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Financial Services (Banking Reform) Bill: Committee Stage Report

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This Bill follows a series of Acts passed since the financial crisis of 2008. Whereas other Acts established a new regulatory framework, this Bill sets out a new 'architecture' of the institutions themselves. The key feature is the ring fencing of banks which separate retail deposit and lending functions from investment banking activities.

The committee stage proceedings must be seen in the context of the consideration of the UK banking system elsewhere. The draft Bill followed the recommendations of the Independent Commission on Banking and has subsequently been fashioned and polished by the (interim) analysis of the Parliamentary Commission on Banking Standards. The recommendations of both bodies were largely accepted by government and incorporated into revised versions of the Bill. Parliamentary proceedings on the Bill, however, began before the Parliamentary Commission had published its final report.

A consequence of this interaction between the process and the parliamentary timetable is that, at committee, the Opposition proposed many of the Parliamentary Commission's recommendations which the Government had rejected, as its own amendments. By contrast, the Government was waiting for the Commission to come to its final conclusions before responding and therefore tabled no amendments or new clauses at all.

The Bill applies to the whole of the United Kingdom.

Timothy Edmonds

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Summary

This Bill follows a series of Acts passed since the financial crisis of 2008. Whereas other Acts concentrated on the establishment of a new regulatory framework, this Bill sets out a new 'architecture' of the institutions themselves. The key feature being the ring fencing of banks, which splits their retail deposit and lending functions from their investment banking activities. Much of the Bill is concerned with the setting of the boundary; defining which activies fall on which side of the fence; how it is policed and reviewed; and the sanctions available if it is breached.

This particular Bill has had a 'collective' history. It started life as the recommendations of the Independent Commission on Banking (the Vickers Report), considered and largely accepted by government. The draft was then consulted on in more depth than perhaps any bill has before; followed by deliberations and recommendations of the Parliamentary Commission on Banking Standards. Its recommendations were considered and again largely accepted by government before they appeared in a revised bill – whilst still waiting for further major recommendations to be made by that Commission.

A consequence of this interaction between the process and the parliamentary timetable is that, at committee, the Opposition adopted many of the Parliamentary Commission's recommendations which the Government had rejected, as its own amendments. By contrast, the Government was waiting for the Commission to come to its final conclusions before responding and therefore tabled no amendments or new clauses at all.

Most of the debate in committee focused on clause 4 which defines the ring fence. The Opposition tabled a number of new clauses to discuss issues such as:

- Leverage ratio;
- Savings schemes, small firms and temporary large balances;
- Professional standards & Code of Conduct;
- Duty of care;
- Remuneration;
- Financial crime;
- Too big to fail/bail; and
- Financial inclusion.

A full description of the Bill can be found in a Library Research Paper (RP 13/15). The Bill can be found here . Explanatory notes to the Bill can be found here.

1 Introduction

The committee stage of this Bill was very different to 'normal' committee stages. Normally committee proceedings are dominated by amendments from the opposition reflecting either their own policy principles or 'probing' amendments seeking clarification about a particular part of the Bill. By contrast, the government uses the committee stage to make changes that have become obvious since its first printing and any subsequent professional scrutiny, or changes made due to changes of policy.

This particular bill has had a 'collective' history. It started life as the recommendations of the Independent Commission on Banking (the Vickers Report), considered and largely accepted by government. A draft bill was then consulted on in more depth than perhaps any bill has before; followed by deliberations and recommendations of the Parliamentary Commission on Banking Standards. Its recommendations were largely accepted by government before they appeared in a revised bill – whilst still waiting for further major recommendations to be made by that Commission.

A consequence of this interaction between the process and the parliamentary timetable is that, at committee, the Opposition adopted many of the Parliamentary Commission's recommendations which the Government had rejected, as its own amendments. By contrast, the Government was waiting for the Commission to come to its final conclusions before responding and therefore tabled no amendments or new clauses at all.

At the start of proceedings the Minister, Greg Clark said:

> The Bill is relatively unusual in the sense that it reflects the views of a Parliamentary Commission, which reported in December. The Government responded to the scrutiny of the Parliamentary Commission in February, the Parliamentary Commission then responded to our response and, in the days ahead, I will respond to its response to our response. It could be that, in our debates about its response to our response, I might feel inclined to respond further to its response as we go on. I am conscious that this could lead us into an infinite regress of responses—and who knows where that will end?—but I say that just to make it clear to the Committee and reassure everyone that the discussions that we have here are important and significant.[1]

This was not always the view taken by the Opposition. Its main spokesperson Chris Leslie said:

> My general anxiety is that the Government are not showing sufficient respect for the Bill's Committee stage in the House of Commons. First, they have truncated the process and tried to conclude it before we even get to see the Parliamentary Commission's final conclusions. Now, they have not even tabled amendments in Committee so that we can properly look at their responses to the Parliamentary Commission.[2]

For brevity, the Parliamentary Commission on Banking Standards is referred to as the 'Commission'. The prior Independent Commission on Banking will be referred to as 'Vickers' after its chair.

2 The Bill and Second Reading

A full description of the Bill can be found in a Library Research Paper (RP 13/15). The Bill can be found here . Explanatory notes to the Bill can be found here.

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1 PBC 19 March 2013 c5

2 PBC 19 March 2013 c4

2.1 Bill summary

The focus of the Bill is the problem of banks that are 'too big to fail'. Because of their size and their central deposit taking and payment-making functions, banks are as central to the normal functioning of an economy as are other utilities.

The Bill contains provision to separate the banking activities on which households and small and medium-sized enterprises depend, 'core activities', from wholesale or investment banking activities which may involve a greater degree of risk and expose an entity undertaking them to financial problems arising elsewhere in the global financial system. This separation is universally referred to as 'ring fencing'. Certain banks carrying on core activities (taking deposits) will be ring fenced: that is, they will have to comply with restrictions on the activities they can undertake. They will also have to comply with rules made by the regulator which ensure that they are capable of carrying on the business of providing core services independently of other members in their group.

They will, for example, be prohibited from carrying on activities (excluded activities) which make them vulnerable to problems arising in the financial system or which may make it more difficult for the banks to be wound down in an orderly fashion (avoiding damage to the wider provision of banking services) if they fail.

The general objective of the Prudential Regulation Authority is amended to require it to discharge its general functions in relation to ring fencing and ring-fenced bodies to protect the continuity of the provision in the United Kingdom of the core services related to core activities.

2.2 Second Reading

The debate was held on 11 March 2013. It was opened by the Minister, Greg Clark:

> The Bill has a simple objective at its heart, which is to answer what the Chancellor has called the British dilemma: how can Britain be one of the world's leading financial centres without exposing ordinary working people in this country to the terrible costs of banks failing?[3]

He continued by describing the journey the Bill had already undergone to get to that stage:

> The Independent Commission on Banking was established as soon as possible after the general election, in June 2010. It took extensive evidence before publishing an issues paper in September 2010 and an interim report in April 2011, on which it consulted, before publishing its final report in September 2011. The Government gave, and consulted on, an initial response in December 2011, before issuing a White Paper for consultation in June 2012. In the light of the responses to the consultation, a draft Bill was published last October and the Parliamentary Commission on Banking Standards was asked to subject it to pre-legislative scrutiny. The parliamentary commission's report was published on 21 December last year and many of its recommendations were accepted in the Bill published in February and laid before the House.[4]

He summarised the 'core' part of the Bill namely the ring fencing of bank activities:

> That recommendation has attracted widespread support, and the Bill creates the basic architecture of the ring fence by making it an objective of the regulator—the Prudential

[3] HC Deb 11 March 2013 c36
[4] HC Deb 11 March 2013 c36

> Regulation Authority and, if necessary, the Financial Conduct Authority—to secure the continuity of core services by preventing ring-fenced bodies from exposing themselves to excessive risks, by protecting them from external risks, and by ensuring that, in the event of failure, core activities can carry on uninterrupted, the so-called resolution objective. The core activities are defined, as recommended by Vickers, as the taking of retail and small and medium-sized enterprise deposits and overdrafts, but they can be added to if required through secondary legislation.
>
> In response to the parliamentary commission's recommendations, the Bill is now clear that to be ring-fenced means that the five so-called Haldane principles of separation should be followed, namely that the ring-fenced bodies should have separate governances, including boards; remuneration arrangements; treasury and balance sheet management; risk management; and human resource management. As the parliamentary commission has also recommended, directors of banks will be held personally responsible for ensuring that the ring-fence rules are obeyed. The parliamentary commission also made a recommendation that the ring fence should be electrified. That is to say that, if the rules are breached, the banks should be forcibly split.[5]

He then set out the policy areas where the Government had not agreed with either Vickers or, to the extent to which it had by then pronounced, the Commission. These were:

- the Government should have delayed presenting the Bill until after the Commission had reported
- there ought to be a reserve power to split the structure of the entire banking sector, rather than simply ring fence its activities; and
- should there be additional leverage ratio constraints above the Basel rules

His comments and explanations on each area are shown below:

Timing:

> The first is the timing of scrutiny [...]. I hope that hon. Members will accept, from the process I described earlier, that these proposals have already benefitted from an exceptional degree of consideration, both in the amount and, if I may say so, in the august quality of its scrutineers. It will soon be three years since the Vickers commission began its work, and it is less than two years until all the secondary legislation must be enacted if this work is to be completed in this Parliament, as I think we all hope it will be. The Bill is comparatively short—20 clauses— and the time envisaged for its Committee stage is not unreasonable for consideration of all the amendments proposed by the parliamentary commission in its report published today.
>
> However, I know that the parliamentary commission has other advice to give, and I welcome its commitment to produce its final report by the middle of May. Once we have received the commission's advice, we will of course want the chance to be able to take it. I therefore give this commitment: subject to the usual channels, I will make sure that this House has enough opportunity to consider and debate whatever further recommendations the commission makes in its final report.[6]

[...]

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[5] HC Deb 11 March 2013 c39

[6] HC Deb 11 March 2013 c41

Sector reserve powers:

> One of the parliamentary commission's policy recommendations was for a general reserve power to split up the entire banking system if it were considered to be appropriate in future.[...]. The Government's view is that such a power would, in effect, introduce a different policy—one that was considered and rejected by the Independent Commission on Banking, which concluded that full separation would have higher costs for a gain "that might not even be positive"— without anything like the three-year period of scrutiny and analysis that this policy has enjoyed.
>
> The proposal would, in effect, legislate for two policies at the same time—ring fencing and full separation. We must legislate for the policy that the Vickers commission proposed. If a future Government were to consider that ring fencing was no longer the right solution—which they would be perfectly entitled to do—they should conduct a full analysis of the case for alternative reforms and, in the light of that analysis, introduce new legislation to Parliament.
>
> In addition, the parliamentary commission has proposed that the exercise of the reverse power by the Prudential Regulation Authority should include safeguards, including a Treasury veto, to ensure that the regulator behaves in a non-discriminatory way. The Government agree that there should be such a veto and will table an amendment to provide for a firm-specific power to require separation while the Bill is before the House. In addition, a further safeguard is available for any bank that believes it has been treated unfairly—namely, recourse to the courts.

Leverage ratio

> One very important point that both the Vickers commission and the parliamentary commission agreed is that, in addition to the enhanced capital requirements on ring-fenced banks, there should be a minimum leverage ratio and that it should apply to unweighted assets of 4.06%, rather than the Basel III standard of 3%.
>
> Let me be clear: this Government support the introduction of a minimum leverage ratio. It provides a simpler measure than risk-weighted assets, the calculation of which can be complex and disputed. Furthermore, it has been established empirically that a rise in the leverage ratio often preceded credit booms in this country and overseas.
>
> The question remaining is about the precise level of the leverage ratio. I referred earlier to the British dilemma of how to maintain an internationally competitive financial sector without imposing risks on domestic taxpayers. This is a case in which that dilemma is, to be frank, most acute. When it comes to capital requirements, international agreements have already established that different countries will have different requirements. The European Union capital requirements directive, CRD4, provides for member states to have discretion to go beyond agreed capital requirements.
>
> In the case of the leverage ratio, the 3% Basel III recommendation was for the requirement to be binding only from 2018, and it is not clear yet whether there will be the flexibility in European law to increase it as Vickers and the parliamentary commission recommend. The Vickers commission did not recommend that the higher leverage ratio should apply before 2019, in order, for reasons that I think we all understand, to minimise the impact on lending in the short term while the economy is still recovering.
>
> Furthermore, during our repeated consultations, concerns have been raised by institutions such as building societies that they could be caught by a 4% leverage ratio despite having a relatively low-risk portfolio of assets, thereby restricting lending to home owners. Moreover, it would lead to assets in Spanish property, for example,

> being viewed as equal to US Government bonds for the purposes of the calculation. Our view, therefore, is that at this time we should follow the international approach and press for countries to have a power to set a higher ratio from 2018, following a review in 2017.
>
> Having said that, in the interests of transparency, we agree with the recommendation of the Financial Policy Committee that banks should disclose their leverage ratios from 2013. I confirm that they will do so from this year.[7]

Leading for the Opposition, Chris Leslie repeated the point about the disconnect between the parliamentary scrutiny and the work of the Commission. He described the remaining issues that Labour disagreed with the Government over, namely the full separation of the sector; the leverage ratio; the inclusion of derivatives within the ring fence and issues surrounding financial inclusion:

> I want to address some of the issues the Minister raised about the detail of the Bill. First, on banking safety and protections for the taxpayer, Labour believes that a reserve power for full separation is needed, not just the firm-by-firm approach that the Government have conceded. Stopping short on backstop powers will reduce the chances that ring-fencing will succeed. Ministers are ignoring the commission's conclusions, claiming that it would be wrong to give the regulators full separation powers, but the commission is scathing in its report today, saying "The Government has erected a straw man which it has then successfully demolished, because we made no such recommendation" in the first place.
>
> It is clear that the commission wants a full separation power only after a full review and decision by Government and Parliament—perhaps it was being inadvertently misrepresented by the Treasury—so it would be far more sensible to legislate now, not just if one or two individual banks misbehave, but in case ring-fencing as a whole fails across the sector. Indeed, we see cross-sector failings, as LIBOR illustrates, so it is not enough to have a half-done backstop. Stopping short will deliver only half the backstop measures that we need and will have corporate lawyers across the City rubbing their hands with glee at the prospect of litigation against regulators who might want to intervene on a case-by-case basis. However, given the possible views of the other place, I suspect that the Government will eventually be forced to change their mind.
>
> Let me turn to leverage and the risk-weighting of assets, which has been introduced as an antidote by regulators to the high-risk, high-reward culture that was pervasive in banks before the crisis. However, the risk-weighting process has been partial and, in some cases, self-defining by the banks, and in the EU the zero risk-weighting attributed to some palpably risky sovereign debts has brought the system into some disrepute. The Basel committee published new evidence in January highlighting the major variants between jurisdictions and banks on this issue. Regulators and the Bank of England need to get a grip of this, but as a counter-balance we also need protections against the over-extended vulnerability of bank balance sheets. That is why the leverage ratio powers need to be clearly set out in the Bill and phased in ahead of the European Union plans for the end of this decade, which is one of the main recommendations and conclusions of the Vickers report.[8]

With respect to the inclusion of 'derivative products' within the ring-fence he accepted the need for some to be within the ring-fence, the test for determining the extent had not been set out fully enough in either the Bill or draft regulations under it.

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7 HC Deb 11 March 2013 c41

8 HC Deb 11 March 2013 c52

With respect to financial inclusion, he said:

> We need also to focus on some of the other issues that should be in the Bill today, particularly rebuilding consumer choice, financial inclusion and a diverse market. The Bill is silent on all those areas. There is nothing about challenger or new entrant banks; nothing to ensure a universal obligation on banks for basic bank account services. There is also pussyfooting around on switching of bank accounts, about which I know some Government Members are concerned. There is nothing on mutuality, despite the pledge in the coalition agreement to "foster diversity in financial services, promote mutuals and create a more competitive banking industry"; and nothing about a fiduciary duty of care for clients and customers. We will table amendments to ensure that high street lenders offer a basic bank account, which is particularly necessary because of the onset of the universal credit. We want a report within six months addressing obstacles to new-entrant challenger banks and current account provision. We also want Parliament to have an opportunity, soon after Royal Assent, to examine the adequacy of customer switching arrangements, and we want the publication of bank data on "lending deserts", the postcode areas where—as we are finding in our constituencies—some small and medium-sized enterprises and customers find it difficult to gain access to credit. Other tests need to be included in the Bill to fulfil the coalition's mutuality pledge. We also want a duty to be imposed on directors of ring-fenced banks to operate prudently and to safeguard deposits, and we want them to have a fiduciary duty of care to customers throughout the financial services.[9]

3 Committee Proceedings

The Committee first met on 19 March 2013 and had eight sittings. The Government Minister was Greg Clark and the Opposition spokesmen were Chris Leslie and Cathy Jamieson.

There were no government amendments, hence all references to amendments or new clauses below are opposition amendments. The Minister accepted outright one opposition amendment and promised to look further or make changes on Report on others. There were seven divisions. None was successful.

As was stated above, most, but not all of the amendments were based on recommendations of the Commission which had been rejected by the Government. Therefore, as Chris Leslie said in his opening remarks, a helpful guide to the context of the debate in Committee is the First Report of the Commission: *Banking Standards First Report*, in particular the section on its conclusions and recommendations.[10] Also useful are two Treasury documents. First its response to Vickers published in June 2012: *Banking Reform: delivering stability and supporting a sustainable economy*.[11]. Second, its response to the first Report from the Commission published in February 2013: *Banking Reform: a new structure for stability and growth.*[12] These documents set out the Government's position regarding the recommendations from both bodies.

Clause 1: Objectives of the Prudential Regulatory Body (PRA)

Amendments were moved to give both the PRA and the Financial Conduct Authority (FCA) explicit objectives to "reduce the risk of ring-fenced bodies assuming disproportionate exposure" [to risk].[13] Chris Leslie outlined how the Bill had changed in response to the

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9 HC Deb 11 March 2013 c55

10 Parliamentary commission on Banking Standards First Report; HC 848, 2013/14

11 HM Treasury, *Banking Stability : Delivering stability and supporting a sustainable economy*, June 2012, Cm 8356;

12 HM Treasury; *New Structure for Stability and Growth*, Cm 8545

13 PBC 19 March 2013 c8

various consultation stages to better reflect the tension between "the concept of continuity and the important goals of safety and soundness".[14] The amendment was withdrawn.

Further amendments regarding how the continuity objective and the resolution of banks objectives are both handled and reconciled, were moved. Part of the point of these was to bring procedures and the regulator's role onto the face of the Bill as suggested by the Commission. Replying, the Minister said that he felt that the Bill provided what the PRA had wanted after the changes that had already been made to the Bill in the course of the consultation and scrutiny process:

> The PRA has asked for clear objectives. It has expressly said that it did not want a set of objectives that it was forced to interpret in the face of what inevitably would be lobbying by vested interests from all sides. It has asked that the terminology be clear and unambiguous from the outset.
>
> Proposed new paragraph (c)(iii), which deals with resolution, requires the PRA to act in such a way that the continuity of core services is protected if a ring-fenced body fails. If this objective is enacted by Parliament and becomes an objective of the PRA, then if the continuity of core services has been protected, it seems to me to follow that it must have been handled in an orderly way.[15]

He said, as he would on several further occasions, that there was little between the parties in terms of their aims, and that he would look to see if the amendment, with perhaps different wording, could be included at a future date.

Clause 2: Objectives of FCA

The clause stand part was debated and agreed to.[16]

Clause 3: Amendment of PRA power of direction

The clause stand part was debated and agreed to. The debate included examples of when the PRA might overrule the FCA:

> The power would be used if, in the judgment of the PRA, a proposed action by the FCA would affect the continuity objective, which is to say that it could trigger a rupture in the continuity of banking services to the people of this country. Let me give an example. Suppose, on conduct grounds, the FCA were to propose immediately to ban particular products and the PRA were to judge that that would cause, perhaps because of the associated revenues, an immediate problem for the funding position of a bank. The judgment then has to be weighed up as to whether the necessary in due course requirements to change the way in which products are sold, or the products themselves, can be reconciled with the stability of the group. It is for the PRA to state and to certify that that, in its judgment, would threaten the continuity objective. In those circumstances, it would have the ability to stay the hand, as it were, of the FCA.
>
> Cathy Jamieson: I thank the Minister for giving way once again. He has obviously thought about the matter in detail. He provides the example of where products may have to be banned. What does he have in mind? From past experience or looking to the future, does he have any particular concerns?
>
> Greg Clark: I do not have any particular product in mind, but one can imagine a circumstance in which a product is important to a bank's current trading position and

[14] PBC 19 March 2013 c9
[15] PBC 19 March 2013 c17
[16] PBC 19 March 2013 c22

> balance sheet. The purpose of getting banks to be more robust and to have better provision for capital, for which the Bill provides, is to reduce the circumstances in which the measure may be necessary, but it is theoretically possible that the sale of a particular product may be sufficiently important to a bank's trading position that to interrupt it immediately could have consequences for its funding position and stability. The proposal is not expected or intended to be used frequently. Indeed, it is not intended to be used at all, as the Bill provides for greater resilience in the banking system.
>
> However, as all hon. Members would accept, if there were a circumstance in which the perfectly proper in due course restrictions for conduct reasons of a bank engaging in a particular activity were to have, without regulators being able to do anything about it, huge and disproportionate consequences for the banking system, it is right to have the ability—it is why the two institutions were created—to have such questions available for separate determination.[17]

Clause 4: Ring fencing of certain activities

The Opposition proposed two of the Commission's recommended changes. These concerned the power of the Treasury to provide exemptions to the 'general prohibition' (not to breach the ring fence), and the criteria for doing so. The Opposition supported the Commission in introducing new, harder, tests before such an exemption could be made. Specifically, any exemption "must positively enhance the stability of the financial system and have proactive benefits for the economy more broadly".[18] The Minister resisted the amendment on the general ground that the hurdle of *positive proof of benefit* was too high for, especially, new, small banks, to overcome. Also, he reminded the Committee that the Bill is "designed to establish the essential architecture of regulation"[19] and that the way in which that 'architecture' will operate is left to forthcoming statutory instruments.

The unusual nature of the Committee was illustrated at the start of the second sitting when an opposition amendment on the impact on competition of ring-fencing exemptions was described by the Minister as not having gone 'far enough' and he promised to 'reflect further'. The Opposition spokesman withdrew the amendment.

An amendment (not derived from the Commission) related to the evaluation, scrutiny and regulation of derivative products within the ring fence was discussed. It aimed to define the nature of the product; set limits to their overall size in relation to the banking business; and require a report on the regulation of derivatives within six months of Royal Assent. The Opposition's view was that the draft orders which covered this did not include satisfactory safeguards for things such as mis-selling of derivative products.

The Minister again highlighted the link between the Committee's proceedings and the Commission:

> Here is another novel twist for the Committee. We spent the morning debating amendments suggested by the PCBS and tabled by the Opposition, and now we have the Opposition anticipating amendments that the PCBS might have suggested had it got to that point in its deliberations.
>
> It is useful to be able to debate these matters, which, I think, have been one of the more difficult things both for the Independent Commission and the Parliamentary Commission to reach a settled view on. There have been discussions backwards and

[17] PBC 19 March 2013 c24

[18] PBC 19 March 2013 c29

[19] PBC 19 March 2013 c34

> forward around this issue. The Government referred the matter to the PCBS and asked it to advise us in its most recent report, and it has thrown it back to us to make the detailed rule. The issue is clearly exercising all sides.
>
> As the hon. Gentleman said, the PCBS has said that there should be three safeguards: adequate protection against mis-selling; a durable definition of what is and is not a simple derivative; and a limit on the proportion of such products on a bank's balance sheets.
>
> There are a couple of outstanding issues that the Committee needs to reflect on. The first is that, as the hon. Gentleman acknowledged, the Parliamentary Commission itself is continuing to reflect on some further aspects, including conduct. He rightly said that that was very important, not least for our constituents, many of whom have been mis-sold interest rate swaps and so have a keen interest in this matter. The Parliamentary Commission has said that it will opine on what the provisions should be on the conduct of the sale of derivatives, and it is appropriate that it should do that.
>
> The other factor that the hon. Gentleman mentioned was that we have published a draft statutory instrument. Given that those recommendations from the PCBS followed some time after some of its other recommendations, the consultation in line with its report will take place in the summer.[20]

The amendment was withdrawn.

A further amendment to extend a 'prohibited act' to include an attempt to circumvent regulations was discussed.[21] The Minister rejected the argument citing the 'electrification analogy beloved of the Commission – "the point of a ring fence is that if you touch it you get a shock. You do not if you go near [it]".[22]

He also pointed out that if a firm had not broken the rules then it would not have endangered the financial system and, anyway, directors of firms had a responsibility to maintain the integrity of the ring fence by their firms, so controls already existed. Chris Leslie compared the situation to the criminal act of conspiracy and characterised the Government's permissiveness as akin to a 'golf club rule misdemeanour'. He said "we have hit upon a big difference of opinion" and pressed the amendment to a vote.[23] It was defeated six votes to nine.

A further Commission-inspired amendment was discussed. It proposed to restrict management/shareholding in ring-fenced bodies to ring-fenced bodies – i.e. to ensure that shares in ring-fenced bodies are held by non-investment bank companies – "a sibling structure, as opposed to a parent-child structure, between retail and investment banks".[24] Expanding the argument, Chris Leslie said that a holding company within the ring fence would make for easier resolution in the case of trouble than an investment bank outside.

The Minister said that the sibling structure had not been suggested by Vickers but that the Government had already moved a long way towards the Commission's views – embodying the Haldane principles as its criteria for separating ring fenced and investment banks. He thought the benefits of the amendment were not 'worth the candle'. The amendment was pressed to a division. It was defeated six votes to nine.

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20 PCB 19 March 2013 c46
21 PCB 19 March 2013 c51
22 PCB 19 March 2013 c55
23 PCB 19 March 2013 c59
24 PCB 19 March 2013 c61

Chris Leslie moved an amendment to insert an alternative system of review of the ring fencing provisions – within four years, and thence every two years – from that in the Bill. The Minister did not support this review cycle, praying in aid the care and expertise of the Vickers Commission and the evidence its views – reflected in the Bill – were based upon. He thought that they were in danger of reviewing reviews of reviews - "specific reviews at this stage […] might be in danger of undermining [Vickers]".[25] The amendment was pressed to a division. It was defeated seven votes to ten.

Chris Leslie moved an amendment that reflected one of the major divisions between the Government and the Commission, namely whether the PRA should have the power to order the complete separation of any ring-fenced firms. He explained:

> Amendment 20 would empower the regulator to require a group to sell off either its retail or its investment bank in certain circumstances. The power to trigger separation of a group needs to lie at the heart of a serious approach to reform. The Commission on Banking Standards has said that such powers are needed to "provide adequate incentives for the banks to comply not just with the rules of the ring-fence, but also with their spirit" and that failure to introduce such proposals would increase the risk of the ring fence failing. Separation is one of the ultimate sanctions available and would trigger fundamental change at a financial group with an impact far beyond that of fines, which, even in this era of LIBOR and PPI scandals, account for only a very small percentage of banks' revenue. A number of approaches have been taken to drafting the back-stop, reserve power of separation. It is interesting that the Commission has concluded that the particular amendment should be drafted in this way. Some have said that we should draft a separation provision, so that something in statute is triggered if a number of tests are passed, but the way the provision works, and the reason why it is linked with amendment 21, is that the provision for separation is essentially put into law as though it is happening, but the commencement of the provision would be ultimately in the hands of Ministers, in case the circumstance arises. That provision is somewhere towards the end of the Bill. The statute essentially sits dormant until such time as it is needed. Ministers could activate those sections of the Act in response to the triggering process.
>
> The Commission's first report said that it found "the evidence that it has received on the benefits for financial stability of some form of separation convincing. The evidence that there has been damage to standards and culture by having these activities side by side, an area not examined by"— the Vickers commission— "is comprehensive and a crucial consideration. There is evidence to suggest that, as well as supporting financial stability and reducing the risk to the taxpayer, separation has the potential to change the culture of banks for the better and to make banks simpler and easier to monitor."
>
> That is the direction in which the Commission was heading. The current Governor of the Bank of England, Sir Mervyn King, told the Commission, in paragraph 162 of the first report, that he had "always felt that total separation was the right way ultimately to go." and that he was "glad that many more people are now coming on board the idea that a move to some kind of serious separation is the right thing to do."
>
> As we have discussed however, the amendment does not necessarily lead to the separation of banking groups, but empowers the regulator or the Treasury to take such action, where necessary.[26]

The amendment only went so far towards his preferred option:

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[25] PCB 19 March 2013 c73
[26] PCB 19 March 2013 c84

> We would of course prefer to implement fully all of the Parliamentary Commission's recommendations, including a full reserve power for the total separation of the entire retail and investment banking sectors, because there is so much interconnected behaviour these days between banks. That would be the real warning and caution to all bankers to beware of contravening the ring-fence rules. It is important that the power is available in statute, ready to be triggered by regulators with Ministers.[27]

The Minister said that "we are amenable to the thrust of the amendment". The Government had changed its position in response to the Commission's, new views, published during the Committee stage, and it intended to bring its own amendments on Report.[28] He continued with a detailed review of the unique process by which policy had been reached in this Bill, a process which had some unfortunate implications for the committee stage.[29] The amendment was withdrawn.

A very similar set of arguments and consequences were applied to the next amendment which was also about giving full sectoral separation powers to the regulator. The amendment was pressed to a division. It was defeated two votes to eight.

Chris Leslie moved two amendments relating to the procedures to be adopted with respect to secondary legislation made under the Bill – namely to increase the degree of parliamentary scrutiny to affirmative or 'super-affirmative' depending on the order in question.

The first, amendment would:

> ensure that orders made under proposed new section 142C about the definition of "core services" for the purposes of the Financial Services and Markets Act 2000 and ring-fencing would be by affirmative resolution. The Treasury are to be given a power to broaden the definition of services beyond accepting deposits, offering overdraft facilities or withdrawing money, which are the definitions already in the Bill. Given that the basic nature of what is at the heart of banking will be set by such orders, it is worth Parliament having the chance to debate and confirm them. We hope that the process will be relatively uncontroversial, but it would be better to add this to the list of order-making powers that use the affirmative procedure.[30]

The **Government accepted this amendment** outright. The Minister rejected the second amendment, to introduce a super affirmative procedure for some powers, relying on the views of the Delegated Powers and Regulatory Reform Committee and the Government's response to those views.[31] The amendment was withdrawn.

The clause stand part was debated.[32] Chris Leslie discussed the position of 'high net worth' individuals within the ring-fence arrangement and whether investment banks might want to compete for retail deposits more actively in the future and, if so, what protections were there for people who opted to make such deposits?

In his speech, Jacob Rees-Mogg (Conservative) commented that ring fencing was not a panacea to all banking problems and that many of the problems today were as a consequence of, for example, poor mortgage lending. The clause was agreed to.

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[27] PCB 19 March 2013 c85
[28] PCB 21 March 2013 c91
[29] PCB 21 March 2013 c92-3
[30] PCB 21 March 2013 c118
[31] PCB 21 March 2013 c120
[32] PCB 21 March 2013 c128

Clause 5: Directors of ring fenced bodies to be approved persons

An amendment would ensure that half the Board of a ring-fenced body was independent "to safeguard the integrity of the ring-fence".[33] Chris Leslie reminded the Committee of the failure of directors to sufficiently challenge their executive directors in the lead up to the financial crisis. Once again the Minister responded by telling the Opposition that although they agreed with the principle behind the amendment and the definitions (of independence) used to underpin it, their amendment was not radical enough. He saw no reason why it had to be just 50% of the Board that was independent. The Government was not convinced however, that the setting of any figure was necessary on the face of the Bill, given the adoption of the 'Haldane principles' on separation enunciated in the previous clause. The amendment was withdrawn.

During the clause stand part debate the Minister, at Opposition prompting, promised to look at the issue of why directors of non ring-fenced bodies should not also be 'approved persons'.

Clause 6: PRA Annual Report

Chris Leslie thought that the requirement in this clause that the regulator should report on how banks complied with the ring fence did not go far enough. He, and the Commission, wanted greater detail about the "nature and extent of activities undertaken by retail banks in the field of derivatives".[34] He said that regular reporting would inform the debate about whether the exemptions applied to such products (allowing them within the ring fence) continued to be justified. The Minister said that the Government currently wanted the report to be "broad in scope" rather than "a detailed checklist of required components".[35] This explanation was rejected as insufficient by Chris Leslie. The amendment was pressed to a division. It was defeated six votes to eight.

Clause 7 & Schedule: Ring fencing transfer schemes

This section of the Bill sets out the way in which, in order to comply with the requirements of the ring fence, banks can transfer, through the courts, assets and liabilities from one legal entity to another without needing the agreement of all those affected. The clause was discussed briefly on a stand part basis. An amendment to the Schedule was moved. Chris Leslie explained its origin and purpose:

> Under section 111 of FSMA, the court may make an order sanctioning the transfer scheme if certain conditions are satisfied, including that the appropriate certificates have been obtained and any authorisations required are in place. In addition, subsection (3) says: "The court must consider that, in all the circumstances of the case, it is appropriate to sanction the scheme."
>
> Amendment 29, which was drafted by the Commission, would require an additional condition to be satisfied before the court sanctioned a ring-fencing transfer scheme. The amendment would prevent courts from making sanctioning orders that "might lead to the dissolution of a company or to the transfer of liabilities owed to any persons in a manner that may prejudice the interests of those persons."
>
> What does that mean? It would implement paragraph 230 of the Commission's first report, which states that safeguards are needed to prevent the creation of the ring fence from being "used as an opportunity to shift liabilities…in an artificial way."

[33] PCB 21 March 2013 c143
[34] PCB 21 March 2013 c150
[35] PCB 21 March 2013 c151

> The Commission felt that such safeguards were needed because the liability for conduct before the split would remain with the legal entity, which was responsible for the conduct in question. Therefore, if a company with outstanding liabilities was dissolved during the division into a ring-fenced or non-ring-fenced set of bodies, the liabilities might also be dissolved with it. It would be a bit like trying to pursue a double glazing or car sales company that had gone into administration; the rights of consumers to pursue a problem would be affected.[36]

The Minister saw that the amendment had 'good intent' but was unnecessary as the protections in the Bill were sufficient:

> The Government's view is that the safeguards that we have put in place should address that. I will outline those which are in the Bill already. First, the PRA's consent is needed, and the expectation is that the PRA would refuse to sanction any scheme that was about artificially evading a bank's responsibilities rather than a genuine implementation of the ring-fencing rules. Secondly, anyone who is adversely affected—whether creditors or, for these purposes, the mis-sold—is entitled to participate in the court proceedings. The court may approve an application only if it considers that application appropriate. It is not a rubber-stamping exercise; the court's scrutiny is to determine whether the proposal is appropriate, so the court could refuse the scheme if it were to conclude that it was artificially avoiding liabilities, as that would clearly not be appropriate.[37]

The amendment was withdrawn.

Clause 8, on the same topic but applied to building societies. The clause stand part was debated and agreed to.

Clause 9: Preferential debts

Chris Leslie moved a 'probing' amendment to discover the "Government's thinking about the impact on charities that are depositors" in insolvent banks.[38] He and other members of the Committee pointed to the example of Cyprus, where depositors' balances were potentially in danger. The problem was that as the Bill gave greater protection to deposits protected under the Financial Services Compensation Scheme (FSCS) – i.e. those up to £85,000, other deposits became more vulnerable and charities were one group that frequently had deposits in excess of the £85,000 limit.

Responding, the Minister pointed out that an insolvency event was a 'zero sum game' and that "if everyone is prioritised no one is prioritised".[39] He also made clear that the vast majority (in number at least) of charities were covered (prioritised) under the Government's plans – "About 1.8% of charities are not eligible for any FSCS protection on account of their size. In total some 3.5% would have deposits above the £85,000 limit".[40] The amendment was withdrawn. The clause stand part was debated and agreed to.

Clauses 10 to 15 were debated briefly on a stand part basis and agreed to.

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36 PCB 26 March 2013 c163
37 PCB 26 March 2013 c164
38 PCB 26 March 2013 c169
39 PCB 26 March 2013 c174
40 PCB 26 March 2013 c175

Clause 16: Orders and Regulations

This clause was debated with together with the Opposition's new clause 19 – Bank bail-in regime - which would require the Bank of England to report on the development of a bail-in regime in the UK. The Commission had proposed such an amendment.

Both the Opposition and the Minister acknowledged the interaction between UK legislative developments and EU developments on the same subject. This has been a common feature of the many areas of reform over the past five years, national governments finding themselves behind, or sometimes in advance of, new EU initiatives that require national harmonisation.

Chris Leslie accused the Government of "dragging their heels...waiting for the EU to determine this particular set of rules".[41] He also cited evidence to the Commission from HSBC which emphasised, for all the surrounding new rules and financial architecture, it was 'financial bail-in which provides the solvency' to support banks.

The Minister had a "good deal of sympathy for the arguments of the Commission and the case put by [Chris Leslie]". He noted that the UK had been one of the 'drivers' for progress in the EU, but it had taken longer to reach agreement than had been anticipated. The measure was a priority for the Irish Presidency, which ended in June 2013, by which time the Bill would reach Report. At that stage, the Government would know what had been agreed and whether it needed to move further unilaterally.

The Opposition did not accept this 'wait and see' argument and the amendment was put to a division where it was lost, seven votes to ten.

The remaining clauses were considered in the clauses stand part debates, either formally or briefly.

3.1 Opposition New Clauses[42]

Leverage ratio

The introduction of a leverage ratio for banks, limiting their expansion to a set ratio to their equity, as well as a capital ratio, received much support from both Vickers and the Commission and from those giving evidence to it. A leverage ratio capable of being varied according to institution and circumstance will be one of the 'tools' available to the Financial Policy Committee by 2018. The new clause would bring the ratio requirement onto the face of the Bill, give clear legal authority for setting such a limit and provide a floor to its rate.

The Government and the Commission disagree over whether the ratio should be 3% or a larger, more prudent, 4%. The Minister noted that the Basel Committee had "established that 3% is the level of the leverage ratio that would be consistent with providing the degree of protection that would have been appropriate [in the crisis].[43] He also drew attention to the concerns of the building society movement who are worried that a higher level would severely harm their business without increasing consumer protection. His opposition to the new clause was partly that it introduced the tool far earlier than international proposals suggested (now as opposed to 2018) and:

> Secondly, the new clause would imply a higher ratio than is proposed in Basel III. The hon. Gentleman alluded to the expectation, certainly in the building society movement, that the proposal would disproportionately hit institutions that focus on activities that in

[41] PCB 26 March 2013 c199

[42] The Government tabled no new clauses

[43] PCB 26 March 2013 c208

> any reasonable assessment are relatively low risk at the moment, such as the activities practised by building societies. Their concern is that far from being the back-stop that the Government and the Independent Commission prefer, for some institutions it could be a front-stop; it could be the primary constraint. As I mentioned earlier, if those institutions were prevented from practising their current business model, it could drive them into more risky lending.[44]

The amendment was pressed to a division. It was defeated eight votes to ten.

Savings schemes, small firms and temporary large balances

Cathy Jamieson described the three new clauses under discussion:

> The group of new clauses deals with some issues on which we feel we need further action to ensure that customers and consumers are protected. New clause 2 deals with protections for customers who buy vouchers. New clause 16 seeks a review into whether the Financial Services Compensation Scheme should do more to prop up small and medium-sized enterprises. New clause 21 deals with extending deposit insurance to cover accounts, the balances of which temporarily exceed £85,000. There are also issues regarding different banks having different brands in the banking family and ensuring that consumers receive more protection.[45]

New clause 2 was inspired by the problems of the Farepak savers – a Christmas savings scheme that became insolvent. Similar problems arose following the failure of retail outlets that issue vouchers or gift cards, e.g. HMV. Whilst the clause would not have stopped the firms becoming insolvent, it would require the FSCS to "publish a review of current protections... [and] whether such payments should be regarded as preferential debts".[46]

New clause 16 would extend FSCS protection to larger firms than are currently included and new clause 21 would address the issue of protection where several 'brands' are included in the protection limit of one bank, so deposits of £50,000 in both the Co-operative bank and Britannia would exceed the £85,000 limit since the Co-operative Group owns Britannia. The new clause would extend protection on a brand basis rather than a bank basis.

Responding, the Minister said that legally vouchers were not financial services but were 'advance payments for goods' and hence excluded from the Act. However he said that:

> The new clause would cause the FSCS to instigate a review. I can tell her that the Government have instigated such a review through the Department for Business, Innovation and Skills, which is responsible for the non-financial services that savings schemes fall into. Discussions are taking place, as part of the review, with industry and consumer groups on establishing a code of practice, mutual industry support schemes and other initiatives. I am sure that my ministerial colleagues in BIS will be happy to report to the hon. Lady on the progress of that review, and there will be occasions elsewhere in the House for her to probe it further. I want to reassure her and make sure that she is aware that we are alive to this important matter. If the Bill is not quite the right vehicle for it, there are others that we will consider.[47]

He was similarly encouraging of the second new clause, new clause 16:

> I am sure that she will be pleased to learn that we expect to be able to go further than is currently possible in the FSCS. The EU directive is being renegotiated, and there is

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[44] PCB 26 March 2013 c209
[45] PCB 16 April 2013 c220
[46] PCB 16 April 2013 c220
[47] PCB 16 April 2013 c225

> a proposal, supported by the UK, to extend to all non-financial businesses, regardless of their size, the protections of the deposit insurance scheme, up to the limit of £85,000. The process is well in train, and we are enthusiastically supportive of it[48]

To complete a trio of positive responses, he said that as part of the renegotiation, the aim of the UK government was to establish deposit protection by brand. The amendments were withdrawn.

Professional standards & Code of Conduct

Two further new clauses were moved. New Clause 3 would introduce a 'licensing regime for all approved persons exercising control functions'. This would go beyond the 'fit and proper' test that currently applies.

The amendment reflected closely recommendations subsequently made by the Commission (but published at the time of the proceedings) in its final report. The Minister commented on this fact, indicating that the Government wanted to wait for its conclusions on this 'central' point of its proceedings. He continued by outlining current arrangements:

> The current arrangement under FSMA is that individuals who perform controlled functions in a financial services firm require the regulator's prior approval before taking up their appointment. That is quite an interesting and perhaps under-appreciated feature of the regime at the moment. The controlled functions relate both to positions of significant influence in financial services firms and to consumer dealing functions, for example the provision of advice.
>
> A firm proposing to appoint a person to a controlled function has to submit in advance an application to the regulator. In some ways, interestingly, the powers currently provided are tighter than in professions where, typically, if people enjoy the approval of a professional body, they are free to practise anywhere, in any firm and in any role. That is not the case under FSMA. FSMA approval is for a specific appointment, individual, function and firm. The powers are quite well designed for what they purport to do. The question arises why they were not used more effectively, and no doubt the Parliamentary Commission is looking at that.
>
> The regulator may not agree to approve a person unless it is satisfied that the individual is a fit and proper person to perform the function to which the application relates. The question of whether a person is fit and proper covers both their competence and integrity. FSMA specifically allows regulators to make rules providing for specific demonstrated training and competence requirements, which are reflected in the new clauses, and to require that any approved person must satisfy those conditions. So far, that requirement been mostly used for customer dealing functions. Hon. Members will know that in the retail distribution review, for example, there is a requirement on independent financial advisers to have gone through training before they can advise their clients. That relates to the current powers on training.
>
> FSMA also allows regulators to issue statements of principle covering the conduct expected of approved persons. It is envisaged that the PRA and FCA will continue to do so. In fact, there are already statements of principles concerning the required standards of integrity that approved persons by the PRA or FCA will need to conform to. Those are binding on approved persons, not optional.
>
> FSMA also provides for codes of practice to be established. They are non-binding and are meant to be descriptions of conduct that would or would not comply with the mandatory statements of principle. From 1 April, following amendments made in the

[48] PCB 16 April 2013 c226

> Financial Services Act 2012, the regulators' statements of principle can apply to the conduct of approved persons in any function that they undertake, rather than to the controlled function. A person needs to be licensed to perform a particular controlled function, but the requirements on their conduct and integrity can apply to all aspects of their work, whether or not they relate to the particular matter that is approved.
>
> The approved persons regime includes disciplinary arrangements that are well known to the Committee. They include financial penalties, public censure and ultimately the withdrawal of approval, if a person is no longer considered fit and proper. Those sanctions are available for conduct that is in breach of a statement of principle, including in parts of the job that are not in a controlled function. We have in place a regime that is in effect a licensing system for individuals. It covers standards as well as technical aspects, with extensive sanctions that are potentially more intrusive than those in many professional bodies. For example, an accountant can practise anywhere without further authorisation for a proposed job.
>
> The question that arises is: why did that not work? Why did the regime not work in the past? It may have exposed the need to make greater use of such powers, to be clearer about the standards expected, and to be more active in removing authorisation and imposing sanctions, which, I hope, is an area that the Parliamentary Commission will advise on. Indeed, it may be that more powers are needed. That is what the Tyrie Commission is considering in depth and extensively. When the Chancellor appeared before the Commission, he gave an undertaking to include in the Bill any recommendations needed to take forward what is required to improve culture and standards. We will therefore have an extended ability to consider such proposals.[49]

The amendment was pressed to a division. It was defeated seven votes to ten.

Duty of care

The issue of whether a fiduciary duty should be placed on those in charge of financial institutions has been debated a number of times in different fora. New clause 5 gave another such opportunity. At its heart, the proposal is based on the argument that banks have not always acted in the best interests of their customers and, as a consequence, had lost their trust. Cathy Jamieson outlined the features of the clause:

> If such a duty were to be applied to banks generally, it could create problems in areas where banks have competing interests, or their customers have competing interests. However, we believe that, in the context of carrying out core services, it is right that customers should be able to rely on the banks to look after their best interests. The new clause would improve customer protection and boost consumer confidence in the banks.
>
> The more general duty of care amounts to a duty to act reasonably when dealing with the customer, or in matters relating to its customers. People may argue, and hon. Members may suggest, that both of those represent a principle that is hard to disagree with: banks should treat customers fairly. They may also argue that similar duties already exist in common law.
>
> I suggest, however, that those duties have developed in a piecemeal way, and creating a general duty would get rid of any uncertainty over whether a duty will be found to exist by a court. There would then not be the scenario where the customer always has to go to court for clarification. Giving the duties some statutory basis would bring them

[49] PCB 16 April 2013 c234

> within the remit of the regulators who cannot oversee the common law duties of care that currently apply to banks.
>
> When a similar amendment was debated in the Financial Services Bill in 2012, the hon. Member for Solihull (Lorely Burt) commented that the duties should not be made too specific or people might be able to circumvent them. However, the duties imposed by this new clause would allow all relevant considerations to be taken into account by a court, while assuring customers that the banks had the legal obligation to act fairly.[50]

She also noted that:

> in July 2010 the US Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, giving the Securities and Exchange Commission the authority to impose a fiduciary duty on brokers who give investment advice. A stronger duty of care would ensure that the industry had to take customers' interests into account when designing products, and had to provide advice throughout the product life-cycle. That takes us back to my earlier point that this issue is not simply about selling products, but about the many stages during which people are advised about what is in their best interests.
>
> We believe that several benefits would arise from placing such duties on ring-fenced bodies. Doing so would increase consumer protection and help to restore confidence in our banks. To return to another earlier point, it would raise standards of conduct in banks if they knew that they would be responsible for acting according to those duties. If the Minister does not feel that a fiduciary duty towards customers in the operation of core services and a duty of care towards customers across the financial services sector ought to be put in place, I would be interested to hear why; if he believes that legislation is not needed, I would be interested to hear what proposals he might have to ensure that those principles would be upheld.[51]

The Minister said that the fiduciary duty arose out of the principal-agent relationship whereas banking was a contractual relationship in law. Applying the former to the latter "would fundamentally confuse the basis on which banks operate".[52] However, N. Ireland Member Mark Durkan (SDLP) raised the issue of government consistency:

> The Minister's arguments differ from the previous Minister's arguments on the Financial Services Bill when we were in Committee and in the Chamber. Whenever many of us tabled amendments to the Financial Services Bill on the fiduciary duty and duty of care, the two arguments from the Government were: first, it does not need to be in the Bill because it is a common law requirement and is binding anyway, so we would not achieve anything extra and it would be otiose; and, secondly, in the context of a Bill that provided for the new regulatory framework, we were providing a fiduciary duty that would almost be a giant, stalking duty affecting everybody in every section of financial services, so it would be an impossible duty to meet and would not be focused and measured in the way needed.
>
> Proposed new clause 5 provides for the fiduciary duty to centre on ring-fenced bodies. The Minister has argued against other Opposition amendments on the basis that they widen the scope of the Bill beyond the guarantees and protections that people want in the concept of ring-fencing. The proposed new clause is focused in a way with which the Government should be comfortable. It applies the concept of a fiduciary duty in these new circumstances.

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[50] PCB 16 April 2013 c241
[51] PCB 16 April 2013 c242
[52] PCB 16 April 2013 c243

> When we debated the Financial Services Bill in Committee, we did not know the revelations about the LIBOR scandal and other things. Many Members said that not only was the fiduciary duty in common law, but it was regularly and competently observed in the banks. The only problems were what happened on the speculative side, which were the result of Government policy and so on, but the conduct of banks and bankers showed that they had a healthy, daily regard to their duty of care to customers. We all know differently now, and we should all know differently now.
>
> [...]
>
> I recognise the Minister's statement that once we get down to insurance companies, agents and so on, there may be greater difficulties, so I accept his slight point about the measure of proposed new subsection (b), but I thoroughly disagree with his argument. It runs contrary to the arguments on the fiduciary duty made by the Government last year.[53]

Although he also criticised the wording of the proposed clause, the Minister's opposition appeared to be more fundamental:

> I hope that the Committee can see that I take all the proposed clauses seriously. I think about them very clearly, and I hope rigorously, and come to a view, advised by my officials. I have given thought to the proposal and had discussions about it. My considered view is that such a change would confuse the situation. However well intentioned, it is imprecise. There is nothing between us at all on this—of course, we want consumers protected and ordinary people's deposits, savings and access to finance guaranteed, as far as they can be. We are doing that, and must do it, by being precise and clear and by putting in place provisions that can be enforced, while being clear who can enforce them and the institutions responsible.[54]

The clause was withdrawn.

Remuneration

The Opposition moved three new clauses related to remuneration, particularly the procedures by which levels are set.

New clause 6 would require shareholders to vote on the appointment of remuneration consultants. Cathy Jamieson quoted comments by Lord Lawson made to the Commission on the conflicts of interest such consultants faced:

> When they are brought in, they know that if they recommend low pay they will not get a repeat performance, so in order to ply their trade, they pitch their recommendation as high as they possibly can.[55]

New clause 7 would place employee representatives on company remuneration committees. New clause 10 would require the government to bring forward proposals on reform of remuneration at banks so that they "take account of the performance and stability…over a five-to ten year period."[56]

Responding, the Minister drew on several principles he said the Government were following:

- promotion of international good practice to avoid risk of regulatory arbitrage;

[53] PCB 16 April 2013 c244
[54] PCB 16 April 2013 c245
[55] PCB 16 April 2013 c245
[56] PCB 16 April 2013 c250

- involvement of shareholders; and
- reduction of threats to the system from the incentives generated by a bonus culture.

He set out what had been done and what was to come:

> Under the Financial Service Authority's remuneration code, being taken forward under the Financial Conduct Authority, between 40% and 60% of bonuses need to be deferred and at least 50% must be paid in shares or other long-term instruments. That means that the up-front cash element of bonuses is now limited to between 20% and 30%. Bonuses, in any event, are down by 80% since 2007. From 1 October this year, a binding shareholder vote will be required on executive pay. Since the financial crisis, we have put in place measures that make the United Kingdom one of the more rigorous regimes in the world regarding remuneration policy.
>
> New clause 6 would require shareholders to vote on remuneration consultants appointed to advise board remuneration committees. The Government consulted on such a proposal last November, but it attracted little support from shareholders. The feedback from the consultation is that that would introduce bureaucratic requirements without any particularly valuable benefit.
>
> Shareholders who responded to the consultation said that greater transparency is needed regarding the appointment of consultants to advise remuneration committees. We will therefore amend the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 to require future remuneration reports for quoted companies to state: whether anyone has provided advice to the remuneration committee; if so, who; whether that person or body has provided any other services to the company; who appointed the group or individual; how they were selected; the cost of that advice; and the basis of payment.
>
> We will lay regulations in the coming months and ensure that the provisions come into effect from October 2013. They will go further than we have done and give shareholders more information than ever before, without micro-managing their responsibilities. That is in the context that from October, there will be a new vote on the proposal for remuneration anyway. Our plan is consistent with the outcome of the consultation, and I hope that the hon. Member for Kilmarnock and Loudoun will find that it meets the spirit behind new clause 6.
>
> New clause 7 would require companies to have an employee representative on remuneration committees. It is important that such committees make their decisions based on a wide variety of information. Companies and shareholders may, if they want to, have an employee representative, but at the moment they are not compelled to.
>
> Our approach is not in any way to resist the idea that the opinions and experience of employees should be made available to boards and remuneration committees in making their recommendations; it is based on transparency. I have said that we will table amendments to the 2008 regulations on disclosure. Some further changes that we will make include requiring companies to disclose whether and how they have sought employees' views on pay and to publish that in directors' remuneration reports. They must say how they have taken into account the pay of existing employees in making pay decisions.
>
> New clause 10 would require the Government to introduce proposals for incentives to take into account performance and stability over a five to 10-year period. Again, I think all of us would recognise and reflect on the fact that some of the very short-term rewards and bonuses contributed to excessive risk-taking in the last financial crisis,

> and that was in the interests of neither shareholders nor taxpayers. The Financial Services Authority's remuneration code as it was drafted, now being taken forward by the Financial Conduct Authority, reflects the global Financial Stability Board's principles for sound compensation practices. This requires variable remuneration for risk-takers to be deferred for at least three to five years, and to be subject to a retention period on vesting.
>
> The difficulty with new clause 10 is that the period of deferral should clearly reflect the type of business that is subject to these provisions. For example, some funds come into existence and are wound up, and their business is completed in less than five years. In those circumstances, the correct alignment of incentives would be with the life of those funds.[57]

The new clauses were withdrawn.

Financial crime

Two new clauses on the broad topic of financial crime were discussed. New clause 8 would establish a new financial crime unit as part of the Serious Fraud Office. Chris Leslie noted that the head of the PRA had described it as "odd" that no one had "been locked up as a result of the banking crisis of several years ago."[58]

New clause 9 would add to the list of circumstances set out in the *Employment Rights Act 1996* which protected whistleblowers, regulatory breaches of FSMA.

Replying, the Minister noted that parts of the current *Crime and Courts Bill* would establish a new national crime agency responsible for economic and financial crime.[59] With respect to whistleblowing, he pointed out that the FSA currently received about a dozen calls a day from employees and over 10% of these were actionable. The evidence suggests therefore that people were not deterred from speaking up he said. He also pointed out that the *Employment Rights Act* protections already extend to LIBOR related offences. He continued:

> Therefore, the proposals in the new clause are covered in existing legislation. However, it is my view that we should not be complacent and it may indeed be desirable to go further in this Bill or in the future. In, I think, Treasury questions or perhaps even the Second Reading debate, the possibility was raised of our considering a whistleblower incentive scheme, similar to that introduced in the US recently by the Securities and Exchange Commission whereby whistleblowers can receive a proportion of any enforcement penalties. I undertook to consider that suggestion, and obviously, any such suggestion raises other issues. In the UK, we have always been very cautious about the use of paid informants, so we need to consider it carefully. I mention that only to point out, as the hon. Gentleman did, that the Parliamentary Commission is considering the matter. I think that hon. Members on both sides of the Committee look forward to hearing its views. We will consider whether further measures on whistleblowing in the financial services arena are needed in the light of its report. I therefore hope that this debate has given the Committee an opportunity to consider the matter for now and to be assured of the Government's absolute intention both to protect the existing provisions to safeguard the interests of whistleblowers, and to consider what might be necessary to enhance them further.[60]

The clause was withdrawn.

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[57] PBC 16 April 2013 c256
[58] PBC 16 April 2013 c258
[59] PBC 16 April 2013 c260
[60] PBC 16 April 2013 c263

Too big to fail/bail

New clause 11 would require a major review of "the obstacles to increasing competition for UK institutions". This led to a wide ranging debate about the competitiveness of the sector and the dominance of the big banks. New clause 22 would place a 20% limit on excessive market power.

Chris Leslie described banking as an uncompetitive market, dominated by a few large banks with poor customer satisfaction ratings. Mark Durkan moved an amendment to new clause 11 and spoke about the similar situation in N. Ireland to that in the rest of the country- a market dominated by the few. Nigel Mills, speaking to his new clause 22, which would place a limit of 20% market share on any ring-fenced body, said that the meat of the Bill, the ring fence did nothing about competition:

> The question that we must try to answer is that if we think that the banks have been too big to fail and perhaps too big to bail, what is "too big" and what are we going to do about it? In itself, ring-fencing will not stop banks from being too big, although it will perhaps have certain key advantages in the other objectives that I will set out.
>
> [...]
>
> It is worth looking at where we got to with our banks over the past decade or so. At the start of the 20th century, the three largest UK banks accounted for only 7% of GDP; by the middle of the 20th century that was 27% of GDP; and by the end it was 75%. A huge concentration took place. In 2007, the assets of the three biggest banks alone added up to about 200% of GDP—that was huge. That was not just a UK phenomenon. In 1998, the five largest global banks accounted for 8% of total banking assets; by 2008, that had doubled to 16%. So we have seen the consolidation right across the world.
>
> It is not a new problem that has been identified since the crash—the 2000 Cruickshank report into competition in the banking sector concluded that there were real problems across all the banking markets and that personal and business current accounts were too highly concentrated in UK retail banking. We have had that information—that we have a problem—around for 13 years now. The OFT looked at it in the early years of this Parliament and it has been considered by the Vickers report. The Parliamentary Commission on Banking Standards is still to publish its view on competition, but I think we will hear some robust recommendations. I am not convinced that it will go quite as far as I have gone with a cap, but we need to get this issue right.[61]

His amendment was supported by Jacob Rees-Mogg who saw it as "an extremely interesting approach that is a market solution rather than an automatically regulator-led solution."[62]

The Minister accepted that the market appeared uncompetitive but pointed out that:[63]

- the PRA had been given an "explicit competition objective";
- that entry conditions for new banks entering the market were less onerous than for established, larger, banks;
- there was a new £38 million DWP fund to encourage credit unions; and

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[61] PBC 16 April 2013 c269
[62] PBC 16 April 2013 c272
[63] PBC 16 April 2013 c273

- the Post Office has announced that it will start to issue current accounts shortly.

The new clauses were withdrawn.

New clause 12 would require the Treasury to Report to Parliament on account portability. The failure to change accounts – arguably because of the administrative burden of doing so – is often cited as a further cause of low competition within the sector. The Minister pointed out that the Government had already established a Payments Regulator and payment systems had received considerable attention in the course of previous, recent financial services legislation.[64] The amendment was withdrawn.

Financial inclusion

New clause 13 would give the FCA the responsibility to monitor access to affordable and simple financial services. New clause 15, more specifically, would compel banks to offer a basic bank account to anyone who wanted one with the exception of those convicted of fraud. This would be a radical change in law and represent another step towards the view of banks, not as companies, but as utilities. The Minister explained that in practice banks mostly complied anyway:

> The number of adults who do not have access to a bank account has fallen from 3.6 million in 2002-03 to 1.5 million. That is still 1.5 million too many, but basic bank accounts are now available to everyone apart from those people with whom, as the hon. Gentleman recognised, there are more difficulties—those who have a record of fraud or money laundering. Only one bank offers basic bank accounts to undischarged bankrupts, but the Insolvency Service will propose legislation to address that and to widen availability in that area. We agree strongly with the aim behind the new clause, but when we have such comprehensive coverage that mirrors the proposals in the new clause, we do not need to legislate so much as to drive take-up.[65]

The amendment was withdrawn.

[64] PBC 16 April 2013 c280
[65] PBC 16 April 2013 c281

Parliamentary Commission on Banking Standards

As has been explained in the body of this Paper events outside of the committee room are likely to have a significant impact on the final content of the Bill.

The Parliamentary Commission on Banking Standards produced its final report on 19 June 2013. It is a substantial document, even in summary form. Its conclusions and recommendations can be found here. Of these, some of those that were touched upon in the committee stage debate include:[66]

A new framework for individuals

The Commission proposes a new framework for individuals with the following elements:

- a Senior Persons Regime, which would ensure that the key responsibilities within banks are assigned to specific individuals, who are made fully and unambiguously aware of those responsibilities and made to understand that they will be held to account for how they carry them out;
- a Licensing Regime alongside the Senior Persons Regime, to apply to other bank staff whose actions or behaviour could seriously harm the bank, its reputation or its customers;
- the replacement of the Statements of Principles and the associated codes of practice, which are incomplete and unclear in their application, with a single set of Banking Standards Rules to be drawn up by the regulators; these Rules would apply to both Senior Persons and licensed bank staff and a breach would constitute grounds for enforcement action by the regulators.

Incentives for better behaviour

The Commission proposes a radical re-shaping of remuneration for Senior Persons and licensed bank staff, driven by a new Remuneration Code, so that incentives and disincentives more closely reflect the longer run balance between business risks and rewards. The main features of the redesign are as follows:

- much more remuneration to be deferred and, in many cases, for much longer periods of up to 10 years;
- more of that deferred remuneration to be in forms which favour the long-term performance and soundness of the firm, such as bail-in bonds;
- the avoidance of reliance on narrow measures of bank profitability in calculating remuneration, with particular scepticism reserved for return on equity;
- individual claims on outstanding deferred remuneration to be subject to cancellation in the light of individual or wider misconduct or a downturn in the performance of the bank or a business area; and
- powers to enable deferred remuneration to Senior Persons and licensed individuals, as well as any unvested pension rights and entitlements associated with loss of office, to be cancelled in any case in which a bank requires direct taxpayer support.

A new approach to enforcement against individuals

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66 PCBS Summary

The Commission envisages a new approach to sanctions and enforcement against individuals:

- all key responsibilities within a bank must be assigned to a specific, senior individual. Even when responsibilities are delegated, or subject to collective decision making, that responsibility will remain with the designated individual;
- the attribution of individual responsibility will, for the first time, provide for the full use of the range of civil powers that regulators already have to sanction individuals. These include fines, restrictions on responsibilities and a ban from the industry;
- the scope of the new licensing regime will ensure that all those who can do serious harm are subject to the full range of civil enforcement powers. This is a broader group than those to whom those powers currently extend;
- in a case of failure leading to successful enforcement action against a firm, there will be a requirement on relevant Senior Persons to demonstrate that they took all reasonable steps to prevent or mitigate the effects of a specified failing. Those unable to do so would face possible individual enforcement action, switching the burden of proof away from the regulators; and
- a criminal offence will be established applying to Senior Persons carrying out their professional responsibilities in a reckless manner, which may carry a prison sentence; following a conviction, the remuneration received by an individual during the period of reckless behaviour should be recoverable through separate civil proceedings.

Better functioning markets

The UK banking sector is not as competitive as it should be. The Commission proposes that:

- the Government immediately establish an independent panel of experts to assess means of enabling much greater personal bank account portability;
- the Treasury examine the tax treatment of peer-to-peer lending and crowdfunding firms to ensure a level playing field with established competitors and review the effectiveness of tax incentives intended to encourage investment in Community Development Finance Institutions;
- the major banks come to a voluntary agreement on minimum standards for the provision of basic bank accounts, including access to the payments system and money management services, and free use of the ATM network, within 12 months or be subject to a new statutory duty;
- competition be an objective of the PRA, subject to its overriding responsibility for financial stability;
- the Competition and Markets Authority immediately commence a full market study of competition in the retail and SME banking sectors to be completed on a timetable consistent with a Market Investigation Reference by the end of 2015; and
- the Government should immediately announce a process for considering alternative strategies for the future of RBS, including splitting the bank and putting its bad assets in a separate legal entity (a 'good bank / bad bank' split), to report by September 2013.