he had found it necessary to consider not only the Impact Assessment, but also the FPC's minutes themselves. In the case of the latest draft Order, we consider that HMT has offered a detailed explanation of the rationale for the instrument which, while operating in a complex area of policy, is of potentially major significance for the future health of the economy.

6 See: <http://www.bankofengland.co.uk/financialstability/Documents/fpc/draftpolicystatement181116.pdf>

7 That is, the Bank of England Act 1998 (Macro-prudential Measures) Order 2015, and this draft Order.

8 See: [Bank of England Act 1998 \(Macro-prudential Measures\) Order 2015 - Hansard Online](#)

INSTRUMENTS NOT DRAWN TO THE SPECIAL ATTENTION OF THE HOUSE

The Committee has considered the instruments set out below and has determined that the special attention of the House need not be drawn to them.

Draft instruments subject to affirmative approval

Consumer Rights (Enforcement and Amendments) Order 2016

Legal Services Act 2007 (Claims Management Complaints) (Fees) (Amendment) Regulations 2017

Draft instruments subject to annulment

Hertfordshire (Electoral Changes) (Amendment) Order 2017

Instruments subject to annulment

- SI 2016/1088 Architects Act 1997 (Amendment) Order 2016
- SI 2016/1089 Driving and Motorcycle Riding Instructors (Recognition of European Professional Qualifications) Regulations 2016
- SI 2016/1090 Police Federation (Amendment) Regulations 2016
- SI 2016/1091 Electromagnetic Compatibility Regulations 2016
- SI 2016/1092 Simple Pressure Vessels (Safety) Regulations 2016
- SI 2016/1093 Lifts Regulations 2016
- SI 2016/1094 European Union (Recognition of Professional Qualifications) (Amendment) Regulations 2016
- SI 2016/1095 Financial Services and Markets (Disclosure of Information to the European Securities and Markets Authority etc. and Other Provisions) Regulations 2016
- SI 2016/1101 Electrical Equipment (Safety) Regulations 2016
- SI 2016/1105 Pressure Equipment (Safety) Regulations 2016
- SI 2016/1107 Equipment and Protective Systems Intended for Use in Potentially Explosive Atmospheres Regulations 2016
- SI 2016/1108 Combined Heat and Power Quality Assurance Regulations 2016

APPENDIX 1: INTERESTS AND ATTENDANCE

Committee Members' registered interests may be examined in the online Register of Lords' Interests at www.publications.parliament.uk/pa/ld/ldreg.htm. The Register may also be inspected in the Parliamentary Archives.

For the business taken at the meeting on 29 November 2016 Members declared the following interests:

Police Federation (Amendment) Regulations 2016 (SI 2016/1090)

Lord Bowness

Close relative of a serving Police Officer.

Electromagnetic Compatibility Regulations 2016 (SI 2016/1091)

Electrical Equipment (Safety) Regulations 2016 (SI 2016/1101)

Lord Trefgarne

Patron (unpaid), Catering Equipment Suppliers' Association.

Attendance:

The meeting was attended by Lord Bowness, Lord Goddard of Stockport, Lord Haskel, Lord Hodgson of Astley Abbots, Baroness Humphreys, Baroness O'Loan, Lord Rowlands, Baroness Stern and Lord Trefgarne.