Financial Services Bill: House of Lords Report & Third Reading stages

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Section Business & Transport Section

This note summarises (mainly) government amendments passed during the Report and Third Reading Stages of the *Financial Services Bill* in the House of Lords. Another standard note (SN/BT/6456) describes the Lords' committee stages.

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Contents

1 House of Lords Report Stage: day 1 **2**

2 House of Lords Report Stage: day 2 **2**

3 House of Lords Report Stage: day 3 **6**

4 House of Lords Report Stage: day 4 **10**

Non-government amendments. 10

5 House of Lords Report Stage: day 5 **13**

Government amendments 13

Non government amendments 13

6 Third Reading **15**

1 House of Lords Report Stage: day 1

Speaking for the government Lord Sassoon moved a technical amendment to **Clause 1** that had been promised during the committee stage. A drafting lack in the Bill would have allowed the Governor or a deputy-governor to have been appointed as chair or deputy chair of the Court of Directors. Given its oversight functions on the actions of the Governor such a situation was not intended and the amendment "puts this beyond all doubt".[1]

Lord Sassoon moved ten 'minor and technical' amendments to Schedules 1 and 2 mainly to substitute 'director' for 'non-executive director'.[2]

2 House of Lords Report Stage: day 2

The proceedings began with three amendments to **Clause 6**, concerned with what was described as the failure of standards, morals and culture amongst parts of the City – its institutions, the practitioners and, on occasion the regulators. Examples of poor behaviour and misguided incentives that resulted in consumer harm dominated the lengthy debates. Divisions were held on each amendment and all were disagreed to.

Lord Newby introduced the first government amendment (to Clause 6) of the day. This was later described as the "access clause":

> My Lords, the question of access to financial services is obviously one that the House has considered very carefully as we have been going through the Bill. We all agree that it is very important that consumers, irrespective of where they live, their income levels, or any other characteristics, should have access to the financial services they need. However, while we have agreed on the principle, we have found it less easy to reach the same consensus on what should happen if the needs of people for access to financial services are not being met.

[1] HL Deb 6 November 2012 c902
[2] HL Deb 6 November 2012 c984

In debate in Committee, my noble friends Lord Sharkey and Lady Kramer in particular spoke eloquently about the problems caused by a lack of access to basic financial services in deprived communities and by a lack of lending and funding for SMEs in those same communities-a state of affairs that can further inhibit growth. The noble Baroness, Lady Hayter, offered her support in speaking up for the importance of ensuring access to financial services for everyone.

[...]

I will reiterate that I agree with these important points. Access to financial services is crucial. However, the Government have had concerns about the role assigned to the Government as opposed to the regulator in addressing these issues. We have made the point on several occasions that while the Government believe that the regulator has a role in promoting access and helping the most vulnerable, this should extend only as far as the FCA making sure that markets deliver, and that supply and demand meet people's needs. Where effective competition cannot deliver, the Government, not the regulator, should step in.

To put beyond doubt that we want the regulator to play a role in promoting access where markets already exist, the Government have tabled Amendment 27 that would add a new "have regard" to the FCA's competition objective. The Bill already states that in considering whether there is effective competition, the FCA may have regard to,

"the needs of different consumers who use or may wish to use financial services".[3]

He continued:

What do we think the FCA will do to put into effect this "have regard" in practice? In support of the new amendment, the FCA will need to undertake, where appropriate, an assessment of whether consumers have access to products and services that meet their needs. In order to do this, it will necessarily gather data from industry on existing provision and work with relevant organisations to understand what problems with access actual and potential consumers are facing. We will return to the question of data later this evening but I wanted to put beyond doubt that the FCA will collect data relating to access. It is in its interest to do so, and as the FCA's CEO-designate, Martin Wheatley, said just this morning:

"The banks have to make a commercial decision as to when they loan and when they don't loan, but getting information out there is an important part of getting society able to judge those banks".

Where the FCA has identified a problem with access, the regulator will consider whether it could take action that could close gaps in provision by promoting competition in the interests of consumers. It may also consider whether in fact its own rules and requirements are posing a burden on competition and restricting access.[4]

A further government amendment to **Clause 6** was discussed. This would require the FCA to have regard to “the differing expectations that consumers may have in relation to different kinds of investment”.[5] Lord Newby illustrated this with respect to social investment, where the financial return was only part of the reason for the investment; however, the amendment would give the regulator leeway in considering the appropriate degree of regulatory

3 HL Deb 12 November 2012 c1320
4 HL Deb 12 November 2012 c1321
5 HL Deb 12 November 2012 c1325

protection for all types of investment offers and products according to their main motivation. He also confirmed that the Government would transfer regulation of peer-to-peer lending to the FCA as part of the transfer of consumer credit responsibilities in 2014.[6] Both government amendments received broad support and were agreed to.

A further amendment to **Clause 6** added 'the financing of terrorism' to a non-exhaustive list of matters that would fall within the definition of 'financial crime'. This omission had been discussed during the committee stage of the Bill.

Also discussed then had been the worth of having a 'practitioner panel' for the PRA. A practitioner panel is an advisory group for a regulator. One already exists in the Bill for the FCA. Lord Newby moved various amendments to Clause 6 to give this effect.[7] They were agreed to.

A further government amendment would require the PRA to have regard for the impact of its actions on competition. During committee, it had been argued that the PRA needed a competition objective. This had been rejected by the Government. Lord Newby outlined the Government's response:

> In Committee we debated several amendments relating to whether the PRA should have a competition objective. Since then, the Government have considered further how the PRA should take account of competition considerations in its work, and decided to introduce provisions that, broadly speaking, require the PRA to be aware of the adverse effect that its actions can have on competition, and to minimise this wherever possible. In my view this strikes the right balance, ensuring that the PRA contributes to the creation of a more competitive environment in banking, but not to the detriment of safety and soundness. The PRA will have to explain how any rules it proposes to make are compatible with this new duty, as with its other regulatory principles.
>
> I hope the new requirement addresses concerns that the PRA's focus on safety and soundness will mean that it could impede competition within the financial services firms that it regulates or that it will ignore the impact of its actions or inactions on competition; for example, in setting barriers to entry for new entrants to the banking sector. In support of the new "have regard" requirement on the PRA, we are also introducing a requirement for the PRA's annual report to include how it has complied with this new duty.[8]

The amendment was agreed to.

In all of the preceding stages of the Bill, there has been a discussion over the extent to which regulatory zeal might suppress innovation and support for the wider economy. No one expressed a wish for the 'safety of the grave yard'. Such calls had been resisted by the Government until Lord Newby moved an amendment to **Clause 6** that would require the regulators to have regard to the 'desirability of sustainable growth in the UK'. Lord Newby explained the change:

> However, at Second Reading and in Committee, my noble friend Lord Sassoon listened to concerns from noble Lords on all sides of the House that the regulators would be excessively focused on their remits and would act in a disproportionate way which might constrain the financial services sector from acting to support activity in the

[6] HL Deb 12 November 2012 c1326
[7] HL Deb 12 November 2012 c1364
[8] HL Deb 12 November 2012 c1366

> wider economy. That is why a commitment was made to return with an amendment that would require the PRA and FCA to consider the wider impact of their actions.
>
> Amendment 44 delivers on this commitment. It requires the FCA and PRA to have regard to the desirability of sustainable growth in the economy of the United Kingdom in the medium or long term. This is a concept with which of course it would be extremely difficult to disagree. Sustainable economy growth is desirable, and it is important that the regulators will now be required to show how they have considered this in carrying out their general functions.
>
> To a certain extent, this gets back to the amendments that we have just debated. The regulators should not be the agents of the industry that they regulate. Regulation itself is not about enhancing the international competitiveness of our domestic financial sector, even if that is an outcome when regulation is proportionate and effective. This amendment recognises the link between an apparently appropriately regulated financial sector and the growth of the wider economy, and requires that the regulators bear it in mind. That is why the amendment I have tabled strikes an appropriate balance: it creates an expectation that the regulators must think carefully about the impact that their regulation may have on the wider economy; this is absolutely right. Seen in the light of the recent financial crisis, it is clear that taking appropriate regulatory action in good time would have served to safeguard sustainable economic growth in the medium to long term. This amendment will ensure that the regulators consider the wider economic impact of their actions.[9]

The amendment was broadly welcomed and agreed to.

Lord Newby then announced a new amendment that would change the way in which with-profits policies will be regulated, compared to the previous intended system:

> We had a very useful debate on this subject in Committee. As my noble friend Lord Sassoon stated at the time, with-profits policies give rise to a particular risk of unfairness because the benefits that policyholders receive are largely at the discretion of the firm. The tensions between the firm treating current and future policyholders fairly, and maintaining safety and soundness, are especially acute. It is therefore difficult to separate the prudential and conduct issues in the regulation of "with-profits", much more so than in any other type of financial services business. The Government's main objective, therefore, is to ensure that there is clarity in decision-making in this area. The approach that was originally envisaged in the Bill was that this clarity would be delivered by giving the PRA sole responsibility for ensuring an appropriate degree of protection for policyholders in relation to the making of discretionary payments.
>
> The noble Baroness, Lady Drake, raised a number of concerns including the possibility that excluding the FCA from decision-making would lead to consumer detriment, as the prudentially focused culture of the PRA may lead it to pay insufficient attention to the fairness element of policyholder protection. The Government have now given further consideration to this, and on balance we agree that this is an area where the Bill could be improved. We have therefore brought forward amendments that will ensure that both the FCA and the PRA have a responsibility in relation to the regulation of with-profits, rather than giving sole responsibility to the PRA. This will mean that the FCA has a full role in consumer protection, as it does in other firms. The PRA and FCA will have to put in place an MoU setting out their respective responsibilities in this area.
>
> However, to preserve the sense that there should be a final decision-maker, the PRA will be given the power to require the FCA to refrain from actions that conflict with its

[9] HL Deb 12 November 2012 c1376

> general or insurance objectives, for example if it considers the FCA action could harm the safety and soundness of a particular with-profits insurer or with-profits insurers generally. To ensure scrutiny and accountability, any such veto must be published unless the PRA considers it is against the public interest to do so. The Government's view is that this approach strikes the right balance between giving the FCA a much stronger mandate, and preserving clarity of decision-making and responsibility in this exceptionally complicated area.[10]

The final government amendment arose out of the LIBOR scandal. The measure would end the current practice of FSA fines on authorised companies from being 'recycled' within the regulatory structure. Put simplistically, today's fines are a subsidy for the levies and fees of tomorrow. The Government decided in the wake of the LIBOR affair that such money should go to public funds, net of enforcement costs. The measure affects all FSA fines from 1 April 2012 and all future fines of the FCA and PRA.[11]

3 House of Lords Report Stage: day 3

Clause 7: Extension of scope of regulation

The main government amendments to **Clause 7** extended regulation to activities connected with LIBOR.[12] The amendments follow on from recommendations made by the Wheatley review of LIBOR.

The amendments would

- Bring any benchmark activities such as LIBOR and, any other benchmarks, to be brought within the scope of regulation.
- create a series of new offences including a new criminal offence for making false or misleading submissions in connection with the determination of a benchmark.
- provide the FCA with new rule-making powers to require banks to submit to LIBOR and other appropriate benchmarks.

Lord Sassoon gave some background to the amendments:

> Amendments 70 to 73 enable benchmark-related activities to be specified as regulated activities under FiSMA. Amendment 70 inserts,
>
> "the setting of a specified benchmark"
>
> as a class of activity which is able to become a regulated activity under FiSMA. Amendment 71 defines "benchmark" as an "index, rate or price", which is defined from time to time by reference to the state of the market, and is used for the purposes of determining sums due under contracts, determining the value of investments, or measuring the performance of investments. A benchmark will be capable of being regulated only if it meets this definition, but the definition has been drafted in such a way as to be able to capture many possible benchmarks, potentially including inter-bank interest rate benchmarks such as LIBOR, equity or bond price indices, commodity benchmarks, and so on. Amendment 73 sets out the scope of activities related to the setting of benchmarks that may become regulated activities. The

[10] HL Deb 12 November 2012 c1382

[11] HL Deb 12 November 2012 c1386

[12] Library Standard Note 6376 contains more information on the LIBOR scandal and the current restricted scope of FSA regulation

activities covered include, among other things, the determination of a benchmark, the provision of information to a benchmark and the administration of a benchmark.

The precise activities and the range of benchmarks which will be brought within regulation will be specified in secondary legislation. Regulation of these activities will enhance and strengthen the FCA's ability to make rules on benchmark-setting as well as the regulator's ability to supervise directly and take regulatory action against persons involved in benchmark-setting processes.

The Wheatley review recommended that banks, including those not currently contributing to LIBOR, should be encouraged to participate as widely as possible in the LIBOR compilation process. Participation in LIBOR is currently voluntary; at present a total of 23 banks are members of different LIBOR currency panels. It is important that banks continue to play an active role in the process of submitting to LIBOR. In the absence of banks' submissions, LIBOR would lack sufficient evidence to be an accurate reflection of bank borrowing costs and could eventually cease to be an authoritative benchmark. In an extreme scenario, the rate may not be able to be published. The failure or absence of LIBOR-given the vast number and variety of contracts that reference the benchmark-would lead to severely disruptive implications for banks, other institutions and international financial markets. While the benefits of LIBOR are enjoyed by all banks, only a small number of banks contribute to LIBOR. Some large banks do not currently submit to LIBOR.

While it may not be necessary for the FCA to use this power immediately-if at all-should the number of LIBOR-contributing banks fall, then the use of this power could be considered. To that end, the power outlined in Amendment 80 allows the FCA to impose requirements on authorised persons to participate in a benchmark, including by reference to any code or other document published by the person responsible for the setting of the benchmark, such as the benchmark administrator. This ensures that the precise detail of what information is required to be provided-in what format, to whom and at what time-can be determined by the administrator through their code, and not directly by the FCA.[13]

When the LIBOR scandal first became known, the lack of clear capacity of the FSA to prosecute in some cases became more apparent. Lord Sassoon explained how the amendments would change this:

The Wheatley review recommended the creation of a new criminal offence to provide an appropriate sanction for those who attempt to manipulate benchmarks, such as LIBOR. While such attempts to manipulate LIBOR could constitute a criminal offence under legislation other than FiSMA, the FSA, and subsequently the FCA, are not in a position to investigate and effectively prosecute such conduct. The Government agree with the conclusion of the Wheatley review that there is a strong case that the body responsible for supervising the conduct of firms in the financial services sector-that is, the FCA-should be able to investigate and prosecute misconduct in this area. Furthermore, the Wheatley review also recommended that the Government review the workability of the existing offences under Section 397 of FiSMA.

To this end, the proposed amendments repeal the existing Section 397 and create provisions for three separate criminal offences. In particular, Amendment 114 repeals Section 397, and Amendments 108 to 110 create the new criminal offences. Amendment 108 recreates the existing offence of making a false or misleading statement in Section 397(2), with modernised language because that offence originally dates back to 1939.

[13] HL Deb 20 November 2012 c1732

> Amendment 109 widens the existing offence in Section 397(3) of misleading practices to include creating a false or misleading impression as to the market in, or price or value of, an investment for the purposes of making a profit or avoiding a loss. Amendment 110 creates a new criminal offence related to misleading statements and practices in respect of specified benchmarks, such as LIBOR. Amendment 111 deals with penalties for the new offences and replicates the penalties for existing offences under Section 397; that is, a person found guilty of these offences may face a prison sentence of up to seven years and an unlimited fine.[14]

He concluded by saying that:

> The detail of the activities which are to be regulated under FiSMA and the investments, activities and benchmarks to which the new criminal offences apply need to be set out in secondary legislation. This secondary legislation will be subject to the draft affirmative procedure, so the prior approval of this House and another place will be required.[15]

Though the opposition spokesman, Lord Eatwell, broadly welcomed the Wheatley proposals he questioned the amendments' details. In particular, he questioned why the Government did not consider establishing an independent body to set LIBOR and suggested the Financial Reporting Council might be included as a possible institution for setting and regulating the LIBOR code.

Two Peers raised the question about a definition of a 'benchmark'. Lord Peston mused that it might include things constructed by the Office of National Statistics, such as GDP deflators. Since such an index was materially affected by government, might not government be caught by the new offences?[16]

Responding to a large number of questions, Lord Sassoon said that the details would be part of the orders to be made under the Act. He said that the consultation on the secondary legislation would "start very shortly with a view to that secondary legislation being laid as early in the new year as the parliamentary timetable permits".[17],

With respect to questions about real commodity markets and the possible manipulation of gas prices which has arisen he said:

> The noble Lord identified something that is consciously in the drafting: it sets a line between purely physical commodity markets where there are other provisions in place which cover price setting. In energy markets, if we are talking about a purely physical commodity price setting, Ofgem is the regulator and has the investigative and enforcement powers for the manipulation of physical markets under the so-called remit legislation. I appreciate that the line drawn raises the questions that the noble Lord has quite rightly asked. With pure commodities that are consciously dealt with in other legislation, Ofgem would be the principle regulator. However, gas, oil and other commodity benchmarks may well be referenced by derivatives or other financial instruments, in which case they are included in this definition. So, pure commodities are not included, but if they are referenced by derivatives or other financial instruments, that is covered in this definition of investment.[18]

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[14] HL Deb 20 November 2012 c1734
[15] HL Deb 20 November 2012 c1734
[16] HL Deb 20 November 2012 c1744
[17] HL Deb 20 November 2012 c1746
[18] HL Deb 20 November 2012 c1746

He confirmed the definition of financial crime caught the new offences, however, he added that it was an "absolute principle that we do not put in place retrospective criminal offences".[19]

On giving the FCA the ability to refer to codes published by the Financial Reporting Council, as well as the body responsible for setting the benchmark, he believed amendment 80 already allowed the FCA to make such a reference.

He rejected the idea that economic indexes such as the RPI and GDP deflators were likely to be caught by the new provisions.

He felt that as the transfer of responsibility for administering LIBOR from the BBA to a successor body was not a legislative matter, he did not think it was appropriate for Parliament or the Treasury Committee to be directly involved.

The amendments were agreed to.

Lord Sassoon moved several amendments related to the transfer of consumer credit regulation from the Office of Fair Trading to the FCA. Some of these related to the fact that credit providers who will now be under the FCA in one capacity may have been under FSA jurisdiction in another capacity. The general rules prevent this 'dual' status. Many firms with consumer credit licenses are already appointed representatives under the FSA for non-credit related activity. The amendment provides for a third option for registration with the FCA.

Lord Sassoon then focused on the group of amendments connected to amendment 94D. Amendment 94D modified Section 23 of FiSMA to provide that a person who carried on a credit-related regulated activity without the relevant permission to do so, even though they might be FSA authorised for other functions, would commit a criminal offence. The amendment sought to fill any possible gap between the two regimes once merged. He gave an example:

> This amendment would bridge the gap and potential loophole between the Consumer Credit Act and FiSMA. Amending FiSMA to make it a criminal offence to lend or collect money without the correct permission would avoid the risk of sophisticated illegal money lenders seeking authorisation for a lower-risk activity-for example, being a credit broker-only to use this as cover to engage in lending or debt collection, to the potential detriment of consumers.[20]

Further amendments would enable the Treasury to confer powers on Trading Standards and the Northern Ireland department to use their existing investigatory powers in the Consumer Credit Act to investigate offences under FiSMA.

Responding to questions from Lord Stevenson (Chairman of a debt charity), Lord Sassoon, reminded peers that government would consult on proposals for the transition of consumer credit responsibility

> I will say again what I have said before-that the Government will consult on their proposals for the transition in early 2013 and no final decisions have been taken. The Government are very much aware of the need to allow the FCA and firms time to manage a smooth transition. In that context, we are considering options for phasing the implementation of the new FCA rulebook as well as interim arrangements for existing

[19] HL Deb 20 November 2012 c1753
[20] HL Deb 20 November 2012 c1760

> licence holders. So I can only repeat that my noble friend's concerns are perfectly fair and reasonable, and the Government are reflecting on them as we speak. Well, I am not-but wiser heads than mine are beavering away on this very topic this afternoon.[21]

Minor technical government amendments to **Clause 10** and **Clause 15** were agreed to.

4 House of Lords Report Stage: day 4

There were nearly 20 government amendments agreed to on the fourth day. Most of these were not debated. One opposition amendment was defeated after a division.

Clause 23: Rules and guidance

The Bill introduces a new power for regulators, namely, to publicise the fact that they have taken action against a 'financial promotion' if they feel it is in the public's interest to do so. Currently any order to withdraw such a promotion is not made public. As it currently stood, the Bill required disclosure on all occasions. The government amendment replaced 'must' with 'may' [disclose] in **Clause 23**. The minister, Lord Sassoon, stressed that this did not weaken the potential powers of the FCA but rather gave the "regulator some helpful discretion"[22]

Clause 36: discipline and enforcement

Clause 36, similarly to **Clause 23**, gives the regulators new powers to disclose if they have given a warning notice to a regulated person. The power itself was generally welcomed in Committee but, as the minister said:

> However, concerns have been raised by members from all sides of the House. These concerns fall broadly into two categories: first, that the power will be used irresponsibly; and secondly, that there should be a greater degree of independence involved in reaching a decision to disclose the fact that a warning notice has been issued. The Government have tabled amendments that I hope will address both these issues.[23]

The three amendments provide for

- the Treasury to repeal the warning notices power; and
- make the use of the power subject to the affirmative procedure
- the issuance of a notice and its disclosure would be by the Regulatory Decisions Committee, not by the regulator, who would otherwise be 'judge, jury and executioner'.[24]

Non-government amendments.

Lord Flight moved an amendment reflecting the common concern amongst independent financial advisers that actions against them are not protected by the *Limitation Act 1980*. Thus, unlike most professional they face the possibility of almost open ended liabilities for claims against them.

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[21] HL Deb 20 November 2012 c1764
[22] HL Deb 26 November 2012 c13
[23] HL Deb 26 November 2012 c59
[24] HL Deb 26 November 2012 c60

This issue was discussed when the original Financial Services and Markets Act was introduced in 2000 and has resurfaced regularly ever since. The general argument for non time limit is that it can take many years before it becomes apparent that a financial product is unsuitable or was wrongly sold, for example, endowment mortgages which were highly recommended by all in the 1980s and equally broadly castigated in the 2000's onwards.

Replying the minister, Lord Newby, said that:

> My Lords, when we debated this issue in Committee, my noble friend Lord Sassoon made it clear that this was an important issue for the regulator to review. The FSA has now committed to consider whether to investigate the case for a longstop as part of its business planning for 2014-15.
>
> The amendment deals with the Limitation Act. It is important to be clear about both the nature of the issue and why I do not think that requiring the regulators to apply the Limitation Act when making rules provides the solution.
>
> First, it is important to be clear that time limits apply for consumers bringing complaints to the FOS. These are: six years from the event that the consumer is complaining about, or, if later, three years after the consumer became aware, or ought to have become reasonably aware, that they had cause for complaint. The question which we are now debating is whether there should be a further absolute or overriding limit, possibly of 15 years. This is an extremely important question for the regulator to review and it is clear that it needs to take into account the particular features of financial services and financial service products in doing so.
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> [...]
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> It is important to realise that many of the matters that the FCA or PRA, or indeed the FOS, which is also relevant here, will be dealing with will not be subject to the Limitation Act at all. The Act applies to certain causes of action in private law, such as actions for breach of contract or negligence, but the FOS is required to determine cases by reference to what is,
>
> "fair and reasonable in all the circumstances of the case".
>
> In some cases, there will be no private law course of action and so nothing for the Limitation Act to apply to.
>
> It is also worth remembering that the Limitation Act is very context-specific legislation. Time limits vary considerably according to the nature of the claim; for example, the time limit for libel is one year whereas for negligence it is six years. The time limit also varies on the facts of the case. For example, it is extended in certain cases involving fraud or where the claimant has a disability. Even the 15-year, longstop period that applies in cases of negligence has exceptions-for example, for claims involving personal injury. Therefore, it would be particularly inappropriate as a guide for the FCA in its rule-making powers. It would be next to impossible for the FCA to know how the Limitation Act would apply to all the cases that could be subject to any proposed rule. Far from bringing the financial services into line with other sectors, we would, in our view, be failing to acknowledge that in financial services, as in other sectors, there are many claims to which the Limitation Act does not apply.[25]

Clause 30: Additional powers to direct UK clearing houses

[25] HL Deb 26 November 2012 c18

In response to amendments that sought to define more closely and limit the powers given to the Bank of England with respect to clearing houses (e.g. the Stock Exchange) the minister said that:

> the Government are minded to bring forward amendments at Third Reading to address some of the concerns raised by the industry.
>
> Before bringing forward amendments at Third Reading, I will reflect further on the debate we have had today. However, I am happy to confirm that the Government are considering amendments to raise the threshold of the trigger for the power of direction to a "necessary" rather than a "desirable" test; to more clearly set out how the power is to be used, including specifying procedures with which the Bank should comply prior to issuing a direction, whether on a routine or an expedited basis; and, finally, to set out in statute the assurance that I have already given the House that the additional power of direction cannot be used to compel a clearing house to accept the business of a competitor.[26]

Clause 38: the financial ombudsman service

Lord Kennedy of Southwark moved an amendment that would give the Treasury power to make regulations regarding the activities of claims management companies. Similar attempts had been tried at various other stages of the Bill's proceedings. The minister, lord Newby, reiterated at length the Government's view that the financial regulator was not the place for regulation of these companies. He outlined what was being taken forward with respect to the sector:

> We are all too well aware that the reaction of the claims industry to the mass mis-selling of payment protection insurance has also brought with it a fall in compliance standards and an increase in poor practices, to some of which the noble Lord, Lord Kennedy, referred. He said that something needs to be done. Something is being done. The claims management regulator is taking forward a programme of reforms which are due to be implemented next year. These include a ban on claims management companies offering financial rewards or similar benefits as an inducement to make a claim; tightening the conduct rules so that the requirements of authorisation are made clearer and protection for consumers is strengthened; and extending the role of the Legal Ombudsman to act as an ombudsman for consumers with complaints about claims management companies, which I think deals with some of the points that were made about the ombudsman.
>
> However, we will continue to require a robust and co-ordinated approach from both the claims management regulator and the FCA in responding to risks of detriment. That starts with the financial services regulator. Lessons have been learnt from PPI. The FCA will have an objective requiring it to intervene earlier to prevent detriment arising and, where mass detriment is occurring, use its powers to establish or agree redress schemes so that affected customers are proactively contacted and compensated. We have seen the FSA already moving much more quickly to agree redress schemes with the major banks in relation to the interest rate hedge mis-selling.
>
> However, where CMCs have a role to play, consumers already seeking redress need to be protected against further detriment. So we will see the claims management regulator stepping up its approach and resources devoted to tackling the underlying problems that exist in the conduct of some CMCs. We have already seen the establishment of a specialist PPI compliance team at the claims management

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[26] HL Deb 26 November 2012 c57

> regulator. To ensure that the regulator is sufficiently funded going forward, the MoJ is proposing to increase fees levied on CMCs, particularly those operating in the financial products and services sector.[27]

The amendment was defeated after a division.

5 House of Lords Report Stage: day 5

Government amendments

Clause 76: Power of Treasury to require FCA or PRA to undertake investigation

Following the debate in committee on this clause the Government moved amendments reflecting those points. In particular it recognised that if it was in the public interest for an enquiry to be held into an actual or potential regulatory failure, then, it followed, that the Treasury 'must' order it to take place, rather than leave it to the Treasury's discretion which was the position in the original draft of the Bill. Responding to other concerns expressed during committee, the Government accept that if the Treasury directs a regulator to not carry out an investigation, or, if it instructs it how to carry it out, the direction should be laid before Parliament – unless there are unintended public interest reasons for not doing so.[28]

Non government amendments

In some ways, the most significant change to government policy and financial regulation came as a result of an amendment moved by Lord Mitchell, even though he later withdrew it in response to Government commitments to further action. The subject was pay day loans.

The problems and criticisms of this sector have been aired many times during the Bill's progress through both Houses. It is not clear what persuaded the Government to change its approach. Various stratagems for reform had been proposed before, but none had found favour. It is not clear whether this amendment was uniquely persuasive, or whether the weight and persistence campaigners had suddenly reached a critical point, or, even, whether it was the supporting intervention of the Archbishop of Canterbury elect which was the decisive influence.

Lord Mitchell described his amendment by saying:

> I want to make one point very clear. This amendment does not seek to ban payday lending; it seeks to give the FCA the power to cap interest rates when they are causing consumer detriment. It is a "may", not a "must". It puts the responsibility squarely into the hands of the FCA. I will go further: we need payday lenders; they fulfil a vital role. There are many people who cannot get credit from traditional sources, and without legalised payday lenders, their alternative is the backstreet loan sharks whose penalty for non-payment is often pretty brutal.
>
> Payday lenders fill a vital gap, but they need to be controlled. Interest rates charged by many payday lenders go well beyond the obscene.[29]

Lord Sassoon, replying gave the following commitments:

> I shall say up front that, if the noble Lord agrees to withdraw this amendment, I will table a government amendment for debate at Third Reading that will address the issues raised by the noble Lord. The Government will go further, not only embedding

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[27] HL Deb 26 November 2012 c69

[28] HL Deb 28 November 2012 c206

[29] HL Deb 28 November 2012 c211

stronger payday loan regulation in primary legislation but ironing out the potential weaknesses that they see in today's amendment.

I cannot accept the noble Lord's amendment as I think that the Government can, with the additional resources provided by officials and parliamentary counsel, improve on it in a number of ways. But, first, allow me to put on record three important points about the problems in the payday loans sector and how the Government will ensure that the FCA will be able to address these problems. Just last week, the OFT set out a wide range of concerns about detrimental practices in the payday loans sector, from firms failing to perform adequate checks that customers can afford a loan to a lack of forbearance when consumers are in financial difficulty. While restrictions imposed on the cost and duration of credit may address some of these problems, it is clear that regulation of the high-cost credit market as a whole needs to improve. Compared to the current regulatory regime under the OFT, the FCA will have a broader and more effective toolkit to monitor and tackle developments in the market and to supervise practice among firms. Its consumer protection objective provides the FCA with the mandate to use those powers and tools.

Secondly, capping the cost of credit and the number of times the loan can be rolled over is a major market intervention. It could bring huge benefits for consumers, as a recent study in Japan has indicated, but experience in Germany and France has shown that there can be equally momentous unintended consequences, including reduced access to credit for the poorest and most vulnerable consumers, even driving them to illegal loan sharks. These international lessons demonstrate that we need robust evidence to support any decision to introduce such a cap.

As noble Lords may be aware, the Department for Business, Innovation and Skills has commissioned research from Bristol University into the impact of a cap on the total cost of credit. This is one of the most comprehensive pieces of research undertaken into the UK high-cost credit market. I am pleased to confirm that the research will be published in the next few weeks and will enable the Government and, in future, the FCA to take an evidence-based approach to regulating the high-cost credit market and, in particular, to assess the pros and cons of a cap on the cost of credit.

However, we need to ensure that the FCA grasps the nettle when it comes to payday lending and has specific powers to impose a cap on the cost of credit and to ensure that the loan cannot be rolled over indefinitely should it decide, having considered the evidence, that this is the right solution. In this, I am entirely in agreement with the noble Lord. So, while I support the spirit of the amendment, I cannot accept it as it is framed as it may have unintended consequences and introduce loopholes which could be exploited by unscrupulous firms.

[...]

However, the Government believe that there is scope to go further than this amendment and to put in place stronger, automatic consumer protections and make the deterrent effect more robust by providing that a breach of these rules would make the agreement unenforceable by the lender. I will draft an amendment and discuss it with the noble Lord, Lord Mitchell, to ensure that it fully meets his concerns, as I believe it will-I believe it will go further-and I can confirm explicitly that it will cover both the total cost and total duration of credit.

Our objectives here are the same: they are to ensure that consumers of financial services have access to credit when they need it and at a price they can afford; and to ensure that the regulator is under a clear obligation, and fully empowered, to ensure that consumers are protected. I hope and expect, therefore, that when the noble Lord,

> Lord Mitchell, sees the draft amendment he will feel able to add his name to what the Government propose.[30]

A later exchange between the minister and Lord Kennedy of Southwark clarified the scope of the proposed government amendment:

> **Lord Kennedy of Southwark:** My Lords, I, too, congratulate my noble friend Lord Mitchell, the right reverend Prelate and other noble Lords for bringing forward this amendment today. I also pay tribute to the Member for Walthamstow in the other place, who has done more than anybody else to bring forward this issue. I would like clarification from the Government on the amendment that they will bring forward at Third Reading. Will it enable interest rates to be capped? That is key here; the cost of the charges and the interest rates levied are the nub of the issue. If that matter is not dealt with, we will unfortunately be back here at Third Reading and all sides will be very cross about it. Will the Minister clarify that?
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> **Lord Sassoon:** Yes, it will be dealt with.[31]

6 Third Reading

Clause 3: Oversight Committee

Large sections of the Bill transfer various powers to the Bank of England. Consequent to this, the Bill includes various provisions relating to the internal management and accountability of the Bank. Principal amongst these is the establishment of a new oversight committee. The creation of this new body requires a definition of what it does, what powers it has and its relationship with, amongst other the Bank's Court of Directors. Very many hours were spent in committee discussing these issues.

At Third Reading, the Minister, Lord Sassoon announced a series of amendments to tidy up issues which had arisen as part of those debates. He explained the background and the resulting changes:

> On Report, the noble Lord, Lord Eatwell, and I discussed whether the court would take the decision whether or not to withhold from publication a report of the oversight committee. I stated clearly that I would expect a decision of this importance to be taken by the court rather than to be delegated to the executive. However, in the light of that debate, I asked my officials to look right through the Bill again to see whether there were other key decisions for which responsibility should lie unequivocally with the court. This group of amendments is the result.
>
> Amendments 4, 5, 6 and 7 confirm that the court will decide whether oversight committee reviews should be withheld from publication in order to protect the public interest.
>
> Amendments 1, 12 and 26 to 31 make the same change to confer a number of other responsibilities directly on the court. These are the power to delegate additional functions to the oversight committee, responsibility for being consulted on the PRA's strategy, and the power to appoint non-executive members to the PRA board.
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> Amendment 25 puts beyond all doubt that the court may not delegate any functions that are explicitly given to it in legislation. I should make it clear that this does not mean that all functions that the legislation confers on the Bank will automatically be

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[30] HL Deb 28 November 2012 c214

[31] HL Deb 28 November 2012 c223

> undertaken by the executive. The court will of course retain discretion either to delegate these roles to the executive or to reserve those decisions for itself. However, I believe that these amendments provide important clarity by identifying those roles within the legislation that will be the responsibility of the court in all cases. I beg to move.[32]

Analogous reasons and causes were ascribed to another government amendment, this time moved by Lord Newby. This amendment concerned the operation of the new Financial Policy Committee and followed on from a Government response to opposition amendments (withdrawn) in committee. The purpose of them was to 'rebalance' the membership of the FPC, in effect to retain Bank majority status on the committee but only by virtue of the casting vote of the (Bank) Chair. Lord Newby explained:

> They will remove the executive director responsible for market analysis from the FPC. This will shift the FPC's balance so that it includes five Bank executives and five non-Bank executives, including four independent members. Crucially, this will retain the Bank's majority on the FPC, as the committee's chair will have a casting vote. As we have said previously, we believe that it is vital that the Bank remains in the majority on the FPC if we are to hold the Bank accountable for its performance. Amendments 23 and 24 reduce the FPC's quorum from seven to six, to compensate for the smaller membership. Noble Lords will note, however, that we have retained the requirement that at least one of the external members be present in order for the committee to be quorate.[33]

Clause 24: Rules & guidance (pay-day loans)

Lord Sassoon introduced the amendment promised on Report to provide further regulation of high cost credit companies. In previous exchanges on this topic the Government had said that moving the regulation of consumer credit from a statute based system overseen by the OFT to a rule based system overseen by the FCA would provide for a much more flexible and responsive system of regulation that would allow the FCA and take whatever action it thought appropriate. Against this background the amendment adds very little. It sets out a list of circumstances wherein the FCA may make rules:

(1) The power of the FCA to make general rules includes power to make rules prohibiting authorised persons from-

(a) entering into a regulated credit agreement that provides for-

(i) the payment by the borrower of charges of a specified description, or

(ii) the payment by the borrower over the duration of the agreement of charges that, taken with the charges paid under one or more other agreements which are treated by the rules as being connected with it, exceed, or are capable of exceeding, a specified amount;

(b) imposing charges of a specified description or exceeding a specified amount on a person who is the borrower under a regulated credit agreement;

(c) entering into a regulated credit agreement that-

32 HL Deb 5 December 2012 c667

33 HL Deb 5 December 2012 c670

(i) is capable of remaining in force after the end of a specified period,

(ii) when taken with one or more other regulated credit agreements which are treated by the rules as being connected with it, would be capable of remaining in force after the end of a specified period, or

(iii) is treated by the rules as being connected with a number of previous regulated credit agreements that exceeds a specified maximum;

(d) exercising the rights of the lender under a regulated credit agreement (as a person for the time being entitled to exercise them) in a way that enables the agreement to remain in force after the end of a specified period or enables the imposition on the borrower of charges within paragraph (a)(i) or (ii).

The amendment is not specific to any group of lenders – there is no definition of 'high cost' for example and it does not lay down, in itself any prescriptive rules. Most significantly it avoids the politically sensitive issue of deciding what interest charge is too high. The amendment does however highlight the two areas of practice most criticised, namely the level of charges and the successive rolling over of loans. Lord Sassoon outlined the differences between the opposition amendment that was withdrawn previously and the new government amendment:

> Those who have compared the Government's amendment tabled yesterday with the amendment of the noble Lord, Lord Mitchell, will have noted that the Government's version is significantly longer and more comprehensive in its detail. I said last week that we would take care to frame the power to prevent unscrupulous firms exploiting loopholes and to ensure that consumers were properly protected. The Government specifically ensured that this power covers associated charges to avoid unscrupulous firms "gaming" the restrictions by, for example, reducing the interest rate but introducing exorbitant fees for related services such as setting up the loan. It also specifically captures the practice of rollovers, which we have seen abused by some players in the payday loans industry. Under the amendment the FCA will have a specific power to impose a limit on the overall duration of the rolled-over agreement and a limit on the number of rollovers that are permitted.
>
> The government amendment has also built in robust protections for consumers who fall victim to lenders' excessive charges. First, the FCA can provide that the lender cannot enforce the agreement and the borrower is not obliged to repay the loan. Secondly, it can provide that any money or property transferred under the agreement-an item that has been pawned, say-must be returned. Thirdly, it can provide that compensation must be paid to the consumer.[34]

The mover of the original amendment, Lord Mitchell said of the proposal:

> It is worth recounting that the Government told us in Committee that the points which we wanted were already in the Bill. We tried hard to find the location of those points-and no doubt they are buried somewhere. However, with an issue like this one, which is so important, it is dangerous to have implied rules which have to be inferred. Many of these payday loan companies have very successful lawyers and access to some of the best brains in the country in this area. The provision would have been a complete dog's breakfast, to be honest.

[34] HL Deb 5 December 2012 c676

We tried again at Report, and I admit that I came in here today ready for battle. However, I was astonished and delighted at the complete turnaround that the noble Lord, Lord Sassoon, has offered. He promised us a better amendment and that is what we have been given. The new amendment is stronger, tighter and more effective, and most of all, it offers complete clarity. I would not be human if I did not savour the moment just a jot. It probably will not happen again, but it is good that it has happened today.

I have been asked why the Government conceded and no doubt at some stage, over a gin and tonic, I will find out.[35]

Returning to the point about what the amendment actually adds to the implicit powers already given the FCA Lord Sassoon said:

First, the noble Lord, Lord Peston, asked whether this means that the FCA has to go into this field. Absolutely it does; it would have to anyway. Putting all this in the Bill will concentrate the FCA's mind wonderfully. However, as the noble Lord knows, it is an enabling power; the FCA may make these rules, but this does not say that it must make them.[36]

Clause 31: Additional power to direct UK clearing houses

Lord Newby moved an amendment promised in committee. The clearing houses had been concerned about new powers given to the Bank that would enable the Bank to issue directions to them. They feared that this could be a direction to recapitalise institutions, either their own or competitors. Lord Newby outlined the amendments:

First, the amendments will require the Bank to be satisfied that any direction made under the power is necessary, having regard to the specified public interest criteria, rather than simply desirable. Secondly, they will put it beyond doubt that this additional power of direction will not be available in instances where the desired direction could be given under the Bank's existing power of direction under Section 296 of FiSMA. Thirdly, the Bank, in instances where it gives a direction under this power without giving the recipient prior notice, will be required to explain to the recipient after the direction has been given why the direction was given, and why no prior notice of it was given. I should also make it clear that any justification given pursuant to this requirement will be given to the clearing house directly, will not be published and will not divulge sensitive information that might harm the public interest. Fourthly, these amendments will give effect to the assurance that we have already given the House that the additional power of direction could not be used to compel a clearing house to accept the business of a competitor. The amendments will provide greater certainty to clearing houses regarding the circumstances in which the additional power of direction could be used.

To alleviate any remaining doubts from industry, I repeat the assurance that my noble friend has previously given the House: the power of direction relates only to the recognised clearing house itself. The Bank of England cannot use the power of direction to require shareholders, members or clients to recapitalise or otherwise fund a failing recognised clearing house, with one exception: where the UK clearing house already has recapitalisation arrangements and agreements in place with its shareholders. In this instance the Bank of England could use the power to direct the

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[35] HL Deb 5 December 2012 c677

[36] HL Deb 5 December 2012 c681

> clearing house to enforce those arrangements, provided that the necessary conditions and safeguards were met. Furthermore, this power cannot be used retrospectively.[37]

Baroness Cohen, a non-executive director of the London Stock Exchange, who had raised the issue on Report, supported the amendment.

All amendments were agreed to.

[37] HL Deb 5 December 2012 c683