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Financial Services Bill

Bill 278 of 2010-12

RESEARCH PAPER 12/08 2 February 2012

The focus of this Bill is to set up a new framework for financial regulation in the United Kingdom. Many reasons have been put forward for why the financial crisis which started in 2008 happened. The Coalition Government believes that regulatory failure played some part. The Bill puts the Bank of England back at the centre of the supervisory system; establishes institutions for 'macro-prudential regulation' and two new regulators which concentrate on the prudential regulation of large institutions and business conduct respectively.

The Bill is subject to a Sewell Convention which means that the Government is seeking consent from the Scottish Parliament to legislate on those aspects which touch on devolved matters.

The Bill was carried-over to the 2012 - 13 Session as Bill 2. Most of its Commons stages had already been completed with only one day of Report and Third Reading remaining. The reissued Bill included a new clause and amendments agreed to by the House on the first day of Report. A summary of Committee Stage proceedings of the Bill and the first day on Report can be found in another Library Paper – Research Paper 12/23.

Lorraine Conway
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Research Paper 12/08

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ISSN 1368-8456

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Summary

1958, 1986, 2000, 2012(?). The frequency with which successive governments have introduced new systems of financial regulation has quickened over the last half century or so. Regulation has often had to play 'catch-up' with the dynamic financial centre that is the City of London. Each stage of development revealed flaws in the existing prudential framework and prompted calls for change. But each reform had to deal with the essential conundrum of how to balance safety and protection with financial innovation and the promotion of the City as a world centre.

The stimulus for the current Bill was the financial crisis of 2008. Whilst deficient regulation alone did not cause the crisis, the current Coalition Government believe that one element of the framework in particular made a contribution:

> Perhaps the most obvious failing of the UK system, however, is the fact that no single institution has the responsibility, authority or powers to monitor the system as a whole, identify potentially destabilising trends, and respond to them with concerted action.

Amidst all the detail in this highly detailed Bill, the provisions which aim to "monitor the system as a whole" perhaps represent the clearest break from past regulatory systems. Another feature of the new system is its emphasis on the pro-active judgement of regulators rather than the minutiae of a rulebook.

The main points on the Bill are

- The Bill creates three new bodies: the Financial Policy Committee (FPC) and the Prudential Regulation Authority (PRA), which sit within the Bank of England, and a separate Financial Conduct Authority (FCA) which will assume many functions of the current Financial Services Authority;
- The FPC is responsible for monitoring and responding to emerging systemic risks, while the PRA will oversee micro-prudential regulation of systemically important firms. The FCA will regulate conduct of financial services firms;
- The Bill gives clearer pre-eminence to the Chancellor during a financial crisis;
- Responsibility for regulation of consumer credit is transferred from the OFT to the FCA, bringing responsibility for all financial services consumers under a single regulator;
- The Bill changes the term of the Governor of the Bank of England from two five-year terms to a single eight-year term; and
- A new system of inquiries and investigations into regulatory failure will be introduced with greater, and earlier, public transparency about such investigations.

The Bill will be followed by a public consultation over the Government's proposals for the FPC's initial set of 'macro-prudential' policy tools, before the tools are laid in Parliament for approval. The role of the FPC and the meaning and implications of the term 'financial stability' dominated parts of the scrutiny during its consideration in draft.

1 Introduction

If the Bill to which this Paper refers becomes law in 2012, it will be the last in a sequence of regulatory systems with ever shorter life spans: the last two having expired whilst still in their early teens. Rather like dealing with a slippery fish, successive governments have struggled to solve the constant twin problems of supervision and regulation.[1]

The fish is slippery because financial markets change and evolve. In the 1970s, it was a London–centric system based on relatively few organisations working on functional lines. There were established ‘utility’ banks fronting their extensive branch networks of imposing architectural high street premises. There were separate ‘merchant’ banks, often long established partnerships, servicing the financial needs of industry. Smaller firms, or partnerships, made up the cast as ‘jobbers’ or ‘brokers’, each with their specialised role (and often uniform too) within a financial system that had serviced the needs of everything from Victorian widows relying on their ‘war bonds’, to companies, investors, governments and the assorted financial needs of the Empire.

The 1985 ‘big bang’ transformed the City into a world centre open to, particularly, the influences of American investment banks. Historical demarcation lines were trampled down. Traditional retail banks expanded their activities to provide the universal service, replacing classically derived high street ‘temples’ with laminate everything and an online ‘presence’. Supermarkets started to sell loans as well as leeks. From the turn of the last century, the pace of change accelerated. Financial innovation combined with advances in technology again transformed the now global financial landscape dominated by huge banking groups offering an exhaustive range of banking services from the ‘exotic’ to the retail.

Each stage of development revealed weaknesses in the existing prudential framework and prompted the need for change. But each stage has to deal with the essential conundrum of how to balance safety and protection with financial innovation, free market capitalism and the promotion of the City as a world centre.

Since the 1970s the nature and emphasis of financial regulation has shifted between the familiar themes of self regulation, statutory regulation, regulatory intrusion and ‘light touch’, and the respective powers and role of the ‘market’ and the Bank of England. In the light of the recent financial crisis, it is little surprise that the new system of regulation which this Bill would usher in relegates self-regulation and market forces and promotes pro-active regulators and the pre-eminence of the Bank: the Governor’s eyebrows are back!

2 Previous and current regulatory systems[2]

1958, 1986, 2000, 2012(?). The frequency with which successive governments have introduced new financial regulatory systems has quickened over the last half century or so.

The system, if it warrants such a title, up to 1986 was a collection of largely single industry Acts, clustered around the *Prevention of Fraud (Investments) Act* 1958, supplemented by various Companies Acts’ provisions. It was administered by either the Department responsible, often the then Department of Trade & Industry (DTI), or by self-regulating bodies, for example Lloyds or the Stock Exchange. On the back of a series of financial

[1] Supervision is normally taken to mean an overall view of how the markets are working and how to deal with a major crisis. Regulation refers to the more micro aspects of the rules of conduct individual firms are required to follow. Together they are commonly referred to as the prudential framework.

[2] A fuller version of this historical review can be found in Library Standard Note 5934

scandals in the late 1970s the DTI commissioned a Report by Professor Gower "to advise on the need for new legislation".[3]

Gower found much to criticise. The current system had, he said, the following defects:

> complication, uncertainty, irrationality, failure to treat like for like, inflexibility, excessive control in some areas and too little (or none) in others, the creation of an elite and a fringe, lax enforcement, delays, over concentration on honesty rather than competence, undue diversity of regulations and regulators, and failure overall to achieve a proper balance between Governmental regulation and self regulation.[4]

Working within what he saw as the political constraints of the day

> Unless the City gravely blots its copy book, I cannot picture a Government of any complexion forcing a (US Securities Exchange type) commission upon it in the near future.[5]

Gower proposed, and the then government accepted, a system comprised of a series of self-regulatory agencies but which would operate within a much broader and more inclusive statutory framework. The result was the *Financial Services Act 1986.*

2.1 Financial Services Act 1986

The Act was passed in November 1986 and came into force on 29 April 1988. Departmental responsibility initially rested with the DTI but was subsequently transferred to the Treasury. Many of the powers under the Act were delegated to the sole, top-tier regulator the Securities and Investments Board (SIB). Under the system, SIB set the overall framework for the detailed standards of regulation, and consulted on, and initiated, policy objectives. Below SIB were a number of Self Regulating Organisations (SROs); Recognised Investment Exchanges (RIEs); Recognised Professional Bodies (RPBs), and Recognised Clearing Houses (RCHs).

The SROs were the most prominent of the regulators. Investment firms had to be authorised by an appropriate SRO if they wanted to conduct investment business in the United Kingdom. The SROs were funded and in part managed by the investment firms which belonged to them. For this reason, the style of regulation was known as self-regulation. At first, there were five SROs but later (after 1994) there were three: the Securities and Futures Authority, the Investment Managers' Regulatory Organisation and the Personal Investment Authority.

Although the deposit-taking activities of UK banks were regulated by the Bank of England, when banks sold investment services, they were regulated by an SRO. This division of responsibilities was altered by the *Bank of England Act 1998*, which transferred the regulation of deposit-taking by banks to the SIB (renamed later as the Financial Services Authority).

The regulatory system set up by the *Financial Services Act 1986* suffered persistent criticism right from the start. The industry was critical of the costs it imposed on the industry, and found the ever-changing regulations expensive to comply with. However, outside critics felt that the self-regulatory structure still favoured the industry rather than the investors, and that whilst the system was expensive; its costs were not proportionate to the degree of investor protection which it provided.

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[3] *Review of Investor Protection*; Cmnd 9125, January 1984

[4] Ibid para 10.04

[5] Ibid p91

Bearing in mind Professor Gower's comment about 'blotting the copy book', arguably the ink was spilt in 1991 in the aftermath of the disappearance of Robert Maxwell. The subsequent discovery of the theft of assets from Maxwell company pension funds lead to criticism of the way that IMRO, the SRO for the investment management sector, had discharged its regulatory responsibilities.

In 1992, in the wake of 'Maxwell' the then Chairman of the SIB, Andrew Large, was asked by the Chancellor of the Exchequer to carry out a review of the effectiveness of SIB's regulatory role. Large conducted what he described as a 'personal review', and published his conclusions in *Financial Services Regulation: Making the two tier system work*.[6]

At the time of the Large review, a number of other challenges faced the regulators. The regulation of retail investment was reviewed, by Sir Kenneth Clucas. It recommended the creation of a new SRO for the retail investment sector which was to be the Personal Investment Authority in 1994. Also in the background of the Large review was a looming problem with the sale of home income plans (which proved very unsuitable for the elderly investors who had bought them), and investigations into events at the London Fox futures market.

Large identified a number of problems which the regulatory regime was perceived to suffer from. These included:

- a lack of clarity in the objectives of the *Financial Services Act*;
- a perception that self-regulation was the same as self-interest;
- doubts about the cost-effectiveness of the regulatory system;
- and a feeling that fraud was allowed to go unpunished.

Large concluded that many of these criticisms were justified, and that SIB should take a more active leadership role in the future, and aim for greater transparency in regulation.

The Treasury Select Committee started its own wide-ranging review of financial services regulation in January 1994. As well as the main report, *The Regulation of Financial Services in the UK*, it issued a number of interim reports on building societies, Lloyd's of London, and retail financial services. The Committee picked up the baton from Andrew Large's review, and investigated whether progress had been made in addressing weaknesses in the regulatory system. It called for the Bank of England's role as the banking regulator to be reviewed, and floated the possibility of a free standing regulator for banks and building societies.[7] Its solution for the confusion of responsibilities between regulators was to concentrate departmental responsibility solely in the Treasury.[8] The Committee had earlier looked at the *Role of the Bank of England* in a separate report, where it felt inclined to retain supervision in the Bank although it recognised that that position would need to be reviewed were a wholesale reorganisation of financial services regulation to take place.[9]

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[6] Andrew Large, *Financial Services Regulation: Making the two tier system work*, Securities and Investments Board, May 1993

[7] Treasury and Civil Service Committee, *The Regulation of Financial Services in the UK*, 23 October 1995, HC 332-I, 1994-95, para 10

[8] Ibid., paras 113, 118-19

[9] 8 December 1993, HC 98-I, 1993-94, paras 102-03

Celebrated regulatory failures across the spectrum of financial services provision and public and industry lack of confidence in the system combined with a change of government in 1997.

2.2 Financial Services & Markets Act 2000

A pledge to address the regulatory structure had been included in the Labour Party's 1997 Business Manifesto[10] and, on 20 May 1997, in a statement to the House, the then Chancellor, Gordon Brown, announced wide-ranging plans to reform the structure of financial regulation and to transfer banking supervision from the Bank of England to an enhanced city regulator based on the existing pattern of SIB:

> There is therefore a strong case in principle for bringing the regulation of banking, securities and insurance together under one roof. Firms now organise and manage their businesses on a group-wide basis. Regulators need to look at them in a consistent way. That would bring the regulatory structure closer into line with today's increasingly integrated financial markets. It would deliver more effective and efficient supervision, giving both firms and customers better value for money, and would improve the competitiveness of the sector and create a regulatory regime to genuinely meet the challenges of the 21st century.
>
> I have decided to take the opportunity presented by the Bank of England reform Bill that we will introduce to reform the regulatory system. Responsibility for banking supervision will be transferred, as soon as possible after passage of the Bill, from the Bank of England to a new and strengthened Securities and Investments Board, which will also, as a result of forthcoming legislation, take direct responsibility for the regulatory regime covered by the Financial Services Act.[11]

The most controversial part of the plan was the reduction in role of the Bank of England. That controversy resurfaced ten years later during the post mortem on the collapse of Northern Rock.

Twelve years after the *Financial Services Act* system came into force, the *Financial Services and Markets Act 2000* was passed. At the head of the system was a renamed SIB, now called the Financial Services Authority (FSA), whose sphere of responsibility has widened significantly during its subsequent history, for example assuming responsibility for general insurance matters and mortgages. As important as the setting up of the FSA was the reorganisation of the Bank of England. This was done by the *Bank of England Act 1998* which transferred banking supervision to the renamed FSA. It also formalised the Bank's newly acquired role of administering monetary policy, and made changes to the Bank's Court (see Appendix for a description of the Court).

The key elements of the new structure were:

- The two-tier regulatory system of the Securities and Investments Board and self-regulating organisations were replaced by a single regulator - the Financial Services Authority (FSA);
- Responsibility for banking supervision was transferred from the Bank of England to the FSA by the *Bank of England Act 1998;*
- Self-regulation was replaced by a 'new and fully statutory system';

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[10] *Labour's Business Manifesto: Equipping Britain for the future*, April 1997
[11] HC Deb 20 May 1997 cc 509-11

- Practitioner involvement was retained; and
- Wholesale and retail markets would be subject to different levels of regulation.

In the light of what was to follow, the reaction of the Bank of England to the new structures is of particular interest. The Bank, including the then Governor, Eddie George, had already made public its opposition to losing its banking supervision responsibilities. At the time of the Chancellor's announcement, it became apparent that the Bank had barely been kept informed of the new Government's plans and that the Governor, was reported to have considered resigning over the move, although perhaps only in passing.[12] The Bank's official response, which quoted the Governor in a press release issued on the day of the Chancellor's announcement, was studiously guarded. Having noted that the Bank had only been informed of the decision the previous day it continued:

> What matters is not the Bank's position but the whole structure of financial regulation and what is best both for depositor, investor and policy-holder protection, on the one hand, and for systemic stability, on the other.
>
> We have never argued that banking supervision for the purpose of depositor protection must necessarily be undertaken in the central bank. We have recognised that changes in financial markets are blurring traditional distinctions between banks and other financial intermediaries. Nevertheless, banks remain of special systemic importance, because of their unique role as providers of liquidity, to both depositors and borrowers, including their central role in payments and settlements, and because their resulting unsecured exposures to each other make them particularly vulnerable to contagion from elsewhere in the system. For these reasons it will continue to be important under the new arrangements that the central bank is able to monitor, through the new regulatory body, the financial condition of individual institutions, as well as that of the system as a whole.[13]

3 The call for reform

A full review of the early period of the FSA's work can be found in a Library standard note[14] which was published in July 2007, barely two months before the collapse of Northern Rock and the start of much else.

The timing is perfect for the light it throws on what was generally thought to be the normality of the then regulatory system. It looks at the issue of enforcement – comparing the more aggressive US response to the FSA's lower key approach; the success of the transition from one system to the other; the overblown and onerous rule book (in the early years) but mainly it looks at the guiding mantra of 'principles based regulation'.

This principle, it was thought, allowed a 'light-touch' system which promoted the competitiveness of London. The Mansion House speech of the FSA's then Chairman, Sir Callum McCarthy, given on 20 September 2005, summed up much of the then contemporary received wisdom regarding regulation:

> As a broad generalisation, I would say that the wholesale financial services markets are characterised by significant, even fierce, competition, with a range of providers of services competing for the business of for the most part informed and competent potential customers.

[12] 'Governor thought of quitting over Bank proposals', Financial Times, 22 May 1997

[13] 'Transfer of banking supervision', Bank of England press release, 20 May 1997

[14] Financial Services authority: looking forward looking back; SNBT 3787

> These happy circumstances allow us to adopt lighter touch regulation where we can rely on the precept of caveat emptor – a principle which has informed our recent statements on the trading of debt instruments; and has enabled us to encourage the industry to develop its own solutions (as we have done with bundled services for asset managers, and are doing for contract certainty in the insurance market), and generally to keep regulatory intervention as a backstop.[15]

In fairness, the FSA was not the only national regulator to have cause to regret relying on caveat emptor.[16]

Ultimately, in the absence of any definitive measure of success or failure in the new system the Library could only conclude:

> Lastly, it is worth making the point that there has been no major financial crisis or scandal that has emerged entirely under its watch. Endowment mortgages predate it by decades, even the [investment trust] 'splits' had their genesis under the previous regime.[17]

Within a few weeks, the FSA had to defend itself against charges that it had 'fallen asleep on the job' and its record of supervision of Northern Rock appeared weak. It launched a full and frank internal review of its own actions which revealed many weaknesses.

But it was not just to be the FSA on 'trial'; also in the 'dock' with it was the 'tripartite framework'.

The tripartite framework

When supervision for banks was taken from the Bank of England and given to the FSA, the Bank still retained responsibilities for financial stability. The fact that the FSA was made independent of government and was therefore the source of most legislation did not mean that the Treasury retained no responsibility either. Thus was the tripartite framework formed: FSA, Bank and HM Treasury.

In light of subsequent discussions about the role that this decision played in subsequent events, the comments of the then Governor, Sir Eddie George, are worth recording. In a speech at the Mansion House in June 1997, he said:

> Weighing these considerations I can see the case for separation - on grounds of the potential conflict of objectives. And I certainly will not mourn the passing of the criticism - whether or not it is justified - that is visited upon the banking supervisor whenever a significant bank does in fact fail - as will inevitably happen from time to time. The key question now is how best to minimise the practical disadvantages of separation, in terms of the Bank's responsibilities for monetary and systemic financial stability, by ensuring that we preserve very close links with the super-SIB[18], including particularly those within the SIB who will have responsibility for banking supervision. I have no doubt that we will indeed be able to establish the necessary close relationship - in our

[15] FSA Mansion House Speech 20 September 2005

[16] Former Federal Reserve Chairman Alan Greenspan, in testimony to a Congressional Committee denied the nation's economic crisis was his fault but conceded the meltdown had revealed a flaw in a lifetime of economic thinking and left him in a "state of shocked disbelief."

[17] Financial Services Authority: looking forward looking back; SNBT 3787 p18

[18] Note: SIB (Securities and Investments Board) was the predecessor body to the FSA, at the time of the original MOU the FSA had not yet been brought into being on a statutory basis.

> mutual interest - not least because the new super-SIB will be headed by our own Deputy Governor, who will be taking many of our own banking supervisors with him.[19]

The relationship between the bodies is governed by a Memorandum of Understanding (MOU).[20] Each body has unique functions and responsibilities.

The Bank of England:

i. ensuring the stability of the monetary system as part of its monetary policy functions. It acts in the markets to deal with fluctuations in liquidity;
ii. overseeing financial system infrastructure systemically significant to the UK, in particular payments systems whether based in the UK or abroad. As the bankers' bank, the Bank stands at the heart of the payments system. It falls to the Bank to advise the Chancellor, and answer for its advice, on any major problem arising in these systems. The Bank is also closely involved in developing and improving the infrastructure and strengthening the system to help reduce systemic risk;
iii. maintaining a broad overview of the system as a whole. The Bank is uniquely placed to do this, being responsible for monetary stability and having representation on the FSA Board (through the Deputy Governor (financial stability)). Through its involvement in markets and payments systems it may be the first to spot potential problems. The Bank advises on the implications for UK financial stability of developments in the domestic and international markets and payments systems and assesses the impact on monetary conditions of events in the financial sector;
iv. undertaking, in exceptional circumstances, official financial operations, in accordance with the arrangements in paragraphs 13 and 14 of this Memorandum, in order to limit the risk of problems in or affecting particular institutions spreading to other parts of the financial system.

The FSA:

i. the authorisation and prudential supervision of banks, building societies, investment firms, insurance companies and brokers, credit unions and friendly societies;
ii. the supervision of financial markets, securities listings and of clearing and settlement systems;
iii. the conduct of operations in response to problem cases affecting firms, markets and clearing and settlements systems within its responsibilities, where:
   a) the nature of the operations has been agreed according to the provisions of paragraphs 13 and 14 of this Memorandum; and
   b) the operations do not fall within the ambit of the Bank defined in paragraph 2 above. (Such operations by the FSA may include, but would not be restricted to, the changing of capital or other regulatory requirements and the facilitation of a market solution involving, for example, an introduction of new capital into a troubled firm by one or more third parties.)
iv. regulatory policy in these areas, including that intended to promote the resilience to operational disruption of authorised firms and Recognised Bodies. The FSA advises on the regulatory implications for authorised firms and Recognised Bodies of developments in domestic and international markets and of initiatives, both domestic and international, such as EC directives.

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[19] Mansion House Speech 12 June 1997

[20] Treasury Memorandum of Understanding

The Treasury:

i. the overall institutional structure of financial regulation and the legislation which governs it, including the negotiation of EC directives;
ii. informing, and accounting to Parliament for the management of serious problems in the financial system and any measures used to resolve them, including any Treasury decision concerning exceptional official operations as set out in paragraphs 13 and 14; and
iii. accounting for financial sector resilience to operational disruption within government.

MOU was first published at the same time as the *Bank of England Bill 1997*.[21] It was modified in 2006. The 2006 MOU can be found on the Bank's website.[22]

The extent to which the three bodies worked together and whether the system they operated was actually workable in a crisis, became one of the main subjects of debate in the aftermath of the financial crisis. There was a general acceptance that the crisis demonstrated weaknesses in the framework. In its Report *Run on the Rock*, the Treasury Committee commented that:

> We cannot accept, as some witnesses have suggested, that the Tripartite system operated "well" in this crisis. In terms of information exchange between the Tripartite authorities, the system might have ensured that all the Tripartite authorities were fully informed. However, for a run on a bank to have occurred in the United Kingdom is unacceptable, and represents a significant failure of the Tripartite system. If the system worked so "well", the Tripartite authorities should take a closer look at the people side of the operation.[23]

The Financial Services Act 2010

In recognition of weaknesses in the workings of the tripartite arrangement exposed by the crisis, the Labour Government introduced various reforms to the system as part of its *Financial Services Bill*.[24] Consideration had already been given to changing the tripartite arrangements in the build up to the *Banking Bill 2008* (an earlier post-crisis reform measure). The Treasury consultation paper *Financial Stability and Depositor Protection: strengthening the framework* [25] noted that:

> Coordination in the UK
>
> 1.54 In the UK, the coordination of the work of the Authorities is set out in a tripartite Memorandum of Understanding (MoU) originally agreed in 1997 and modified in 2006.
>
> 1.55 As supported by the Treasury Select Committee, the Authorities believe that the tripartite structure continues to be the right approach for the UK. However, the Authorities propose to make a series of changes to make these tripartite arrangements more effective in future, so:

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[21] HC deposited paper Dep 99/1398. A version was reproduced in the *Bank of England Quarterly Bulletin* May 1998, p97

[22] Bank of England website at: http://www.bankofengland.co.uk/financialstability/mou.pdf

[23] Treasury Select Committee, *Run on the Rock*, 5th Report HC 56 2007-8

[24] *Financial Services Bill*, Bill 6 2009/10

[25] *Financial Stability and Depositor Protection: strengthening the framework* , Cm 7308;

> the Authorities intend to apply some of the lessons from the operation of COBR[26] to the working of the tripartite arrangements;
>
> the FSA and the Bank of England will consider the scope for greater combined initiatives to develop common understanding;
>
> the Authorities propose to clarify responsibilities within the MoU for decisions around providing support to firms – in particular emergency liquidity assistance

The *Financial Services Bill* would have replaced the existing Standing Committee on Financial Stability [27] with a Council for Financial Stability. Since, the Council retained the same participants as its predecessor, and since, its terms of reference were only ever produced in draft form,[28] it is difficult to know what changes might have accrued from the new arrangements. In the event, the passage of the Bill was interrupted by the 2010 General Election and the legislative 'wash-up' which preceded it. The Bill was passed but several clauses, including those affecting the tripartite authorities, were abandoned.

A general discussion of many of the issues affecting high level supervision can be found in the July 2009 Report by the Treasury Committee *Banking crisis: regulation and supervision*.[29] The Committee cautiously welcomed the proposal to replace the tripartite arrangements with a Council for Financial Stability, although it saw this change as largely cosmetic. It argued that clarity was needed on the tools necessary for "macro prudential regulation" before deciding who should use those tools. Whatever the final outcome, it was imperative that responsibilities were clear:

> 113. We cautiously welcome the replacement of the Tripartite Standing Committee by the Council for Financial Stability (CFS) in respect of the publication of clear terms of reference for the new body and the fact that minutes of its meetings will now be published. We look forward to engaging with the CFS over how Parliamentary accountability might be improved. However, we view the change as one which is largely cosmetic. Merely rebranding the Tripartite Standing Committee will achieve little by itself; what is required is an improvement in cooperation amongst its members, and a simplification and clarification of responsibilities for each of its members.
>
> 114. Devising an appropriate institutional framework for macro prudential supervision is extremely important and should not be rushed. We agree with the argument made by each of the Chancellor, the Governor and the Chairman of the FSA that it is necessary to reach an agreement on the precise instruments needed in the macro prudential toolbox, before considering which organisation should wield those tools.
>
> 115. Whatever the final outcome of any institutional arrangements it is absolutely imperative that responsibilities are clear. The biggest failings of the Tripartite's handling of Northern Rock were that it was not clear who was in charge, and, because the Tripartite took a minimalist view of their respective responsibilities, necessary actions fell between three stools. We are not confident that this issue has yet been adequately resolved. Where before no-one had a formal responsibility for financial stability, now many do—the Bank of England, the FSA, the Treasury, the Council for Financial Stability and the Bank's Financial Stability Committee. Where responsibility lies for strategic decisions and executive action was, and remains, a muddle. The Treasury's

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[26] COBR is the mechanism through which the Government coordinates its response to a large-scale disruptive event. It brings together the relevant departments and agencies and facilitates timely decision-making with clear lines of responsibility and accountability.

[27] The Standing Committee on Financial Stability. This was chaired by the Treasury with representatives from all three arms attending.

[28] Available from Treasury website:

[29] Treasury Committee, *Banking crisis: regulation and supervision*, Fourteenth Report HC 767 2008-09

> design of the institutional framework for financial stability must bear in mind that, when the dust eventually settles on a new system, the question that we, and others, will ask is "Who gets fired?" if and when the next crisis occurs. It is a blunt question, but one which is necessary. Only if we have such clear responsibilities can we expect good decisions to be made and the right actions to be taken. Once those responsibilities have been clarified, the appropriate powers must be properly aligned.

4 Post General Election proposals

4.1 Introduction

The Bill currently before the House is the culmination of several consultation papers and a draft Bill which was considered by a Joint Committee of both the Lords and Commons. The Committee was able to call witnesses and take evidence from a wide range of groups and officials. This part of this Paper picks out some of the developments and evidence produced during this process.

4.2 The prudential framework

In July 2010, the Coalition Government published a Green Paper on regulatory reform – *A new approach to financial regulation*.[30] The Green Paper identified the reasons why the Government thought the old system had failed:

> - it places responsibility for all financial regulation in the hands of a single, monolithic financial regulator, the Financial Services Authority (FSA), which is expected to deal with issues ranging from the safety and soundness of the largest global investment banks to the customer practices of the smallest high-street financial adviser;
> - it gives the Bank nominal responsibility – and, since the Banking Act 2009, statutory obligations – for financial stability, but does not provide it with the tools or levers to carry out this role effectively; and
> - it gives the Treasury responsibility for maintaining the overall legal and institutional framework, but no clear responsibility for dealing with a crisis which put tens of Billions of pounds worth of public funds at risk.
>
> Perhaps the most obvious failing of the UK system, however, is the fact that no single institution has the responsibility, authority or powers to monitor the system as a whole, identify potentially destabilising trends, and respond to them with concerted action. This is a problem which Lord Turner, the chairman of the FSA, and Paul Tucker, Deputy Governor of the Bank for financial stability, have referred to as 'underlap': a phenomenon whereby macro-prudential risk analysis and mitigation fell between the gaps in the UK regulatory system.[31]

The specific proposals contained in the document are set out below:[32]

> First, there must be a dedicated focus on macro-prudential analysis and action, to ensure that risks developing across the financial system as a whole are identified and responded to. That is why the Government will create a new **Financial Policy Committee** (FPC) in the Bank of England, with primary statutory responsibility for maintaining financial stability.

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[30] HM Treasury, *A new approach to financial regulation: judgement, focus and stability*, Cm 7874 July 2010

[31] *Ibid* p3

[32] *Ibid* pp4-5

[...]

> Second, the regulatory architecture has to ensure that macro-prudential regulation of the financial system is coordinated effectively with the prudential regulation of individual firms, and that a new, more judgement-focused approach to regulation of firms is adopted so that business models can be challenged, risks identified and action taken to preserve stability.
>
> That is why the Government will transfer operational responsibility for prudential regulation from the FSA to a new subsidiary of the Bank of England. This new **Prudential Regulation Authority** (PRA) will be responsible for prudential regulation of all deposit-taking institutions, insurers and investment banks. The PRA will have a board chaired by the Governor of the Bank, and a chief executive who will also be the newly created Deputy Governor for prudential regulation.

[...]

> The Government will therefore create a dedicated **Consumer protection and markets authority** (CPMA) with a primary statutory responsibility to promote confidence in financial services and markets. This objective will have two important components. First, the protection of consumers through a strong consumer division within the CPMA. And second, through promoting confidence in the integrity and efficiency of the UK's financial markets.
>
> In its consumer-focused role, the CPMA will therefore take on all the FSA's responsibilities for conduct of business regulation and supervision of all firms, as well as arms-length oversight of the Financial Ombudsman Service, the Consumer Financial Education Body, and the Financial Services Compensation Scheme. The creation of a regulator with specific responsibility for consumer protection will ensure that the interests of consumers are not forgotten about or subordinated.
>
> 1.23 At the same time, a markets division within the CPMA will regulate all aspects of the conduct of participants in wholesale markets, as well as various elements of market infrastructure such as investment exchanges. The CPMA markets division will also represent the UK at the new European Securities and Markets Authority.[33]

Accountability, to Parliament and government, is provided by a proposed requirement that the FPC will be required to produce six-monthly Financial Stability Reports. These will go to the Chancellor and will be laid before Parliament. It is envisaged that the Treasury Committee will have a similar role towards the FPC as the one it already has with respect to the Monetary Policy Committee.

In November 2010 and in February 2011 the Government produced further consultation documents responding to the responses it had received. The February document: *A new Approach to Financial Regulation: building a stronger system*[34] identified the key issues that had emerged from the previous consultations:

> 1.17 The overwhelming majority of consultation respondents welcomed the proposed framework for financial regulation; most also supported the specific emphasis on promoting financial stability and the enhanced focus on macro-prudential as well as micro-prudential regulation. Alongside this general support, respondents also highlighted a number of areas for further consideration. The Government identified five key themes in its summary response:

[33] Note: the CPMA was renamed Financial Conduct Authority in February 2011

[34] Cm 8012, February 2011

- the need for the regulatory authorities' core statutory objectives to be balanced and supplemented with other factors;
- the importance of accountability and transparency for the PRA, the FCA, and the FPC;
- the need for a strong, coherent markets regulation function within the FCA, including the functions of the UK Listing Authority;
- the importance of the European and international agenda, both during the transition phase and in steady state; and
- the importance of effective coordination between the new regulatory authorities.

A further document of interest with respect to the supervisory reforms is part of the latest *FSA Business Plan*.[1] As well as providing a good description of the huge amount of regulatory work that is ongoing, it discusses how the FSA is preparing for a possible post-FSA world.

The Treasury Select Committee published *Financial Regulation: a preliminary consideration of the Government's proposals* in February 2011. This covered both supervisory structure and regulatory issues. One of its key concerns was that the timetable for introducing the new rules was too rushed.

> The financial services industry is an important contributor to the United Kingdom's economy. It needs to be regulated effectively but proportionately. It should not have to deal with regulation in a state of flux, which could result if the initial reforms turn out to require further change. Urgency could be counter-productive for stability and certainty.[35]

It recommended that the Government delay introducing firm proposals until the Vickers, Independent Commission on Banking had reported in the summer 2011. Choosing to ignore this recommendation the Government published its White Paper *A new approach to financial regulation: blueprint for reform* in June 2011.[36]

4.3 Draft *Financial Services Bill*

Announcing the draft Bill the Financial Secretary, Mark Hoban, said:

> It is now well known that the tripartite system set up by the last Government failed spectacularly in its mission to maintain stability. The decision to divide responsibility for assessing systemic financial risks between three institutions meant that in reality no one took responsibility. The crisis dramatically exposed this flaw and cost the taxpayer a vast amount of money. Mr Speaker, we cannot allow another crisis as the one we have just witnessed.
>
> Shortly after taking office we set in train a consultation on reforming our system of financial regulation. Today, after two extensive rounds of consultation, I am presenting to the House a White Paper, including draft legislation, setting out the blue print for a completely new system of regulation. Let me summarise the main proposals.
>
> **Financial Policy Committee**

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[35] *Financial Regulation: a preliminary consideration of the Government's proposals*, HC 430-2010-12, Summary
[36] HM Treasury, *A new approach to financial regulation: blueprint for reform*, June 2011, Cm 8083

> A permanent Financial Policy Committee will be established inside the Bank of England. Its job will be to monitor overall risks in the financial system, identify bubbles as they develop, spot dangerous inter-connections and stop excessive levels of leverage before it is too late. It has already started operating, on an interim basis, and is having its first formal meeting today. Subject to legislative progress, the permanent body will be in place by the end of next year.
>
> **Prudential Regulatory Authority**
>
> We will abolish the Financial Services Authority in its current form, and transfer its significant prudential functions to a new Prudential Regulatory Authority that will sit in the Bank of England. The Prudential Regulatory Authority will focus on micro-prudential regulation. It will bring judgement to the vital task of regulating the soundness of individual firms that manage risk on their balance sheet, particularly banks and insurance companies.
>
> But we recognise, of course, that these types of firms engage in very different types of business, which is why we are proposing to provide the PRA with a specific statutory objective for its insurance responsibilities.
>
> **Financial Conduct Authority**
>
> We are also bringing a new approach to protecting consumers. A new Financial Conduct Authority will oversee the conduct of financial services firms, the operation of markets and the protection of consumers, with new powers to ban the sale of toxic products. I can confirm that as an integral part of its mission to secure better outcomes for consumers and investors, this Authority will also have a new duty to promote competition. Judgement, discretion and pro-active intervention will be the hallmark of our new regulators.
>
> **[...]**
>
> **Conclusion**
>
> Mr Speaker, when the coalition government came into office questions were being asked about the future of banking and regulation, but they had not been answered. It has been our job to resolve them. Our goal should be a new settlement between our financial system and the British people. A new settlement where the banks support the people, instead of the people bailing out the banks. This statement today sets out the progress we have made towards building this new settlement and the actions we are taking to complete it. [37]

The draft Bill was split into five substantive parts.

Part 1: includes provisions to enable the Bank of England to take on its new role

Part 2: establishes the new regulators – the FCA and PRA – and the consequent necessary changes to the existing Financial Services and Markets Act 2000, changes to the powers and duties of the new bodies and of the Financial Services compensation Scheme and the Financial ombudsman service

Part 3: sets out the memorandum of understanding and rules of conduct between the Bank of England, the Treasury and the other regulatory bodies – in essence the tripartite arrangements replacement

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[37] HC Deb 16 June 2011 c959

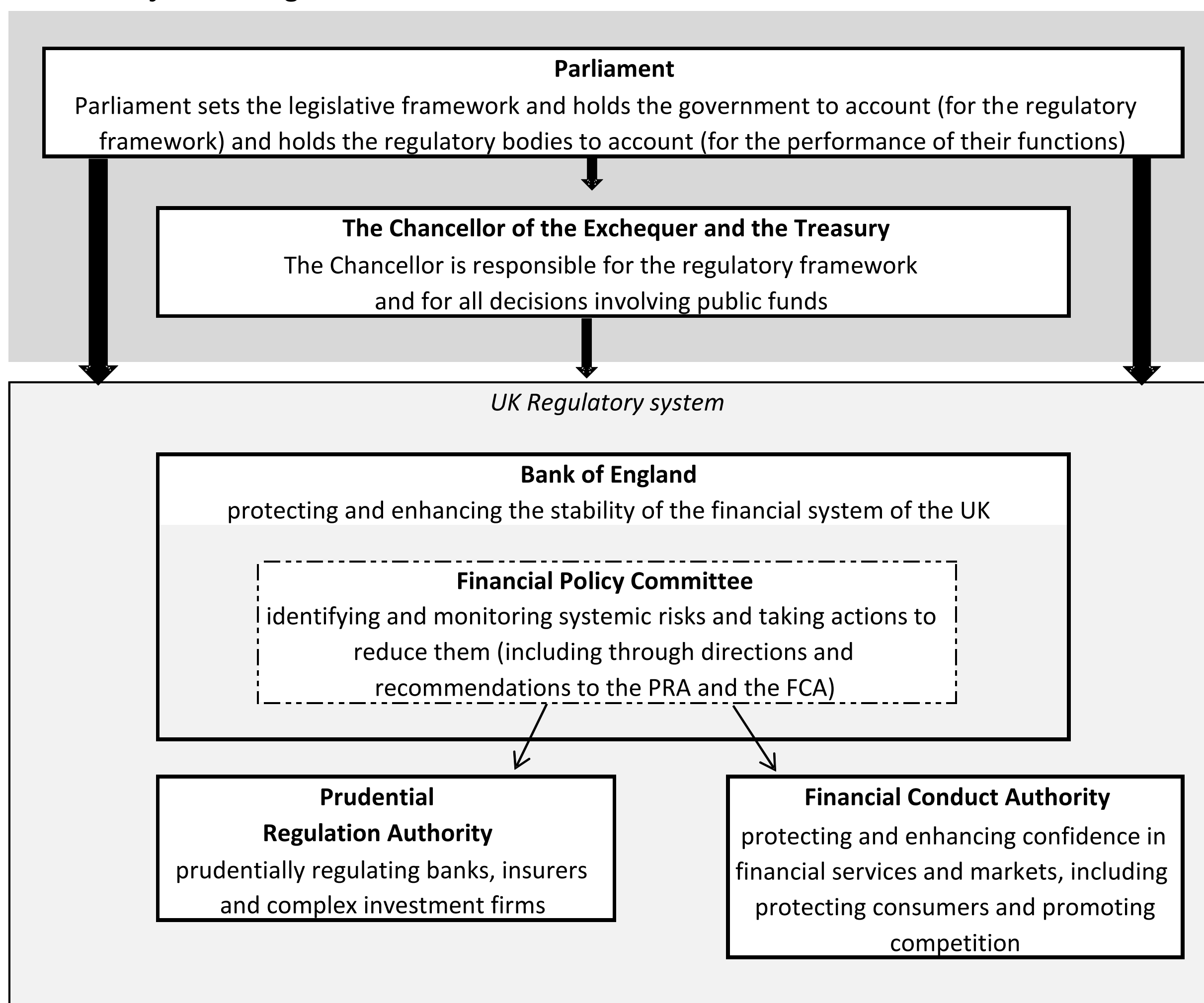
Part 4: establishes the circumstances when the Treasury or the regulator can conduct 'inquiries and investigations' into the activities of financial institutions or into cases of possible regulatory failure

Part 5: makes changes to the banking special resolution scheme introduced by the *Banking Act 2009*.

The draft Bill was narrower in scope than the current Bill in that some provisions (part 6 of the current Bill and Companies Act amendments for example) were not included. Thus discussion on it during the Joint Committee sessions was similarly restricted.

One useful feature of the documentation produced for the draft Bill was the simplified diagrammatic representation of the 'roles and accountabilities' in the new system. It is shown below:

The new system diagram



4.4 Draft Bill: Joint Committee proceedings

There were 14 evidence sessions to the Joint Committee. Oral and written evidence can be found here. The committee's final report can be found here.[38]

Some themes emerged more frequently than others during the oral sessions. Some were more thematic orientated while others focussed more on the details in the Bill itself. Of the former type, the Committee asked about:

- the danger and importance of regulatory arbitrage
- regulation culture – rules versus judgement
- an examination of whether the new arrangements would have prevented the previous crisis
- the challenge for the FSA to retain staff and resources in the transition
- how to deal with the shadow banking sector

Others that were more directly focussed on the Bill included:

- the role of the FPC;
- the definition, or lack of, financial stability; and
- accountability of the Bank of England and the Governor

Of the witnesses who were asked directly, most were broadly in support of the Bill, though several had specific issues with parts of it. Despite the broad approval few were prepared to state that if the Bill had been in force five years ago, it would have prevented the financial crisis. Elements of the crisis were imported from abroad and when things are going well regulators are not necessarily looking for potential trouble. The prevailing view amongst nearly all those questioned was that the culture and experience of regulators amounted to much more in terms of practical regulation than specific structures. Regulators it would seem can fall asleep as easily in a tripartite system as they can on top of 'twin peaks'.

Various quotes from the oral evidence sessions, which illustrate these comments are shown below.[39]

The 'City' view:

> ***Mr Beales***: My name is Peter Beales. I represent AFME, which is an association established to represent, in Europe, firms active in the capital markets. [...] We feel that the legislation is a very helpful development. The focus on prudential regulation was found to be wanting in the previous regime and a major thrust of this legislation is to rebalance the focus, both by separating prudential regulation from conduct regulation but also through establishing the FPC. The Treasury are clearly listening to views expressed on the previous consultations, both from the industry and consumer side. We still think there is some more work to be done on the Bill, both in terms of the relationship with European regulators, which, from AFME's point of view, will be a

[38] *Joint Committee on the draft Financial Services Bill*, HC 236 2010-12

[39] The quotes are grouped under representative headings. They do not imply, for example, that the views of those quoted represent the views of all bankers or all academics.

rather important test of the success of this measure, but also in terms of the accountability of the regulatory bodies, some of their powers, due process and those kinds of issues which the Treasury is exploring, but we do not think they have quite reached the drafting finality that we are seeking. I think there is important work for your Committee here.

Mr Brown: That is a very helpful answer, if I may say so. Do you want to add anything, Mr Florman?

Mr Florman: I would support everything that Peter has just said. I am Mark Florman, the Chief Executive of the British Venture Capital Association. The members of the association are private equity firms and venture capital firms, so we have very little to do with banking as such. I cannot really comment on financial risk and banking risk, but I think, overall, the Bill is excellent and a great improvement on the past.[40]

The Bankers' view:

Mr Laws: If we re-ran the last decade with this policy architecture in the Bill in place, including the FPC and everything else, how does each of you think the last few years would have been different? In particular, are you at all optimistic that we would have had better policy outcomes?

Bob Diamond (Barclays): You ask a very difficult question. I don't think any of us in hindsight could say clearly one way or the other. What I would say is that we are broadly supportive of this architecture. It raises issues around balance—in my mind, the issues around this are the balance of jobs, economic growth and making sure it is connected with Parliament and the Chancellor. The issues around this are balance in terms of the G20 and the EU: is it consistent with what goes on there? There are issues around governance. So much of this depends on the people and not the model. I hesitate to think that there is a model that is going to prevent something, for the reason that, under any model, it is really about the people, the culture and the governance.

Mr Laws: That is obviously an important point. When Sir John Gieve [Bank of England] gave evidence to us the other day, he touched on the issue whether, if we had had the architecture, we would have made the right decisions. The Barclays evidence on this particular point, on the FPC, which is, I suppose, one of the crucial elements of the Bill that could have made a difference, sounds quite sceptical on whether this would really have made a difference. In particular, the evidence that you have given says: "It is worth adding that the concepts and tools of macro-prudential regulation are largely new and untried. As it is currently proposed, the FPC will be using untested tools to achieve an undefined concept." That sounds pretty sceptical, if I may say so, as to whether you really think the FPC would do a good job in the way that, as Mr Gulliver suggested, in a more ideal world it could have done a few years ago.

Bob Diamond: [...]. There is no question in our response that we are supportive, very broadly. There are questions that were raised that can be refined on governance. There are questions that could be refined on the other two issues that I mentioned, but I do not recall exactly where that phraseology fits in. I think it is on the definition of financial stability. Is it? Yes, it is. We are clearly supportive.[41]

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[40] Joint Committee on the draft Financial Services Bill: Evidence 18 October 2011 Q351-2
[41] Joint Committee on the draft Financial Services Bill: Evidence 1 November 2011

The (ex) Chancellor's view

Chairman: Mr Darling, [...] Perhaps I may begin by asking the very obvious question: what features of the tripartite regulatory architecture which prevailed at the time represented any particular difficulty when you were handling, first, the Northern Rock crisis and then subsequent banking rescues?

Alistair Darling: [...] To turn to your question, Mr Lilley, one of the things that I think is important to keep in the front of our minds is that basically you can make any regulatory structure work. At the end of the day, what is more important are the individual judgments of the men and women who either regulate or, in the case of the tripartite committee, had to reach decisions in 2007 and, more acutely I suppose, in 2008.

[...] it is terribly important that as the Committee looks at the new structure what will make or break this are the individual judgments. I hope that I will have an opportunity to say something about crisis management, because perhaps a year later that came into sharper focus. I do not think the problem was so much the structure as individual judgments, although I should perhaps flag up at this stage that in a crisis the question of who actually makes the final decision as to what you do is a very real one. As I explain in the book, I became frustrated that the Bank would not put more money into the system. Only the Bank could do that, and the Treasury would have had to set up a new structure to do that. At the end of the day, I had to answer to Parliament and the country as to what was going on. So, yes, there is always a possible conflict and, as we develop the argument this afternoon, it remains in the new structure, but the big thing is the judgment of individuals.

Chairman: Do you think that effectively it is unavoidable whether you have a tripartite, twin peaks or single structure?

Alistair Darling: Once you have more than one person in the room it is a problem.[42]

The Bank of England's view

David Mowat: If I may move on to Europe, we have had evidence from a number of people who have said that the principal issue in terms of regulation is not necessarily structure but people and how they exercise judgment, and all that goes with that. Therefore, within reason most structures could be made to work effectively, and yet the twin-peak structure that we are putting in place is quite different from the European structure that overrides it in terms of the sectoral versus matrix approach to it. Do you see that being a problem, or is it something we can work with?

Sir Mervyn King: No. The reason we want to move towards a twin-peak approach is precisely to deal with the point made in your first sentence, which is that it is a question of judgment and culture, not structure. I was in favour of the 1997 reforms, but I came to see that it proved extraordinarily difficult to enable the regulators to make judgments in the field of prudential regulation when the same people were being asked to carry out conduct of business, enforcement and consumer protection regulation, which by its nature has to be rule-based, is highly legalistic and will appear to be rather bureaucratic. It is very important to get away from that when it comes to prudential regulation.

As to prudential regulation, the reason it has become so legalistic and bureaucratic—it matters that we avoid this—is not because of the FSA but the firms themselves. Their

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[42] Ibid oral evidence 11 October 2011 Q207 -208

lawyers will tell them that, provided they cannot find a specific rule that prohibits an activity, they can go ahead and do it. That stops the firms themselves thinking, "Is this taking too much risk on the balance sheet? Is it an activity in which we ought to be involved at all?" The judgments which ought to be made about the ethics, ethos and the culture of the bank itself tend to get undermined when you end up with a game in which the regulators are continuously rewriting the rules because at the same moment the firms are devising new products to get round the detailed legal rules which were in place before in order to avoid the spirit of regulation.

I give two examples of where we think it will be important for regulators to exercise judgment and why we need to make a break from the style of regulation we have seen in the past. One is that I would like Andrew and his colleagues to be able to say to a bank—this is a hypothetical example but is clearly relevant to what happened before the crisis—"Your leverage has gone up from 20 to one to 40 to one in the past four or five years. You have not broken any rules. Nevertheless, this is a highly risky set of activities to undertake, and we want you to reduce your leverage." The only way that regulation can have an effect is if the regulators have the freedom to impose their judgment and not base it purely on a myriad of detailed rules.

Another example would be to say to a bank, "The structure of your bank is so complex and opaque, with so many offshore and onshore legal entities, that we don't understand the risks you are taking. We are not entirely confident that you do either, but certainly outside investments cannot assess it. We think that degree of opacity is inconsistent with a sensible and stable contribution to financial stability." These institutions are operating not only for themselves; they are big enough to affect the economy of the whole country. Therefore, the regulator has to be free to make a judgment about that degree of opacity, even though nothing is done that could be said to violate a specific detailed rule. That degree of judgment is vital. The choice is yours. If you want to stay with a highly legalistic and bureaucratic regime for regulation, which many of the institutions would prefer, please do not give it to us. We would not want to take on that responsibility. If you want judgment to be exercised, we are prepared to take it on.

David Mowat: For the avoidance of doubt, you don't see a conflict between the ESA structure that the Europeans are developing and the twin-peak structure that we have?

Sir Mervyn King: I don't think so. We are the only country in Europe to have a Financial Policy Committee which has a direct parallel at the European level in terms of the European Systemic Risk Board, so in that area we are much closer to Europe than other countries. Broadly, all countries recognise that they have different structures to deal with banking and insurance regulation. For a long time we were out of kilter with the majority in taking this away from the central bank. I don't have a particularly strong argument to say why it has to be in the central bank, but the Prime Minister and Chancellor put to me reasons why they wanted it in the central bank. After the experience of the past four years I thought they were pretty compelling reasons. It makes sense to go down the road which the Bill proposes, but the choice is yours.[43]

Of all the specific Bill details, the one commented on most frequently was the role and accountability of the Financial Policy Committee (FPC) which, under the Bill will have an overarching responsibility for identifying and reducing systemic risks. To use an old central bankers joke, it is the FPC which is in charge of the 'punch bowl'.

Extracts from the oral evidence on the role of the FPC are shown below:

[43] Ibid oral evidence 3 November 2011, Q 767

The consumer watchdogs' view:

> ***Christine Farnish*** *(Chair Consumer Focus)*: I would be very happy to kick off, if I may. Obviously, it is very important we strengthen and seek to improve the UK's regulatory regime in the wake of the recent crisis. The danger will be that we lurch too far in one direction in pursuit of a single objective. As we all know, the world is a lot more complicated than that. We have quite serious concerns about the fact that very significant powers are being given to the new Bank of England group. The FPC will be able to direct the new regulatory bodies, both the PRA and the FCA. The PRA will have a veto over the FCA. We do not think the balance is right yet in this draft Bill; it is too one-sided. If you go too far in terms of financial stability obviously you will not deliver what is required for both the UK consumers and businesses in this country. It is a balancing act, and we think the strategic objectives are not yet sufficiently balanced.
>
> **Chairman:** Is that a general view?
>
> ***Martin Lewis***: When I went through it I had to read it again and again until I started to understand how the system began to work. Even once I started to understand what the FPC, PRA and FCA did—frankly, there are more acronyms than the driving licence authority—I realised that it did not include competition and credit, which are what people think finance is about—making sure it is competitive and there is credit out there. [...] When you look at where consumers are in this—it is the third body that cannot look at competition and does not really deal with credit, which is what I tend to have most problems with because debt is really what it is all about. Then you may have some consumer representation on the consumer panel, but the other two big and important bodies do not. Therefore, when a decision is made that we need to curtail the amount of lending done by the FPC because it is impacting the economy, and suddenly realise that effectively you trap people in their existing high-rate mortgages so they cannot remortgage and leave them stuck at that level, we have a real problem about the limited extent to which consumers are being thought about in the system. More importantly, we cannot have faith in a system we do not understand.[44]

The ex- Chancellor's view:

> ***Alistair Darling***: The FPC is a good thing. I am pretty sure I suggested something similar in one of my Mansion House speeches [...]. I am bound to say that it was not developed to anything like this extent. On the other hand, as the Government's own paper here notes, it is novel in that nobody actually knows how to do this. It is all very well to say we should have a mechanism that allows you to lean against the wind. There are lots of distinguished papers on all this stuff, but nobody knows how you do this in practice. You have a committee which, incidentally, from the point of view of the Bank is far too top-heavy; it has six Bank members and four outsiders. That just won't wash. I do not understand why it has been farmed out as a subsidiary of the Court.
>
> Its other flaw is that it can make recommendations to just about everyone under the sun except the Bank. Who controls monetary policy? It is the MPC. You can tell the Treasury that its fiscal policy is no good; you can tell the Chancellor that his policies are wrong. Naturally, you can, fair enough, tell the regulator or issue instructions, but it seems rather lop-sided. It has all the hallmarks of things being bolted on. The Government will be pleased to know that I have no direct knowledge of this, but this looks like the result of negotiation of the sort I recall all too well.[45]

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[44] Joint Committee on the draft Financial Services Bill: Evidence 15 September 2011,Q119-120

[45] Ibid , 11 October 2011, Q212

The ‘City’ view:

> **Mr Laws:** On the FPC and its objectives, obviously some people have criticised the definition of the objective and whether it is clear enough. Barclays in their submission to this Inquiry commented to us: “As it is currently proposed, the FPC will be using untested tools to achieve an undefined concept”, in terms of the objective. Do you have any sympathy with that view?
>
> ***Mr Florman***: We are not in the banking business, but I know that there is an impact for private equity because we need to work closely with banks. The counter to macro-prudential supervision and overall systemic risk oversight is to ensure that the industry functions, works and continues to lend money. The overall objective has been proposed to maintain a sustainable supply of credit. That is also a very valid thought to make sure that banks continue to behave, to lend and to be part of industry. There are almost two aspects, and, if we go overboard in regulation in all aspects of financial services, we can find that we create an effect that we did not anticipate.
>
> ***Mr Beales***: We feel that elements of the Bill should be amended to require the FPC to explain how it envisages using the tools and there should be a reporting mechanism so that when a tool is applied there is a method of assessing how that works in practice, both good and bad effects. More can be done—not to circumscribe what it does but to make what it does explicable and capable of being judged.
>
> **Mr Laws:** Are you content with the way the objective is defined at the moment?
>
> ***Mr Beales***: Given that the nature of macro-prudential regulation is still being explored, this is going to be a definition that we have to revisit in any case. Hopefully, the international consensus will be emerging sufficiently for us to know whether the Bill fits with it when this is debated formally.[46]

The academics’ view:

> **Mr Laws:** The other issue mentioned earlier by the former Chancellor was accountability of the FPC potentially to the political world. You have mentioned the Treasury Select Committee which has quite a lot of work to do and is already reasonably stretched. Are you satisfied that the political accountability of the FPC as it will be set up under the Bill is going to be effective enough both in crisis and non-crisis situations?
>
> ***Professor Goodhart***: In non-crisis situations, the argument for the independence of the FPC is the same as the argument for the independence of the MPC, which is that the regulation has its major effect during the upswing. If you are in a crisis and everyone is in panic, the market constrains you and your risk aversion is so much greater that the regulators are now trying to find ways to reduce the ratios but hope that it will not appear to be too odd at a time when banks are obviously in difficulties. The real time when financial regulation can affect the system is when it is in a strong upswing. The problem with that is that a strong upswing is enormously popular because everyone is getting richer and tax revenues are coming into the system. Everyone thinks that it is all right; the lenders love it and the borrowers love it. Borrowers and politicians loved subprime. It was quite largely the politicians who pushed Fannie Mae and Freddie Mac into doing more of this. The difficulty is that, if you are faced with a housing price bubble and one of the possibilities you may want to undertake is to raise capital requirements on banks lending on housing, or tighten up loan-to-value ratios, it will be enormously unpopular politically. To leave the politician

46 Ibid ; 18 October 2011, Q362-3

with the problem of having to take action which will be extremely unpopular politically, even if necessary, will be quite hard.

Mr Laws: Do you think that perversely that might justify people seeing a greater degree of political accountability, in the sense that this committee might be taking even more difficult judgments than the MPC, if that is possible? Therefore, when the unpopular decisions you are describing are made, people might well say, “We can’t get mortgages and buy houses. Who are these people who are squashing the economy for no good reason?

Professor Goodhart: It is a judgment you can make. I know that my colleague Willem Buiter, who I always enjoy listening to, very much takes the opposite line. He uses as his model the Financial Supervision Oversight Council in the USA which is chaired by the Secretary of the Treasury. He thinks that that is a better framework. You can argue this either way. I understand the line of argument which says that leaving everything to the independent judgment effectively of the Bank of England is undemocratic. I have been doing a study of Swedish monetary policy along these lines. There are very considerable questions about whether Sweden will want to put all responsibility for macro-prudential control into the Riksbank. The question is where you place the macro-prudential control: do you place it with the central bank or the FSA or the micro-prudential authority? It is a delicate issue. I do not think it would be proper to say there is necessarily a right or wrong answer.

Professor Kay: One should think of these political implications in a fundamental way. I hope that one of the things you will be doing is to ask the people who are before you what would have happened, and how things would have been different, in relation to some of the events which happened in the years leading up to 2007. That is true in relation to both the FPC and PRA. Would the attempts by both Barclays and RBS to take over ABN AMRO have been blocked? As the former Chancellor seemed to imply when he talked to you earlier, would you have raised capital requirements in response to that? If you had done that, is that intended to be a way of saying no, or is it a sort of fine for having done something that is not considered wise? What would these two agencies have done in respect of mortgage lending in the UK and to restrict Northern Rock?

Mr Laws: You have to give us your conclusion of this. Are you optimistic that they would have made a difference?

Professor Kay: My belief is that it is unlikely they would, but, as Charles has said, there is no political constituency at all for taking these forms of actions. The bankers that we are attempting to regulate are against it; the public will be against it; the press will, quite reasonably, be asking why you are depriving us of our cheap mortgages, etc., and our higher deposit rates when it comes to Kaupthing and Landsbanki, which is an even more interesting case of regulatory failure.[47]

The bankers’ view:

Chairman: I open the questioning by raising an issue that at least two of you have put in your written submissions to us, which is that the current objective of the Financial Policy Committee as laid out in the Bill to focus on financial stability is ill-defined and might be better replaced by something on the lines of: “In relation to financial [stability] policy, the objectives of the Bank of England shall be (a) to maintain a sustainable supply of credit, and (b) subject to that, to support the economic policy of Her Majesty’s Government, including its objectives for growth and employment”, thereby, particularly

[47] Ibid ; 11 October 2011, Q263-265

in the latter respect, bringing it much more into line with the objectives of the Monetary Policy Committee.

[...] Do you think there is any potential for conflict between the policies of the Financial Policy Committee and those of the Monetary Policy Committee, between one trying to affect stability and, in your view, the supply of credit, and the other affecting interest rates, inflation and the price of credit? Do you think they are ever potentially in conflict?

Stuart Gulliver: I guess that is our concern. The way we would see it is that the Monetary Policy Committee is clearly affecting the price of credit into the system—that is the price of money. Therefore, we were expecting that the Financial Policy Committee would be looking at the supply of credit into the system. You would have two mechanisms, one of which deals with inflation and setting interest rates, and the other with how you can ensure macro-prudential tools are used to cool the economy when it is overheating, and indeed support it when it is cooling down. Tools that are used regularly, for example, in Asia Pacific, are adjusting cash reserve ratios and loan-to-value ratios on mortgages—these types of fine-tuning tools.

The way the FPC has been set up is that it is focused entirely on stability. You could have a situation where the economy is stable, i.e. all the financial institutions are very conservatively capitalised and so on, but there is actually no lending going into the economy. You could see a situation where everything has been secured to such an extent that there is no risk of a failure but there is no credit going into the economy either. We had expected there almost to be a symmetry between these two—the left and the right arm, which is the MPC and FPC. One is going to the price and one is going to the supply. That is why we are a bit concerned about the definition, because there is not that symmetrical approach now, so one could contradict the other.

Chairman: Would that suggest that there might even be an advantage in simply merging the two committees?

Stuart Gulliver: [No]... It would, therefore, be important for the FPC to have the same goals that the MPC has, which is that the UK Treasury should be setting out what the Government's goals are for growth, employment and job creation and saying to the FPC, "Use your macro-prudential tools to ensure that you achieve the Treasury's goals." That needs to be brought out a bit more in this legislation because what it says is, "Create stability," when stability may not be consistent with the goals of the Government, to create economic growth and jobs. But I would not go as far as to suggest that they should be combined. They are different disciplines, although there will clearly be a common set of people at the umbrella level.

Chairman: Would others agree or disagree?

Bob Diamond: We support it. It was HSBC who first brought up the concept of sustainable credit into the market, and we supported that. Our take on it was similar.

Stuart Gulliver: The other thing we would seek to see is almost a parallel structure in how the FPC seeks to change things, meaning that, if there is a departure from or an addition to the macro-prudential tools and they are going to be examined, it will be dealt with by a letter to the Chancellor, copied to the Chairman of the Treasury Select Committee, so that there is that kind of openness, just as there is about missing inflation targets and so on. You would, in essence, have a parallel structure for these two committees.[48]

[48] Ibid; 1 November 2011, Q692-3

The Bank of England view:

> **Baroness Wheatcroft:** It is a big responsibility, as you said at the beginning. Perhaps I may ask you about the overwhelming responsibility for financial stability that you are taking on. The Bank has always had a financial stability objective. Are you confident that as a group we are clear what financial stability actually is? Opinions seem to differ. Would it help if there were firmer objectives as to what financial stability might be?
>
> ***Sir Mervyn King***: Let me say what I think broadly financial stability is and why I don't think that a precise definition is something on which we should pin every hope. Financial stability is about ensuring the financial system can play its role in three areas: the payments system, so that people can make payments all the time; the transfer of savings into investment, providing savings vehicles that can be used to finance corporate investment; and the allocation of risk in the economy towards those who are most willing to bear it. That is the social role that all financial markets play.
>
> The reason I was unhappy about the Bank's financial stability role before the crisis was that, although no one could define financial stability terribly clearly, what mattered more to me was that we had no tools to do anything about it other than write financial stability reports. What matters in terms of holding the FPC accountable is that you in Parliament will decide what instruments we will have. They could be counter-cyclical capital requirements; some people think they could be loan-to-value ratios. There has to be a public debate about this, and you in Parliament will decide what instruments we will use. They will be delegated to us and you should hold us accountable for the use of those instruments and the commentary of the FPC in the financial stability report. For the first time we will have some instruments we can exercise, and the main focus of accountability should be to say, "Why did you change or not change those capital requirements?" and, "Explain yourself in terms of the instruments we gave you to use."[49]

The Government view:

> **Mr Laws:** [...] When Lord Turner was giving evidence the other day—I do not know whether you have seen all of his evidence—he was pretty supportive in this area. But he picked out a number of things that he would have wanted to do if he could have replayed 2003 to 2007 again. Some of them sound sensible and pretty uncontroversial. One of them was, essentially, to burst the property price bubble to avoid it getting out of control rather than relying upon the interest rate by controlling the amount of mortgage lending—the loan-to-value ratios which you have just mentioned. That sounds very sensible, but it would also be extremely sensitive for many of our constituents, who might find it more difficult to get the credit they need and might also question some of the people who are making those types of decisions.
>
> Without asking you to pre-empt the process of consideration that you and the FPC are currently going through, are you looking at any ways of trying to control, limit or improve the amount of public accountability in these areas which are going to be very sensitive?
>
> ***Mr Osborne***: First of all, I would hope that this is an area that your Committee would take an interest in and advise on. It is a classic dilemma. On the one hand, we want to maintain democratic control and oversight for accountability. On the other hand, the whole purpose of this area of policy making is that you do not get politicians, who are vulnerable to the temptation of trying to win a general election, taking the punchbowl away when the party is really getting going, in the housing market, for example. In

[49] Ibid 3 November 2011, Q788

monetary policy we have found a good set of arrangements, where the Chancellor of the elected Government is accountable to Parliament. He sets the inflation target, and then the Monetary Policy Committee is independent in meeting that target. The Bank Governor is accountable to the Select Committee and others for his Committee's success in meeting that target. We have found a good balance.

This is more difficult [with respect to the FPC] partly because, [...] there are not such straightforward metrics as inflation targets, or certainly none that I am aware of at the moment. You have to get that balance right between giving them the tool and then giving them the operational independence to deploy the tool, even when it may be very politically inconvenient to the Government of the day. That is the challenge. [...] But we have to think long and hard before suggesting that Parliament could override the use of the tool. Maybe that is something we should think about, but it would come with a downside. There was a temptation in 2005 or 2006—and this would be true potentially of any Government, not just the Government that was in office at the time—to keep the housing market going and find good excuses for why this was a long-term trend rather than a bubble.[50]

The other issue touched on at length during the evidence sessions was the role, governance and accountability of the Bank of England. It is frequently referred to as the 'Sun King' issue, after reference to it by Alistair Darling in his testimony.

The Consumer organisations' view:

Baroness Wheatcroft: Are you uncomfortable with it all being taken under the wing of the Bank of England and with the governance of the Bank of England itself?

Christine Farnish: Perhaps I may comment on the question raised by Baroness Wheatcroft about the Bank of England, which is a very important issue. The Bank of England group going forward will have an unprecedented suite of powers. It will be responsible for monetary policy, financial stability, what is known in the jargon as macro-prudential regulation and micro-prudential regulation, which we have just been talking about. It will have the function of lender of last resort and the provision of liquidity to the financial system; and it will be overseer and regulator of the payments systems. In addition, it will be a special resolution authority if a major institution goes belly up. That is an enormous suite of very wide and significant powers which potentially will have a huge impact on everyone's daily lives, the availability of credit, the way in which the financial system is working and the economic welfare of this country. To us it is very surprising that that suite of powers is being granted to a body that has no formal accountability to Parliament or the general public. There is a lot of work to do in the way in which the accountability and governance arrangements in this Bill are formulated to strengthen those arrangements.[51]

Sir John Gieve (Deputy Governor of the Bank of England during the crisis)

Lord Newby: Do you think he [the governor] is being given too much power under the new regime?

Sir John Gieve: All of that is a very heavy burden, especially when you add in that he is chair of the Basel Committee, deputy chair of the European System of Central Banks and is on the G7, G20 and so on. His life could be one long series of committee meetings. On the whole, it does put too much weight on one person's shoulders and it

[50] Ibid 8 November 2011, Q1018
[51] Joint Committee on the draft Financial Services Bill: Evidence 15 September 2011,Q123

would be good, assuming the Bank will have these new responsibilities, to delegate up or down a bit.

Lord Newby: [...] if you had to reduce it in any respect which do you think it would be most appropriate for him not to do, as it were?

Sir John Gieve: Within the structure that has been set up, the obvious thing is to give one of his Deputy Governors a proper job and make them chair of something. The PRA would be the obvious one. That is a bit awkward because you have a Deputy Governor who will be chief executive, and so on. None the less, I would delegate that. The Governor's role is very odd. Mostly, we move to a chairman and chief executive arrangement and in this case we have not. We have an executive chairman except in the Court, and the relationship between the chair of the Court and the Governor is not the normal chairman and chief executive relationship. Within the structure we have got one obvious thing to do would be to make Paul Tucker chair of the PRA.[52]

On the question often asked during the post-crisis investigation – who's in charge...

Sir John Gieve: In terms of financial stability and taking actions to prevent the breakdown of stability, it is very clear who is in charge: the Governor is in charge and he is responsible. That is a change. There is not a question of whether responsibility is with the FSA or the Bank; it is now definitely the Bank. Ambiguity may arise if there is a crisis. Is the Chancellor in charge or not? I have not studied the Bill at huge length on this, but there seems to be a trigger mechanism in which the Bank informs the Chancellor of a potential risk to public funds. In practice, at that point the Chancellor takes over. Throughout the process from 2007 to 2011 the Chancellor chaired the meetings and set the agenda, but Alistair said afterwards that he found it very frustrating, that we were very difficult to deal with, et cetera. I can understand that. The only question is whether the Bill needs to give some recognition of that. I do not think it should go to the point of transferring all the Bank's and FCA's legal powers to the Chancellor at a trigger point, but it would be sensible to have some recognition that in a crisis where the taxpayer is at risk there is a duty for the Bank and FCA to co-operate under the chairmanship of the Chancellor.[53]

The Bank of England view:

Mr Mudie: [...] In the proposed changes, there is a view that too much power, but above all responsibility, is being placed on your individual shoulders—[...] Are you quite adamant that the holder of the post can chair and participate in various international and national regulatory matters? If there is a view that changes would have to be made because it is too much to put on someone's shoulders, do you have a view on what changes should be in the field for consideration?

Sir Mervyn King: Yes, I do. I certainly don't want to be adamant on anything. It is already a big job and, to be honest, it has changed in the last three years. We are already in a position where I have to spend a lot of time on monetary policy, the Financial Policy Committee and the PRA—we are spending a lot of time on designing and constructing the PRA—plus the international commitments. How am I coping with this, and what are we doing in terms of the post? Before the crisis, I chaired all the minutes meetings of the Monetary Policy Committee, where we drafted the minutes. That I delegated to Charlie Bean, so I do not chair all the meetings of the MPC that I did before. On the Financial Policy Committee, the driving of the work is the responsibility of Paul Tucker, and he chairs the Bank's Financial Stability Committee,

[52] Ibid 27 October 2011,Q653-5
[53] Ibid 27 October 2011, Q680

not me. In terms of the PRA, most of the work is done by Hector Sants and Andrew Bailey, and the Governor will be involved only in a question about a major institution.

I say two things in conclusion. First, I am convinced that if there were to be a major problem in any of these areas and these responsibilities were in the Bank of England you would want to call the Governor of the Bank of England before the Treasury Select Committee and ask what went wrong. I don't think you can do that unless the Governor is chairing those bodies. I would draw a distinction between chairing the bodies and the amount of time involved. It is not just an additive thing. Most central banks are involved in these things. We would be returning to a more conventional central bank portfolio. The reason my view has changed since 1997 is that my experience of the crisis has led me to believe that when you have a financial crisis like this the central bank is inevitably and inextricably involved with the liquidity and capital position of banks, macro-prudential measures and monetary policy. You have to construct a mechanism by which a lot of the activities that the Governor was doing before 2007 are now delegated to the Deputy Governors, of which there will be three. This year one of the major strategic objectives in the Bank of England is to tell the whole of the Bank that each level will be delegating more authority down, because we have to do that for the Bank to function.

Secondly, if you are not persuaded by that argument, the right thing to do would be to take a responsibility away from the Bank of England completely, not try to pretend that you can have—

Mr Mudie: For example?

Sir Mervyn King: The only one you could conceivably take away that would make sense would be the PRA. The FPC and macro-prudential is inextricably linked with the sort of issues that central banks are bound up with. If your opinion is that it is too much, then the PRA is the body you should take away from the Bank of England. I would recommend that it should then be a separate stand-alone body, but if you would like the Bank of England to do it, it is manageable, provided it is understood that the Governor will delegate many of the responsibilities he was doing before.[54]

[54] Joint Committee on the draft Financial Services Bill: Evidence 3 November 2011,Q778-9

5 The Financial Services Bill

5.1 Introduction and guide

The *Financial Services Bill* (Bill 278 2010-12) was published on 26 January 2012. It will have its second reading in the Commons on Monday 6 February 2012.

A copy of the Bill can be found online here.

A copy of the explanatory notes can be found online here. The Bill applies to the whole of the United Kingdom.

The government response to the Treasury Select Committee (TSC) and the Joint Draft Bill Committee's (JC) Report into the Bill is published as: *A new approach to financial regulation*: Cm 8268. In the text below, this is described as the government response.

Appendix A of the government response summarises TSC responses; Appendix B, Joint Committee responses and Appendix C summarises all responses.

The impact assessment of the Bill can be found here. Few outside guides to the Bill have yet been published. Part of one is shown in Appendix 1 to this Paper. Another, by Cicero is admirably concise and helpful.

As a very broad guide, the Bill may be divided between:

- provisions which set up the new regulatory system and bodies and provide them with updated objectives, powers and duties;
- 're-organisational consequentials' on existing legislation, for example references to the FSA needs to be replaced by references to the FCA; and
- other measures including rule changes to the regulatory system and the workings of the Special Resolution Regime (the bank insolvency procedure).

What the Bill is not is a complete re-write of regulatory legislation. This is because the main financial services 'law', at least from the point of view of practitioners, is the FSA Rulebook which is determined by the FSA – a statutory, but independent body. Much of the Bill therefore replicates existing parts of existing legislation with some additions or 'tweaks'.

The Bill is not an easy read in its original form since it comprises in the most part a series of, often very lengthy, amendments and insertions, grouped under a single clause number, into other legislation namely either the *Bank of England Act 1998* or the *Financial Services and Markets Act 2000* (FSMA).

In the text below, as in the official explanatory notes, reference is made to '**new sections**' and '**new schedules**' of the relevant Acts. Where a clause in the Bill has been amended from how it appeared in its draft version (because government responded to a TSC recommendation for example) it is described as being an '**additional clause'** or part additional clause. A list of principal changes made between draft bill and the current bill stage can be found in Appendix 2 of this Paper.

Commentary and recommendations by the TSC and the JC are referred to as 'the committees' if they both made the same point.

The Bill has eight substantive parts; two of these are to do with matters other than the regulatory system.

Part 1: includes provisions to enable the Bank of England (the Bank) to take on its new role

Part 2: establishes the new regulators – the FCA and PRA – and the consequent necessary changes to the existing *Financial Services and Markets Act 2000*, changes to the powers and duties of the new bodies and those of the Financial Services Compensation Scheme and the Financial Ombudsman Service

Part 3: includes provisions for the future regulation of mutual societies (in particular building societies) under the new system.

Part 4: sets out the memorandum of understanding and rules of conduct between the Bank of England (the Bank), the Treasury and the other regulatory bodies – in essence the tripartite arrangements replacement.

Part 5: establishes the circumstances when the Treasury or the regulator can conduct 'inquiries and investigations' into the activities of financial institutions or into cases of possible regulatory failure.

Part 5: makes changes to the banking special resolution scheme introduced by the *Banking Act 2009*.

Part 6: provides the procedures for complaints to be made against regulators and an exemption from legal actions against them.

Part 7: makes changes to the special resolution regime introduced for banks by virtue of the *Banking Act 2009* and has measures connected with the inter-bank payment system.

Part 8: makes amendments to the *Companies Act 1989* and introduces provisions concerning the dematerialisation (non paper-based) of shares.

The following sections of this Paper outline in brief detail some of the more major clauses and highlight in particular where the Bill has changed from the draft Bill or why it hasn't in controversial clauses. Such commentary can be found in the text boxes between the relevant sections of each clause.

5.2 The Bank of England

The main governing legislation of the Bank is the *Bank of England Act 1998*. The 1998 Act was recently amended by the *Banking Act 2009* which was one of the post-crisis reform measures.

The TSC produced a Report into the Bank which has fed into the Bill:

Accountability of the Bank of England, 21st Report HC 874, 2010-12 and a Response from the Court of the Bank to the 21st Report (HC 1769 2010-12).

Clause 1 sets out in more detail than at present the membership and composition of the Bank's Court. In doing so it creates the new post of Deputy Governor responsible for prudential regulation.

This is unlikely to be the last word on changes to the Bank's governance as the government response makes clear:[55]

[55] Cm 8268 pp17-18

> 2.29 With respect to changes to structures of governance, the Court of the Bank of England published its response to the TSC's recommendations on 17 January, and the Government is pleased to note the positive and constructive approach the Court has taken to engaging with the TSC's report. Court's model proposes the creation of an oversight committee for financial stability, made up entirely of non-executive members of Court. The oversight committee's remit would cover the entirety of the Bank's financial stability activities and members would have access to the meetings and papers of the Bank's policy-making committees, including the FPC. In addition to conducting its own scrutiny of the processes and information used by the Bank and its committees to reach and implement their policy decisions, the oversight committee would also be expected to commission periodic or ad-hoc retrospective reviews of policy-making and implementation performance from expert external authorities – such as the International Monetary Fund (IMF).
>
> 2.30 On 23 January the TSC published a response to Court's proposals, in which it notes the importance of internal policy reviews, in addition to external assessments. The Chancellor has therefore agreed with the Governor and the Chair of Court that the oversight body will also be expected to commission retrospective internal reviews from the Bank's policymakers of policy-making and implementation performance – for example from the FPC, or from other parts of the Bank with responsibilities relevant to financial stability, such as infrastructure regulation or bank resolution. The oversight body will be responsible for setting the terms of reference of the reviews and ensuring that they are conducted properly and effectively, for publishing their findings and for ensuring that the conclusions are followed up.
>
> 2.31 The Government will consider how best to take forward these proposals for strengthening Bank governance, including what legislative provision may be necessary.

An article in the *Financial Times* described this as "stronger oversight than Mervyn King wanted ... but weaker than MPs urged".[56]

The Joint Committee's view on Bank governance issues is shown below:

> **Governance of the Bank**
>
> 307. The governance structures within the Bank of England have recently been the subject of a detailed report by the House of Commons Treasury Committee.[241] That committee concluded that the role of the Court of the Bank of England needed to be substantially enhanced. It suggested replacing the Court with a new smaller supervisory board with expert members. The new Board would have new responsibilities including conducting ex-post reviews of the Bank's performance in the prudential and monetary fields. The Board would have the responsibilities that the draft Bill gives the Court for setting the Bank's financial stability strategy. It would have sight of all the papers considered by the MPC and FPC and the Chairman of the Board would observe MPC and FPC meetings.
>
> 308. The Treasury Committee recommended that the new Board would be responsible for responding to requests for information by Parliament and that it should take a more open approach than the Court.
>
> **309. The evidence we received in the course of our inquiry indicated that the House of Commons Treasury Committee was right to conclude that the governance structures within the Bank need considerable strengthening. Our**

[56] Financial Times, *Osborne clears way for greater financial stability*, 30 January 2012

recommendations about the role of the FPC add weight to this. We support the idea that the Court should be replaced by a Supervisory Board with expert members some of whom should have experience in prudential policy. The new Supervisory Board would be empowered to scrutinise work of its sub-committees and conduct retrospective reviews of decisions taken by the FPC. The reforms in the draft Bill give the Bank significant new powers in macro- and micro- prudential policy. These powers must be paired with reforms to ensure that clear accountability processes are in place. In addition we recommend that the Chairman of the Supervisory Board should be consulted over the appointment of the Governor.

Scrutiny of macro-prudential tools

310. The FPC will be given its key instruments, the macro-prudential tools, in secondary legislation. The FPC's toolkit will be largely untested. Some of the tools being considered will put considerable new burdens on banks and other firms. Some may be different from the tools being deployed in other countries. It is of utmost importance that Parliament has a proper chance to consider the impact of each tool in some detail before a decision is made about whether to grant the tool to the FPC.

311. Normally, Parliament will be asked to grant each macro-prudential tool through approval of a draft affirmative instrument or, in urgent cases, the 28-day "made affirmative" procedure. The made affirmative procedure involves less parliamentary control. The tool could be used the day it is laid before Parliament and therefore before any scrutiny has taken place. If however approval does not follow within 28 days of the instrument being laid, it would be withdrawn. The Government views the made affirmative procedure as a last resort believing it will "rarely—if ever—need to be used". [242]

312. The Treasury Committee noted that approval of draft affirmative instruments in the House of Commons would normally only require a 90-minute debate in a General Committee and a decision without a debate in the House. It recommended that it should have sight of the text of draft orders two months before they are laid in order to report to the House of Commons in time to inform debate. It also recommended a requirement that debates on orders prescribing macro-prudential measures be held on the floor of the House of Commons, free of the 90-minute restriction. [243]

313. We agree that there should be a system of enhanced parliamentary scrutiny of these important tools. This should apply in both Houses. In para 217 we recommended an enhanced procedure for scrutinising the statutory instruments that will define the PRA's regulatory perimeter. This procedure was based on section 11 of the Public Bodies Act 2011. This would provide for consideration by the relevant select committees in both Houses and where appropriate would place a duty on the Treasury to consider those committees' recommendations before laying the final instrument.

314. We are attracted to a similar procedure for the statutory instruments containing macro-prudential tools. The role given to designated committees of both Houses would allow the Treasury Committee and the appropriate committee in the Lords to bring expertise to bear and trigger the enhanced procedure only if necessary. The enhanced procedure would place a duty on the Minister to consider the reports of each committee and make material changes to the Order if those reports persuade him change is necessary.

315. The macro-prudential tools to be used by the FPC are of considerable importance. Some of the tools being considered will have a direct effect on the economic circumstances of constituents. Parliament must have an opportunity

> **properly to scrutinise these powers. On the other hand there must be flexibility to grant the FPC new tools quickly in rare and urgent circumstances. In non-urgent cases we recommend that the tools be subject to an enhanced affirmative procedure similar to that set out in Section 11 of the Public Bodies Act 2011. This would provide for consideration by the relevant select committees in both Houses and where appropriate would place a duty on the Treasury to consider those committees' recommendations before laying the final instrument.**

Clause 2 amends the Bank's financial stability objective in line with its enhanced role under the new system. Section 238 of the 2009 Act defines the objective as "An objective of the Bank shall be to *contribute to protecting and enhancing* the stability of the financial *systems* of the United Kingdom (the "Financial Stability Objective")."

The new definition replaces the text in italics with "protect and enhance" and "system".

Clause 3 is the first major clause in the Bill. It inserts new sections 9A to 9X into the 1998 Act. The focus of the clause is to:

- establish the 'financial stability strategy' of the Bank (9A)
    - this will be established by the Court of Directors in consultation with the Treasury and FPC.
    - Strategy must be reviewed at least every three years
- to establish a group responsible for the strategy (the Financial Policy Committee (FPC)) (9B)
    - to be a sub-committee of the court of directors
    - members to include those appointed by Governor and Chancellor (appointed members)
    - an appointed member may not be part of the government or the monetary policy committee
    - must meet at least four times a year
- to give the FPC certain functions ("monitoring the stability of the UK financial system with a view to identifying and assessing systemic risks" and then taking action)
    - systemic risk defined in new section 9C as "a risk to the stability of the UK financial system as a whole or to a significant part of that system"

Clause 9C is an additional clause. It reflects criticism from the JC that the original was too narrowly drawn. In response, the government response was:

> 2.7 While supporting the Government's general approach, the Joint Committee recommends two clarifications expanding upon the types of risk the FPC should focus on. The Government believes that the language in the draft Bill already covered the particular risks identified by the Joint Committee. However, in line with the Joint Committee's recommendation, the Bill has been amended to make this absolutely clear. Therefore:
>
> • new section 9C (3) of the Bank of England Act 1998 (inserted by clause 3 of the Bill) now requires the FPC to look at "systemic risks attributable to structural features of financial markets, such as connections between financial institutions,". This language incorporates an explicit reference to the interconnected nature of the financial sector, as recommended by the Joint Committee; and
>
> • new section 9C also makes clear that for the purposes of the definition of systemic risk it is immaterial whether the risks involved arise in the United Kingdom or elsewhere.

- To set out how the FPC will interact with other organisations such as the Treasury and other regulatory bodies
  - The Treasury may make recommendations to the FPC (9D) and it must respond. All such exchanges must be published and laid before the House
  - FPC may give directions to the PRA and FCA (9F & 9G) to implement macro-prudential measures (to be defined in secondary legislation) – though not specific regulatory action against one company
  - Where the FPC can only recommend that an action is taken, the recommendation may require the regulator to 'comply or explain'
  - The FPC must 'prepare and maintain a written statement' of its general policy on the use of its power of direction in relation to macro-prudential measures. (9L).

Clause 9L is an additional clause. The government response (p15) states:

> The Government therefore intends to consult publicly on its proposals for the FPC's initial set of policy tools, before the order is laid in Parliament for approval by both Houses. Once the FPC has been provided with its first toolkit, it will also be vital that the FPC explain publicly how it intends to use those tools and what impact it would expect them to have.

- The FPC has wide powers (9N – 9Q) to make recommendations to the Bank, Treasury, regulatory bodies and others

Clause 9O is an additional clause. The government response states (p15):

> In order to ensure that the FPC can have access to the information it needs more quickly if necessary, the Bill has been amended to ensure that the Treasury is able to extend the PRA's information-gathering powers to new activities or classes of firm once the FPC has advised the Treasury that the information is desirable for the exercise of its functions

- to establish the process by which the Committee may require the regulators to implement macro-prudential measures
  - by virtue of new section 9K a macro prudential measure must be prescribed by order by the Treasury
  - except in emergencies Treasury orders must be laid before the House (9M)

The government response notes that the JC recommended that the Treasury should have even greater powers over the FPC in determining its remit. It disagrees:

> however, if the FPC was required in all cases to act in accordance with those recommendations, this would seriously compromise the independence of the FPC. Macro-prudential judgements are such that the FPC may need to make unpopular decisions – for example, to limit the availability of credit to address an unsustainable asset bubble. It is vital that such decisions can be taken independently of undue political influence; indeed, this is why the FPC has been given responsibility for macro-prudential supervision of financial services sector as an expert body in the Bank, independent of the Treasury.
>
> 2.11 However, the Government accepts that the FPC should not have complete discretion to disregard the Treasury's remit, and accepts the Joint Committee's suggestion (also proposed by the TSC) that where the FPC does not agree with the Treasury's recommendations, it should make its concerns public and explain why it does not intend to act in accordance with those recommendations. The Bill has therefore been amended to require the FPC to respond publicly to the Treasury's remit, setting out how it intends to comply with the recommendations and, where appropriate, setting out its reasons why it does not intent to act in accordance with the remit.

This last provision is effected by additional clause 9D.

The introduction to this Paper noted the history of successive regulatory measures each including similar elements but with changed emphasis, often reflecting the nature of the previous crisis. This Bill repeats this to an extent, however, the inclusion of (see new section 9G) macro-prudential measures specifically within the regulatory framework is a new departure from previous measures.

- to establish procedures of accountability of the Committee to Parliament and to the wider public
    - publication of a twice yearly financial stability report (9T)
    - record of FPC meetings to be published within six weeks (9R) unless against 'public interest' (9S)
    - record to include decisions taken, or none, and recommendations made

The issue of Bank governance generally and the accountability of the FPC specifically were the most commented upon issues by both the Joint Committee and the Treasury Select Committee during the pre-legislative scrutiny. The Joint Committee's Report includes several conclusions and recommendations regarding the FPC:

> 32. The drafting in Bank of England Act new clause 9C which requires the FPC to pay attention to systemic risks including "unsustainable levels of leverage, debt or credit growth" goes on to define debt and credit growth as "debt owed by" and "lending to" "individuals in the United Kingdom and businesses carried on in the United Kingdom". We cannot see why this limit to the United Kingdom is specified. British banks faced in 2007, and could again face systemic risks as a result of lending to, or debts owed by, individuals, businesses or, indeed, governments abroad. As drafted it would appear to exclude US sub-prime lending or Greek and Italian bonds from the categories of credit and debt which the FPC is required to monitor. It is true that the clause does not prevent the FPC looking beyond UK lending and debt but it does require the FPC to start with this narrow focus. This adds to the impression that the draft Bill has been written initially as if it applied only to the UK with at best a belated recognition that banking is a global industry. **We recommend the Government reconsider the drafting of clause 3 (new Bank of England Act 1998 clause 9C(6)) to make clear the importance of monitoring the global exposure of UK banks.**[57]
>
> 33. Before and during the 2007 crisis regulators underestimated risks that were building up. These risks were sometimes greater than the sum of their parts due to interconnectedness between firms but this was not properly understood or monitored. In order to achieve financial stability the FPC must carefully consider the interconnected nature of the system. **The reference in the FPC's objective to monitoring "systemic risks attributable to structural features of financial markets or to the distribution of risk within the financial sector" is presumably intended to place a duty on the FPC to consider the interconnected nature of the market—this duty should be made more explicit.** An interim FPC has already been established and we were pleased to see that at its meeting on 16 June 2011 it observed that there are "vulnerabilities relating to the structure of the financial system itself. In particular, these related to interconnectedness in the financial system and to complex or opaque instrument structures with the potential to amplify or propagate any stresses that emerged".[18]
>
> 40. **Preventing excessive or inadequate growth of credit will be an important part of the way that the FPC meets its objective. However, it will also need flexibility to consider other factors which bear on the stability of the financial system. Moreover, it would in our view be premature to attempt to set quantitative targets for credit growth before the FPC has experience of developing and applying macro-prudential tools. So we do not recommend setting a credit based objective for the FPC.**

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57 This is reflected in the drafting of the final Bill, see New Section 9C (6) below

> 44. **The Government is right to require the FPC to consider the impact of its decisions on growth. But the Bill's current drafting is too strong and restrictive. The FPC is not authorised to take any actions to promote stability if it is likely to have a significant adverse effect on the financial sector's contribution to growth in the medium or long term. The Bill should be redrafted so that like the MPC, the FPC must have regard to the Government's growth and other economic objectives subject to meeting its primary responsibility of attaining financial stability.**
>
> 49. We would address concerns about accountability of the FPC in two ways. We support the proposal of the Treasury Select Committee for the replacement of the Court of the Bank of England by a supervisory board to oversee the work of the Bank, and of the MPC and the FPC (see para 309). But while the supervisory board can provide independent assessment and review of the performance of the Bank, it cannot provide political oversight; that has to be exercised by either the executive or by Parliament. Therefore, in order to provide effective political accountability, **the draft Bill should be amended so that the Treasury, not the FPC, has the final say about the interpretation of the remit of the FPC. We would normally expect the Treasury and the FPC to come to an agreement about the remit and therefore we would not expect the Treasury to have to override the FPC on a regular basis. If the FPC has any objections to the annual remit issued by the Treasury it should make these public and alert the House of Commons Treasury Committee. Notwithstanding that the Treasury may have suggested matters that the FPC should regard as relevant to the Committee's understanding of the Bank's financial stability objective the Bank of England remains responsible for the entirety of that objective.**[58]

Clause 4 (schedule 2) this clause and schedule amend schedule 1 of the *Banking Act 1998* and change the period of office holding of the Governor of the Bank and a Deputy. Currently the Governor or Deputy can be appointed for any number of five year terms. By virtue of the new schedule, the Governor can be appointed for a single eight year period and Deputies up to two, five-year terms. This is an additional schedule inserted at the recommendation of the TSC.[59] Directors of the Bank can be appointed for four years instead of the current three.

5.3 Co-operation between the Treasury, Bank of England and the new regulators

Part 4 of the Bill sets out the successor rules to the memorandum of understanding (MOU) of the tripartite authorities (see above).

Clause 54 places the initial duty of notifying the Treasury of a possible call for funds on the Bank in cases where either a bank is likely to become insolvent or if the FSCS is likely to need to borrow to meet its liabilities. Where this notification has been given, **clause 57** sets out the circumstances under which the Treasury will direct the Bank to provide assistance. Two conditions are possible:

> Condition A is that the giving of the direction is necessary to resolve or reduce a serious threat to the stability of the financial system of the United Kingdom which is connected—
>
> (a) in case within subsection (1)(a), with the matters to which the public funds notification relates;

58 Joint Committee on the draft Financial Services Bill, HC 236 2010-12, pp14-17

59 Cm 8268 p17 (Treasury Select Committee, Accountability of the Bank of England, HC 874 2010-12,November 2011 paragraph 143)

> (b) in a case within subsection (1)(b), with the matters that gave rise to the provision of the qualifying financial assistance.
>
> (4) Condition B is that—
>
> (a) the qualifying financial assistance was provided for the purpose of resolving or reducing a serious threat to the stability of the financial system of the United Kingdom, and
>
> (b) the giving of the direction is necessary to protect the public interest in connection with the provision of that assistance.

All the notifications and directions have to be in writing (**clause 58**) and (**clause 59**) these must be laid before the House by the Treasury.

Clause 60 is an additional clause. The Government accepted the Joint Committee's view that a duty to co-operate should appear on the face of the Bill.[60] However, it rejected the view that more of the detail of crisis management should be in the Bill rather than within the new MOU.

For comparison purposes readers may wish to look at the current MOU which covers similar ground to these clauses. It can be found online here. A quick read through of the clauses compared to the MOU reveals that the latter is more proscriptive in terms of what must happen and when, whereas under the current arrangements the respective parties retain some discretion over things such as when they need to inform the other parties. The new proposed crisis management MOU can be found in Annex E of the government response. Reading through it, it provides a far clearer answer to the question 'who's in charge' than previously existed under the existing MOU. See, for example the proposed wording:

> The Chancellor's power of direction over the Bank
>
> 25 The Bank has primary responsibility for financial stability and operational responsibility for managing financial crises. But consistent with the Treasury's overall responsibilities, the Chancellor may, in some circumstances during a financial crisis, use additional powers to direct the Bank. This is provided for in Section [57] of the Act, which allows the Chancellor to direct the Bank to:
>
> • conduct special support operations for the financial system as whole, in operations going beyond the Bank's published frameworks;
>
> • provide ELA in a support operation going beyond the Bank's published frameworks to one or more firms that are not judged by the Bank to be solvent and viable;
>
> • provide ELA in a support operation going beyond the Bank's published frameworks to one or more firms on terms other than those proposed by the Bank; and
>
> • implement a particular SRR stabilisation option.[61]

One can recall the passage in *Back From the Brink* by the previous Chancellor, Alistair Darling, that this was a power he felt he had lacked:

> The Bank was slow to recognize the nature of the crisis. The underlying problem may have been lack of capital, but the immediate cause was lack of liquidity. Moreover if a

[60] Cm 8268 p16
[61] Cm 8268 p112

> liquidity problem remains untreated, it has a tendency to make a problem with solvency worse. [...]I was so desperate that I had asked the Treasury to advise me as to whether or not we could order the Bank to take action. The answer was that it might be legally possible, but that there would be wider implications of such an action. We had set great store by making the Bank independent and a public row between myself and Mervyn would have been disastrous, particularly at this time.[62]

5.4 The new regulators

The Bill amends provisions of the *Financial Services and Markets Act 2000* (FSMA). Hence new sections/schedules referred to in the text relate to new sections/schedules of an amended FSMA.

Clause 5 and Schedule 3: establishes the remaining new bodies envisaged under the proposed system. The bodies, a brief resume of their function and the new sections which introduce them are shown below:

Financial Services Bill: clause five provisions

Regulatory Body	Role	New FSMA sections
Financial Conduct Authority	Protecting and enhancing confidence in financial services and markets, including protecting consumers and promoting competition. Responsible for prudential regulation of those authorised firms that are not regulated by the PRA	1A - 1T
Prudential Regulation Authority	Prudentially regulates banks, insurers and complex investment firms	2A -2N
Joint Measures		3A -3Q
Consumer Financial Education Body	Enhancing public understanding of financial matters	3R

A brief guide to these new sections follows.

Financial Conduct Authority

- FSA renamed Financial Conduct Authority (FCA) (1A)
- The constitution of the FCA is set out in **schedule 3** of the Bill (new schedule 1ZA). The governing body of the FCA includes:
    - A Chairman and Chief Executive appointed by the Treasury
    - The Bank's Deputy Governor for prudential regulation
    - Two members appointed jointly by the Secretary of State and the Treasury
    - At least one other Member appointed by the Treasury

[62] Bank From the Brink, pp57-58

By way of comparison, the FCA is independent but reports to the Treasury whereas the PRA is more of a Bank subsidiary.

- New objectives for FCA a strategic objective of ensuring that the relevant markets (for financial services) function well (1B(2)) underlying which are new operational objectives:
    - Consumer protection objective (1C)
    - Integrity objective (1D)
    - Competition objective (1E)

Note: these objectives replace the existing FSA objectives of market confidence, financial stability (inserted by the *Financial Services Act 2010*), protection of consumers and the reduction of financial crime. There are elements of the previous objectives in the new sections, however, the competition objective is the most obvious new one.

- The FCA is given a general duty to consult (1M) with the following Panels (1N – 1Q)
    - The Practitioner Panel
    - Smaller Business Practitioner Panel
    - Markets Practitioner Panel
    - Consumer Panel

Currently FSMA (sections.9 & 100 establishes a Practitioner and a Consumer Panel. A Smaller Businesses Practitioner Panel also exists, though this was set up by the FSA in the light of their experience in trying to deal with all practitioners in one group. The Bill therefore effectively introduces one new panel – the Markets Practitioner Panel. This is likely to be aimed at market institutions, e.g. exchanges, rather than market sectors e.g. insurance, however, the exact composition is as yet undecided.

- The Treasury may appoint an independent reviewer of the effectiveness with which the FCA has used its resources in discharging its functions (1S).

Work by the FSA to evolve into the FCA has been ongoing for some time. The FSA published a 'blueprint' for its new role in the document *The Financial Conduct Authority: Approach to Regulation.* A convenient summary can be read in a speech in June 2011 by the interim managing director of the FCA, Margaret Cole. This can be read online here.

Prudential Regulatory Authority

The PRA, as a separate body distinct within the regulatory system, is another new feature of the proposed system compared with previous systems. Its objectives however, can be traced back to aspects of the current FSA remit, for example, declaring credit institutions in default.

- Objectives of the Prudential Regulatory Authority (PRA)
    - General objective "promoting the safety and soundness of PRA-authorised persons" (2B (2))

  - The general objective is to be advanced primarily by seeking to ensure that the business of PRA-authorised persons is carried on in a way which avoids any adverse effect on UK financial stability, and by seeking to minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on UK financial stability (new section 2B(3).

- Insurance objective "contributing to the securing of an appropriate degree of protection for those who are or who may become policyholders" (2C (2))

- Additional objectives may be specified (2D)

  - The objectives are not to be regarded as requiring the PRA to ensure that no PRA-authorised person fails (new section 2F).

- Its general functions (making rules, preparing and issuing codes of conduct and general determination of policy) are set out in new section 2I.

- The constitution of the PRA is set out in **schedule 3** of the Bill (new schedule 1ZB 2 & 3). The governing body of the PRA includes:

  - Governor of the Bank
  - Bank's Deputy Governor for prudential regulation (chief executive of the PRA)
  - Bank's Deputy Governor for financial stability
  - The chief executive of the FCA; and
  - Appointed members

- Appointed members must comprise the majority of the Board; they are appointed by the Bank with Treasury approval (new schedule 1ZB para 6 and 8).

- The PRA must report to the Treasury at least annually on the discharge of its functions (this is an additional part 18 to new schedule 1ZB with a similar additional part 10, new schedule 1ZB for the FCA). A copy of the Report must be laid before the House.

The Bill adds one additional clause (2J) to the draft Bill as a result of consultation.[1] The government response notes:

> 3.6 The Joint Committee recommends that "the Bill should be amended to place a duty on the PRA to supervise firms" to provide an explicit legislative marker for the responsibility of the new regulator to carry out its supervisory role, in a way that goes beyond monitoring of compliance with requirements.
>
> 3.7 The Government agrees with this recommendation. The PRA should be explicitly empowered and required to go further than making rules and ensuring that authorised persons comply with them. Giving the PRA a specific "duty to supervise" will ensure an enduring statutory commitment for the PRA to take a judgement-led approach to supervising individual firms through engagement, scrutiny of business models, and forward-looking assessments of risk. It will allow the PRA's supervisors to exercise judgement on aspects of a firm's business that affect safety and soundness, and to take action where they are of concern. The requirement on the PRA to maintain arrangements for the supervision of PRA-authorised persons delivers this.

Provisions common to both Regulators

- Regulatory principles (3B)
  - Efficient use of resources
  - Regulatory requirements should be proportionate to the benefits
  - Consumers should take responsibility for their decisions as should senior managers of firms "the FCA and PRA should not aim for a zero-failure regime"[63]
  - The desirability of publishing information relating to regulated persons
  - Regulators should exercise their functions in a transparent manner
- Relationship between FCA and PRA
  - Duty to co-ordinate functions (3D)
  - Preparation of memorandum of understanding (3E)
  - Treasury has the power to determine responsibilities between bodies (3G) but any order made under this power must be approved by a Resolution of the House (3H)

5.5 Consumer Financial Education Body

The CFEB, whose work is now carried out by the Money Advice Service, was set up by section 2 of the *Financial Services Act 2010*. New section 3R largely replicates these provisions but adds (3R (4)):

- Assisting members of the public with the management of debt
- Working with organisations which provide debt services

5.6 Other issues

Consumer credit

The history of FSA regulation has been marked by an ever increasing workload as more and more activities have been included within its remit. It is extraordinary to think, now, that some mortgage business and general insurance was not the responsibility of the FSA when it first began. Under the previous system government decided, by way of Orders, what was to be regulated, leaving the 'how' to the independent FSA.

Clause 6 is a classic example of the ever increasing scope of the FSA (FCA). This clause has the effect of allowing the government at some point to place the control of consumer credit within the remit of the FCA. Currently, loans by deposit takers such as banks, and consumer finance companies, including high cost lenders, are regulated by the Office of Fair Trading. The government response recognises that this shift will bring about regulatory issues. For example, banks have to abide by FSA determined principles of conduct. Consumer credit loans will remain governed by the *Consumer Credit Act 1974* and these will have to be aligned with FCA rules. The government response continues:

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[63] Explanatory Notes p 25

> 4.19 Respondents to the Government's consultation on the credit regime generally supported the proposal for a single regulator for all retail financial services, and a stronger, more flexible regime than is currently possible under the CCA. However, respondents also emphasised the diversity of firms and activities covered by CCA and the need for a proportionate, risk-based approach. They also noted that the consumer credit industry has only recently had to adapt to changes to the CCA. Further detail can be found in the summary of responses published in July 2011on the Treasury's website.4
>
> 4.20 Further engagement with stakeholders in recent months has made clear that many would welcome an outcome that brings consumer credit firms, particularly providers of high-cost credit, within FCA regulation, while maintaining the core rights and protections provided by the CCA.
>
> 4.21 Therefore, the Government is now working to develop a model that will ensure that regulation does more to protect consumers, but also reflects the particular characteristics of the consumer credit market, and remains proportionate.
>
> 4.22 The Financial Services Bill therefore includes provisions enabling a full transfer of consumer credit regulation to the FCA, with retention of substantive CCA provisions. The Government will exercise these powers if and when it has identified a model of FCA regulation that is proportionate for the different segments of the consumer credit market. The exercise of these powers will be subject to impact assessment and the approval of both Houses of Parliament.[64]

Clause 6 of the Bill will also bring within regulation the work of credit reference agencies.

Clause 7 requires that in future, draft orders made Treasury that determine what are regulated activities will need to be approved by the House before they are made (except in emergencies). Similar requirements will apply to the designation of an activity as a PRA-regulated activity (**clause 8**).

Passporting rights

Clause 10 – dealing with 'passporting rights' has been amended, but mainly to reflect the fact that either the PRA or the FCA might be the appropriate body, and the new need for the new bodies to co-operate with each other. The following section highlights FSMA-related clauses where significant changes are introduced to existing legislation. Details of the changes can be found in the explanatory notes on clauses.

Clause 12 makes changes to the system of approval of authorised persons. Both the PRA and FCA will have their own areas of responsibility for approving persons. The PRA will focus on 'significant influence functions' whereas the FCA will focus on 'customer dealing functions'.

Share listings

Clauses 14-18 make significant changes to the legislation dealing with share listings. At the time FSMA was enacted, it was not clear that the FSA would undertake on a permanent basis the functions of the competent authority for listing. The Bill provides for listing to be the responsibility of the FCA. **Clause 16** changes the rules about share 'sponsors', allows for public censure of sponsors who have contravened requirements; and extends the range of disciplinary powers currently available. Concurrent with the Bill the FSA is consulting on changes to the listing rules.

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[64] Cm 8268 p30

Rule making powers

Clause 22 introduces new provisions concerning the rules which regulators can make. As was stated above, the vast bulk of the requirements faced by financial services firms are derived from rules made by the FSA. A recent new departure for the FSA is the intention to intervene earlier and more pro-actively against products which the FSA believe cause consumers harm. This is called 'product intervention rules'. Put simply, the fact that companies can devise products which do not actually break any existing rule will no longer prevent the regulators from acting. The FCA is given a tailored power to make rules that can prohibit entirely sales of particular products (or more complex agreements or arrangements) or place restrictions on sales to particular classes of customer or methods of selling. **Clause 22** inserts a new clause 137C to effect this change of approach. The same clause also includes new section 137G which covers compliance with a remuneration policy. The FCA will also have the ability to make temporary product intervention rules if there is an urgent need to protect consumers and there is not time to wait for the outcome of the normal consultation process (new clause 138M).

Disciplinary measures and enforcement

Clause 30 confers new powers on the Bank and the FCA with respect to disciplinary action, against recognised bodies. **Clause 34 and Schedule 9** confer powers on the FCA and PRA to take disciplinary action against authorised persons. These include, in accordance with the Government's stated presumption that the regulators will use transparency and disclosure as a regulatory tool, a new power for the FCA and PRA to make public enforcement action that they are proposing to take.

Some lawyers have noted the absence of requirements of standards of evidence or proof required before the FCA might use this new regulatory tool.

Financial Services Compensation Scheme

Clause 35 and schedule 10 make changes to the operation and accounting of the Financial Services Compensation Scheme (FSCS). The FSCS is the scheme responsible for providing compensation for investors and others when an authorised firm is 'in default'. The financial crisis exposed the scheme to a level of financial demands and a volume of business it was never set up to meet. One new change introduced by the Bill in new section 218ZA is that in future the FSCS accounts will be audited by the NAO and laid before Parliament. As well as providing some small degree of improved protections for consumers, **clause 36 and schedule 11**, propose the same accounting change for the Financial Ombudsman Service.

Inquiries

Clauses 64 – 68 of Part 5 of the Bill introduce specific provisions which give the Treasury the power to set up independent inquiries and to publish reports based on the findings of the inquiry. Clearly governments have general powers to set up inquiries either on an ad–hoc basis or under powers derived from the *Enquiries Act 2005.* A lack of specific power has not prevented, for example, past inquiries into Equitable Life or Lloyd's. Existing legislation on inquires can be found in section 14 of FSMA.

The powers given under these clauses can only be invoked when 'there is a serious threat to the UK financial system' possibly due to 'a serious failure in the system established by FSMA 2000' (**clause 64**). Inquiries held under these provisions will give the person appointed to hold the inquiry the same powers with respect to calling witnesses etc as a court would have.

Clause 69 requires the FCA to investigate events which, amongst other things, indicate that there has been 'a significant failure to secure an appropriate degree of protection for consumers'. Having investigated the FCA is required to make a Report to the Treasury. The FSA can and does instigate investigations of a non-enforcement nature into the activities of

authorised persons. However, the FSA has been criticised for the fact that such proceedings are secret unless enforcement action ultimately taken. Currently there is no requirement on the FSA to make public its findings where no enforcement action has been taken. This fact came to light most recently with the initial decision by the FSA not to release details of its investigation into the running of the Royal Bank of Scotland.[65] **Clause 70** imposes similar duties on the PRA.

This section therefore does promise to provide significantly more transparency in a significant part of the regulators' job.

Complaints against regulators

Part 6 of the Bill (**clauses 79 to 81**) requires the three regulators to establish complaints schemes and establish means by which complaints can be investigated and resolved. Currently, under FSMA, the FSA has set up a Complaints Commissioner. The Complaints Commissioner considers complaints made against the FSA (e.g. for unprofessional behaviour, lack of care or bias).

As a separate matter disagreements persist between the FSA and firms or individuals about the FSA's disciplinary decisions, are referred to the Upper Tribunal (Tax and Chancery Chamber). The Upper Tribunal is an independent judicial body established by the *Tribunals, Courts and Enforcement Act 2007*. The Tax and Chancery Chamber is the part of the Upper Tribunal, which, as of 6 April 2010, hears references arising from certain decisions and supervisory notices issued by the FSA.

Clause 79 gives the Treasury the role of appointing the independent investigator.

Further details of the FSA complaints procedures can be found on its website here.

6 The Special Resolution Regime

6.1 Background

The *Banking Act 2009* (BA 2009) established a permanent 'Special Resolution Regime' (SRR) to provide the authorities with the tools to deal with banks that are failing.[66] With some modifications, the SRR also applies to failing building societies, for example, the SRR was used to resolve the collapse of the Dunfermline Building Society in March 2009.[67] The Bank is the lead resolution authority in the SRR. The Act replaced the temporary powers in the *Banking (Special Provisions) Act 2008,* which had been enacted on an emergency basis in order to bring Northern Rock into temporary public ownership and was subsequently used to resolve Bradford & Bingley and various Icelandic banks.

The SRR exists to deal with the situation where all or part of the business of a bank has encountered, or is likely to encounter financial difficulties. The objective of the SRR is to enable the current tripartite authorities (the Bank, the Treasury, and the FSA) to intervene in the business of a failing bank at a pre-insolvency stage to attempt to achieve a swifter and more orderly resolution to its problems. This is made possible through the clear set of powers that the Act creates, as well as careful controls about when they can be used. The overriding aim of the SRR is to promote financial stability:

65 After consultations, the FSA did finally agree to publish an account of its investigation. The report can be found here: http://www.fsa.gov.uk/pubs/other/rbs.pdf

66 For the purposes of the Banking Act 2009, a bank is a UK institution which has permission under Part 4 of the Financial Services and Markets Act 2000 to accept deposits

67 HM Treasury, Dunfermline Building Society

> This is an essential means to promote financial stability and equip national authorities with the tools needed to effectively respond to a crisis, to protect taxpayers and the broader economy. Use of the SRR must balance the statutory objectives of protecting depositors, maintaining financial stability, enhancing public confidence in the banking system, protecting public funds and preserving property rights.[68]

Parts 1 to 3 of the BA 2009 make provision for the SRR. In Part 1 the SRR provides for three pre-insolvency 'stabilisation options' to be applied to a failing bank:

- **private sector purchase** – under the SRR, the Bank can arrange the compulsory sale of all or part of a failing bank's business to a willing commercial purchaser;[69]
- **bridge Bank** – the Bank can transfer some or all of a failing bank's business to a temporary vehicle (a 'bridge bank'), wholly owned and controlled by the Bank;[70] and
- **temporary public ownership** (the Treasury's decision) – the Treasury can temporarily take a failing bank out of the private sector in order to maintain financial stability.[71]

The Act provides that the stabilisation options may be exercised only when various preconditions or circumstances are met. These are, that the FSA is satisfied (a) that the bank is failing, or is likely to fail, to satisfy the threshold conditions set out in FSMA to permit it to carry on regulated activities; and (b) that it is not reasonably likely that other action will be taken by or in respect of the bank that will enable it to satisfy those threshold conditions.[72]

Each of the three 'stabilisation options' can be achieved through the use of so-called 'stabilisation powers' conferred on the Bank and the Treasury, namely:

- the share transfer powers – to transfer some or all shares in the bank thereby transferring ownership interests in the bank;[73] and
- the property transfer powers –to transfer of some or all of the bank's property, rights and liabilities to a relevant transferee).[74]

In addition to the three pre-insolvency 'stabilisation options' outlined above, the SRR powers also allow the authorities to apply to the court for the use of the Bank Administration Procedure (BAP) to deal with a part of a bank that is not transferred and is instead put into administration. The SRR also includes a Bank Insolvency Procedure (BIP), to ensure that eligible depositors as soon as reasonably practicable either receive payment from the Financial Services Compensation Scheme (FSCS) or have their account transferred to another institution.[75]

The BA 2009 sets out five key objectives in choosing which stabilisation option to use:[76]

- to protect and enhance the stability of the financial systems of the UK;

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68 *Financial Services Bill* [Bill 278], Explanatory Notes, 26 January 2012
69 Section 11 of the Banking Act 2009
70 Section 12 of the Banking Act 2009
71 Section 13 of the Banking Act 2009
72 S7 Banking Act 2009
73 Sections 14 to 32 of the Banking Act 2009
74 Sections 33 to 48 of the Banking Act 2009
75 More details on the FSCS can be found in Library Standard Note 4466
76 Bank of England, Special Resolution Regime

- to protect and enhance public confidence in the stability of the banking systems of the UK;
- to protect depositors;
- to protect public funds; and
- to avoid interfering with property rights in contravention with the *Human Rights Act 1998.*

6.2 Amendments to the *Banking Act 2009* SRR

The Bill introduces new schedule 17 into the BA 2009. This new schedule makes a number of organisational consequential amendments to the BA 2009 as a result of the conferral of the FSA's functions on the FCA and the PRA.

In addition, the Bill presents an opportunity for the government to make a number of minor changes (clauses 84 to 90) to the SRR. These adjustments are intended to enhance the transparency of the regime and make technical improvements:

- to allow property to be transferred back from a private sector purchaser (PSP), with the PSP's agreement;
- to remove an area of legal uncertainty by specifying that a property transfer instrument or order may modify terms of a trust only to the extent necessary or expedient to ensure that a transfer is effective;
- to require that reports about the operation of a bridge bank or a bank in temporary public ownership must include financial information that gives a true and fair view of the state of affairs of the firm; and
- to require the Bank to make a report to the Chancellor of the Exchequer about the exercise of the Private sector purchase tool, to be laid before Parliament;
- to enable the Treasury to direct a person appointed as a bank administrator to comply with such measures as are necessary for the purposes of assisting the UK in obtaining the approval of the European Commission for any State aid provided in connection with a resolution under the BA 2009;
- to enhance powers in relation to inter-bank payment systems

These are predominantly minor and technical amendments to the SRR, and the information that follows on the respective clauses relies heavily on the Explanatory Notes that accompany the Bill.

6.3 Reverse transfer powers and private sector purchasers

As outlined above, the SRR provides the authorities with three stabilisation options and the stabilisation powers needed to intervene in the business of a failing bank or building society at a pre-insolvency stage and attempt to achieve an orderly resolution. Under sections 26 to 31 and 42 to 46 of the BA 2009, following an initial exercise of a transfer power, the relevant authority may use supplemental, onward and reverse transfers.

A 'reverse transfer" can be used to transfer the securities, or property, rights and liabilities from a transferee back to a transferor. For instance, if, having transferred property, rights and liabilities from a failing bank to a bridge bank, the Bank then decides to transfer some of that business back to the failing bank, this would be a reverse transfer. There may be various reasons why the Bank may wish to do this, but one obvious reason would be to minimise the

need to capitalise a bridge bank with public funds where the assets transferred from the failing bank are found to be significantly impaired.

A current difficulty with the BA 2009 is that reverse transfer powers are not available in respect of securities or property, rights and liabilities which have been transferred to a commercial purchaser. **Clause 84** of the Bill seeks to correct this by inserting a *new section 26A and 42A* into the BA 2009 and making other modifications to Part 1 of that Act to extend the availability of the reverse transfer powers to transfers to commercial purchasers. The aim being to provide the authorities with greater flexibility, for instance, where it is considered necessary to remedy the situation in which securities or property, rights and liabilities have been transferred in error.

However, in order to retain the interest of prospective acquirers of securities or property, rights and liabilities under a transfer instrument, it is proposed that these new reverse transfer powers may be exercised only where the person from whom the securities or property, rights and liabilities are to be transferred has given their prior consent in writing.

6.4 Property transfer instruments

Under section 33 of the BA 2009, a property transfer instrument is an instrument which may provide for:

- the property, rights or liabilities of a specified bank to be transferred;
- may make other provision for the purposes, or in connection with, the transfer; and
- may relate to some or all of the property, rights and liabilities of the failing bank

In practice, there are various circumstances in which a property transfer instrument may be made by the authorities. For instance, a property transfer instrument may be made by the Bank for the purposes of:

- effecting a transfer to a private sector purchaser or to a bridge bank[77];
- and may also be made to make, for example, additional transfers from the failed bank[78], reverse transfers from the bridge bank to the failed bank[79] and onward transfers from a bridge bank to another person[80]

The Treasury may also make property transfer orders to transfer property, rights and liabilities from a bank in temporary public ownership[81] and reverse transfers[82] .

Currently, sections 34 and 36 to 40 of the BA 2009 make provision for some of the issues which may be provided for in either a property transfer instrument or property transfer order. Specifically, section 34(7) specifies that a property transfer instrument (or order) may make provision about property held on trust.

However, the Banking Liaison Panel, which was established under section 10 of the BA 2009 to advise the Treasury about the effect of the SRR on banks, building societies and the financial markets, has raised concerns about the effect of section 34(7). Specifically, that the wording of section 34(7) suggests that provision could be made in a transfer instrument or

77 Respectively, sections 11 and 12 of the Banking Act 2009
78 Section 42 of the Banking Act 2009
79 Section 44 of the Banking Act 2009
80 Section 43 of the Banking Act 2009
81 Section 45 of the Banking Act 2009
82 Section 46 of the Banking Act 2009

order to modify or terminate the terms of trust arrangements for reasons other than to effect a transfer and irrespective of the consequences for the beneficiaries of the trust.

To deal with these concerns, **clause 85(2) and (3)** of the Bill makes minor amendments to section 34(7) of the BA 2009 in order to make it clear that the terms on which trust property is held may only be modified or altered to the extent necessary or expedient, in the opinion of the Bank, to transfer the legal or beneficial interest in that property and any powers, rights or obligations in respect of that property. **Clause 85(4) and (5)** of the Bill provide for the same restrictions to apply in the case of property transfer orders made by the Treasury.

6.5 Reports following use of a stabilisation power

Under the BA 2009, there are strict reporting requirements following the use of the stabilisation powers by either the Bank or the Treasury.

In brief, where the Bank brings about a transfer of property, rights and liabilities from a bank to a bridge bank under section 12 of the BA 2009, it is required to report to the Chancellor about the activities of the bridge bank as soon as is reasonably practicable after:

(a) the end of one year beginning with the date of the first transfer to the bridge bank, and
(b) the end of each subsequent year[83]

In turn, the Chancellor is required to lay a copy of each report before Parliament.[84] Further, the Bank must also comply with any request from the Treasury for a report on any matters in relation to a bridge bank.[85]

It is also a requirement of the BA 2009, that where the Treasury makes a share transfer order under section 13(2) to transfer the shares of a bank into temporary public ownership, the Treasury are required to lay reports before Parliament on the activities of the bank.[86] This reporting requirement is also applied in the case of a transfer of the parent undertaking of a bank (a holding company) into temporary public ownership under section 82 of the BA 2009.[87]

A criticism of the BA 2009 is that there is no provision stipulating the information that must be included in such reports. In effect, there is the potential for reports to be produced on the operation of a bridge bank or a bank in temporary public ownership without any reference being made to the institution's financial position. A further criticism of the BA 2009 is that the Bank is not required to prepare a report where it has exercised its transfer power under section 11(2) of the Act to transfer the business or shares in a bank to a private sector purchaser.

To counter these criticisms, **clause 86** of the Bill inserts new sections 79A *and* 81A into the BA 2009. New section 79A requires the Bank to report to the Chancellor about an exercise of the transfer power under section 11(2). Whilst new section 81A requires reports produced under section 80 and 81 of the Act to include accounting information about the bank in temporary public ownership of a bridge bank that is the subject of the report.

[83] Section 80(1) to (3) of the Banking Act 2009
[84] Section 80(4) of the Banking Act 2009
[85] Section 80(5) of the Banking Act 2009
[86] Section 81(1) to (3) of the Banking Act 2009
[87] Section 83(2)(g) of the Banking Act 2009

6.6 State aid and the requirement for Treasury directions

Part 3 of the BA 2009 established a new bank administration procedure (BAP) for use where there has been a partial transfer of business from a failing bank. This new procedure is largely based on the existing administration provisions of the *Insolvency Act 1986* as amended by the *Enterprise Act 2002*, but with modifications where required.

Under this BAP, following an application by the Bank, a bank administrator may be appointed by the court to administer the affairs of an insolvent residual bank created either where part of the bank has been transferred to a private sector purchaser or to a publicly controlled bridge bank under the SRR.[88] The bank administrator has two objectives:

- The first is to provide support to the acquirer of the transferred business in order to ensure the business can continue to be operated effectively.
- The second are the normal objectives of administration, namely rescuing the residual bank as a going concern, or achieving a better result for the bank's creditors as a whole than would be likely if the residual bank had been wound up without first being placed in bank administration.

The bank administrator is required to begin working towards both objectives immediately upon appointment.[89] However, the administrator is expected to give priority to objective 1.

Clause 87 of the Bill inserts into Part 3 of the BA 2009 a *new section 145A. This new section* confers a power on the Treasury to issue directions to an appointed bank administrator for the purposes of ensuring compliance with any undertakings, commitments or conditions given or imposed in relation to the consideration and approval by the European Commission of any state aid given in connection with an exercise of transfer powers under Part 1 of the BA 2009.

This new clause is deemed necessary because Article 107 of the *Treaty on the Functioning of the European Union* effectively prohibits Member States from using state resources to provide aid to institutions on a selective basis where such aid would distort or threaten competition (as this would be incompatible with the principles of the internal market), unless such aid is approved by the Commission. It goes without saying that in many cases of failing banks or building societies, the use of one or more of the stabilisation powers under Part 1 of the BA 2009 will involve the use of public funds.

A direction from the Treasury may compel a bank administrator to act in such a way as may be necessary to secure compliance with any conditions imposed by the European Commission but which would otherwise be incompatible with the administrator's duties towards the creditors of the failed bank. Therefore, under **clause 87(7)**, the Treasury is empowered to give the bank administrator immunity from liability in damages for action or inaction taken in accordance with a direction.

6.7 Inter-bank payment systems

The BA 2009 introduced a clearer and more robust framework for the oversight of inter-bank payment systems. The Act gives the Treasury the power to designate an inter-bank system as a 'recognised payment system'. Once recognised, the Bank formal powers of oversight

[88] Respectively, section 11(1) and section 12(1) of the Banking Act 2009
[89] Section 137(2) of the Banking Act 2009

apply. The Bank performs its functions under Part 5 of the Act in pursuance of its overriding financial stability objective.[90]

Clause 88 (2) to (5) of the Bill makes technical amendments to Part 5. Whilst **clause 88(7)** inserts a *new section 202A* into the BA 2009 which enables the Bank to apply to the court for an injunction in those cases where there is a reasonable likelihood that there will be a compliance failure as defined in section 196 of the Act.

Clause 88(8) inserts *new sections 203A and 203B* into the BA 2009 which impose certain requirements on the Bank in relation to the discharge of its functions in connection with recognised payment systems. In particular, *new section 203A* requires the Bank to maintain satisfactory arrangements for recording decisions made in the exercise of certain of its functions under Part 5 of the Banking Act; *new section 203B* requires the Bank to report to the Treasury at least once a year in relation to, among other things, the discharge of its functions under Part 5.

Clause 88(9) inserts a *new subsection (1A)* into section 204 of the BA 2009 which provides that the Bank can require the operator of a recognised payment system to provide information in connection with any other of the Bank's functions undertaken in pursuance of its financial stability objective. The Bank can already require persons to provide information in connection with its functions under Part 5.

6.8 International obligations

Clause 89 of the Bill inserts a *new section 206B into the BA 2009.* This is important because the new section enables the Treasury to direct the Bank in exercising its powers under Part 5 of the BA 2009 (inter-bank payment systems) not to take proposed action if:

> [...] it appears to the Treasury that action would be incompatible with Community obligations or any other international obligations of the United Kingdom. The Treasury may also direct the Bank to take action which it has power to take where that action is required for the purpose of implementing any such obligation. This power is similar to the power in section 410 of FSMA (international obligations).[91]

6.9 Amendments relating to new regulators

Clause 90 introduces schedule 17 to the Bill which makes a number of organisational ***amendments to the BA 2009 as a result of the conferral of the FSA's functions on the FCA and the PRA.*** Schedule 17 is divided into four parts:

- Part 1 deals with the amendments to the SRR as set out in Part 1 of the BA 2009;
- Part 2 deals with the amendments to the bank insolvency procedure as set out in Part 2 of the BA 2009;
- Part 3 deals with the amendments to the bank administration procedure as set out in Part 3 of the BA 2009; and
- Part 4 deals with the amendments to Parts 4 to 6 of the BA 2009 (FSCS, inter-bank payments systems, and bank notes in respect of Scotland and Northern Ireland).

[90] Specified in section 2A of the Bank of England Act 1998 as amended by clause 2

[91] *Financial Services Bill* [Bill 278], Explanatory Notes, 26 January 2012, http://www.publications.parliament.uk/pa/bills/cbill/2010-2012/0278/en/2012278en.htm

The technical detail on each of these amendments is set out in the Explanatory Notes that accompany the Bill.

The Bill amends the provisions of the BA 2009 which confer functions on the FSA. The PRA is given responsibility for 'pulling the trigger' for the SRR (i.e. determining whether the general conditions of section 7 are met), but must consult the FCA before doing so. More generally, where the Bank or the Treasury are required to consult the FSA, this is replaced by a duty to consult the PRA and the FCA.

As outlined above, the Bank Insolvency Procedure (BIP) makes provision for a special insolvency procedure which can be used as an alternative to an exercise of the stabilisation powers or a 'normal' insolvency procedure. Schedule 17 to the Bill makes important changes to this BIP.

In brief, the PRA is to inherit the FSA's power to apply to the court for a bank insolvency order in respect of a failed bank (which is a PRA-authorised person). [92] The PRA may only apply for such an order where certain conditions are satisfied, these conditions are that:

(i) the Bank has given its consent;
(ii) the PRA is satisfied that the conditions in section 7 of the BA 2009 have been met; and
(iii) the bank has eligible depositors and that the winding up of the bank would be in the public interest or would be fair[93]

Schedule 17 to the Bill further amends the BIP such that the liquidation committee must initially include an individual nominated by each of the FCA and the PRA.

7 Reaction to the Bill

The draft Bill received broad approval from a range of witnesses at the Joint Committee hearings. Such approval was tempered by the equally common comment that the details of any regulatory system were far less important than the culture and attitude of those involved in the regulatory process and concern about individual issues. For example, the Final Report from the Joint Committee concluded on this issue that:

> 24. To be successful the reforms will have to change the regulatory culture and philosophy. It is through a change in culture and philosophy that the relevant authorities can best ensure both financial stability and good conduct of business. A key aspect of the cultural change needed will be a shift towards forward looking supervision as explained in paras 188-198. This will require staff with appropriate experience, approach and attitudes. A change in culture is not something that legislation can guarantee but legislation can influence the culture of a regulator by:
>
> (1) setting objectives,
>
> (2) allocating and aligning powers and responsibilities,
>
> (3) establishing appropriate systems of accountability.[94]

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[92] As set out in section 95 of the BA 2009 (application to court for an order placing a bank into the BIP), section 96 (grounds for applying for such an order) and section 100 (liquidation committee)

[93] Section 96(3) of the BA 2009

[94] Joint Committee on the draft Financial Services Bill, HC 236 2010-12, pp24

The most comprehensive and detailed guide to many 'stakeholder' views can be found by looking at the written evidence submitted to the Joint Committee on the draft Bill.[95]

The broad acceptance of much of the Bill has continued post publication. As has been outlined above there have been several changes made to the draft Bill reflecting comments by the two committees and promises in other areas by the Government to look at other contentious issues. At the time of writing only a few bodies and organisations have published their reaction to the final Bill.

General comment

Association of British Bankers

> "Today's publication of the Financial Services Bill is an important milestone in rebuilding trust in the financial services sector. There are still many issues to work though and we will continue working with government so the new structures, as they emerge, help supervisors improve their decision-making."
>
> On specific points Mrs Knight said:
>
> **Governance of the Bank of England**
>
> "The British Bankers' Association believes that greater power requires closer scrutiny. Concentrating regulation at the Bank of England needs to be balanced by stronger governance and accountability. The Court of the Bank of England will need to be ramped up and we are pleased people are now talking about strengthening oversight arrangements in light of the Bank's new responsibilities.
>
> "We also believe the scales of supervision must be better balanced so that the Financial Policy Committee has equal status with the Monetary Policy Committee. "
>
> **Crisis management**
>
> "The British Bankers' Association believes it is vital to bring the Chancellor into crisis management decisions at an early stage – and sooner than the current proposals suggest. The Bill has got it right when setting out the responsibilities for all the different crisis management functions but we feel there should be a rethink about the point when the Bank involves the Chancellor to include situations in which the Bank might trigger the Special Resolution Regime.
>
> "The way the financial system copes with crisis also needs to dovetail across the EU so that what happens in the UK is in step with everyone else. Unless we operate the systems in parallel we will end up with two regimes per bank."

Consumer credit and consumer affairs comment

FSA Financial Services Consumer Panel

> Panel welcomes intention to transfer consumer credit regulation to the FCA
>
> **27 January 2012**
>
> The Financial Services Consumer Panel has today welcomed the announcement of the intention to transfer of responsibility for consumer credit to the new Financial Conduct Authority (FCA) from the Office of Fair Trading (OFT).
>
> The FCA will take over from the FSA once the anticipated Financial Services Bill is enacted.

[95] Joint Committee on Draft Financial Services Bill Evidence,

Adam Phillips, Chair of the Consumer Panel, commented:

"The Consumer Panel welcomes the intention to transfer responsibility for consumer credit regulation to the FCA.

The Panel has long advocated this commonsense proposal which is what most people assume to be the situation now. When this happens, this will create a single regulator responsible for delivering effective consumer protection, whether consumers are saving or borrowing money. However, we consider it essential that all consumer protection mechanisms under the existing Consumer Credit Act are retained through this transfer .

Office of Fair Trading

27 January 2012

Following today's announcement regarding consumer credit, the OFT will work with the Government, FSA and other partners to help to design a model of FCA regulation that enhances strong protections for consumers in this market.

Until any transition takes place, the OFT will continue to work hard protecting consumers and tackling businesses that fail to meet their legal obligations and the standards we expect of them.

The OFT supports the Government's position on the FCA's competition powers and objectives and will build on its close working relationship with the FSA over the coming months to implement a new FCA framework that works well for consumers and the markets alike.

FSA executives' speeches on the forthcoming FCA

Speech by FSA Director of Supervision, Conduct Business Unit "FCA supervision" January 2012

Speech by managing director of the conduct business unit "A new regulatory Approach" June 2011

Speech by Chief Executive of FSA "The future of Banking Regulation in the UK" June 2011

Appendix 1 The Court of the Bank of England

The following description of the activities of the current Court of the Bank is taken from a Bank Response[96] to the Treasury Select Committee Report Accountability of the Bank of England, 21st Report HC 874, 2010-12

> 58. The role of Court has changed considerably since 2003. It comprises 12 members of which 9 (including the Chairman) are Non-Executive and 3 are Executive (the Governor and two Deputy Governors). This compares with a Court of 19 before the 2009 Banking Act of which 16 were Non-Executive. The lower number results in stronger participation and more structured discussion.
>
> 59. Some of Court's functions are similar to those carried out by the Board of a public company. Its principal role is governance, which it exercises through surveillance designed to ensure adequacy of resources and a rigorous approach to process. As with a public company Court delegates appropriate tasks to sub-committees, in particular Audit and Risk, Remuneration, and Nominations. It forms ad hoc sub-committees to oversee specific tasks, a recent example of which has been to determine the future accommodation of the PRA.
>
> 60. Again as with a public company, Court approves the annual budget and financial forecasts of the Bank, which involves the allocation of resources, and regularly monitors actual performance against budget. Court approves the Annual Report and Accounts. It also oversees the setting of personal objectives for the Executive, promotes value for money initiatives, participates in succession planning and induction programmes for new entrants and annually reviews its own effectiveness.
>
> 61. Court also has specific responsibilities for a range of activities that are peculiar to the Central Bank. It has a 'catch all' responsibility for managing the affairs of the Bank which includes determining the Bank's objectives and strategy. This responsibility is discharged partly by delegation to the Governor and partly through specific matters that it reserves to itself. These are carefully documented and reviewed annually. The aim of Court is to ensure the effective discharge of the Bank's functions and to ensure the most efficient use of the Bank's resources.
>
> 62. Court approves the Bank's strategic priorities for the year ahead under the headings of Monetary Stability and Financial Stability and, on a regular basis, monitors progress against them. Court also reviews risks to the Bank's balance sheet on a regular basis and monitors closely the risk map of the Bank through the Audit and Risk Committee which in turn receives regular reports from the internal audit function.
>
> 63. A specific responsibility of Court, undertaken by the Chairman but with a report back to Court, is to review with individual MPC members the processes and procedures followed by the MPC. Informal meetings are held by the Non-Executive Directors with external members of the MPC and the Non-Executive Directors are invited to attend pre-MPC meetings to familiarise themselves with current monetary policy issues. Visits around the UK with the Bank's Agencies are also encouraged. The Chairman plans to extend these activities to the FPC.
>
> 64. More recently, Court and the Audit and Risk Committee have been closely involved in monitoring the PRA transition project both as regards costs and timing. This is

[96] Response from the Court of the Bank to the 21st Report (HC 1769 2010-12).

probably the largest project the Bank has undertaken and involves considerable Bank resources.

Appendix 2: Changes to the bill post draft bill consultation stage

Principal changes to the Financial Services Bill between draft and final bill stages. This list was produced by the law firm Herbert Smith.[97] It is not an exhaustive or complete list but merely a guide to the larger changes.

- FPC must maintain a written policy on the exercise of its power of direction in relation to each macro-prudential measure
- Treasury will have a power to direct the Bank to provide financial assistance, or to use its stabilisation or bank administration powers
- PRA veto has been extended so that the PRA can require the FCA not to use its insolvency powers in respect of a PRA-authorised person
- PRA will have a specific duty to supervise firms
- Government will review and, if necessary, consult on any proposed changes to the threshold conditions; the Bill empowers the FCA and PRA to make "threshold condition codes" which will be binding on firms
- Proposed amendments to the "with-profits" regime may have some unintended implications
- FCA's strategic objective is now "to ensure that the relevant markets function well"
- FCA will have an operational objective to promote effective competition in the interests of consumers
- FCA will have the power to appoint skilled persons itself, and to charge the expense to firms (or individuals); it will not however be able to order issuers, sponsors or primary information providers to commission skilled persons' reports.
- Consumer bodies will be able to make super-complaints, and the FOS and regulated persons will be able to make referrals, to the FCA
- There will be a single complaints commissioner and process for FCA and PRA
- Regulators' powers in relation to holding companies (including unregulated holding companies) have been strengthened
- FCA will be given a basis in which to distinguish between retail and wholesale consumers

More detailed proposals for coordination on regulatory processes, enforcement and legal intervention are set out in the draft MoU between PRA and FCA.

[97] Herbert Smith Briefing