Financial Services (Banking Reform) Bill: Lords stages

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This note summarises Lords committee stage proceedings on the *Financial Services (Banking Reform) Bill* 2012/13 to 2013/14. A summary of the Commons committee stage can be found in another Library Research Paper (RP13/40).

The original Bill practically trebled in size following the introduction of a very large number of government amendments made during this stage. These amendments reflected, in part, the recommendations of the Parliamentary Commission on Banking Standards which had published its final Report – *Changing banking for good* – in June 2013.

The majority of these amendments were not fully discussed at during either the committee or Report stages.

Most of the debate was over opposition amendments. Most of these covered issues where the Government disagreed with the Commission or where they thought the Government had not gone far enough in implementing them.

The Government was defeated on one issue when an opposition amendment to introduce tougher 'licensing' and qualification requirements for bank employees (see page 25).

Government changes to the Bill included:

- Powers to enforce the ring fence ('electrification')
- Criminal sanctions for reckless conduct
- Regulation of payment services
- Regulators given competition objectives
- Bringing forward of the review of the ring fence to two years after completion;
- Review of proprietary trading

- Senior managers licensing/certification regime
- Mandatory ‘cost of credit’ cap
- Obligatory meetings between auditors and regulators.
- Cost of complaint scheme against claims management companies to be recouped

Contents

1 Committee stage

1.1 Introduction

The *Financial Services (Banking Reform) Bill*[1] is the latest in a series of bills introduced to change the regulatory system and practices of the financial services sector. It was introduced at the same time as the Parliamentary Commission on Banking Standards was considering its findings following its own investigation into the banking system. It was always anticipated that the Commission's recommendations would form part of the Bill at a future date.

But, because the Government decided not to delay the introduction of the Bill until the Commission had published its final report, the original bill was perforce something of an interim measure and there was considerable Opposition criticism during the course of its Commons stages that, the proceedings were a sham. For example, there were no government amendments to the Bill during its Commons committee stage at all.

Government amendments were made on Report particularly recommending the Commission's views on the 'electrification' of the ring fence. Government amendments introduced in the Lords Committee are described briefly below:[2]

- amendments to streamline the procedure for the regulator to require a banking group to separate under the 'electrification' power introduced at Commons report stage;

- reforms to the FSMA approved persons regime including: giving the regulators the power to make approvals of senior managers in banks subject to conditions or time limits; 'reversing the burden of proof' enabling the regulators to take enforcement action against a senior manager in a bank where regulatory breaches occur in the senior manager's area of responsibility; extending the time limits for regulatory enforcement actions against individuals; giving the regulators the power to make 'banking standards rules' applying to employees in banks as well as for approved persons;

1 Bill 130 2012/13; HL Bill 38 2013/14
2 HM Treasury, *Bill Overview (Briefing for Peers)*, October 2013

- the introduction of criminal sanctions for reckless misconduct by senior managers in the management of a bank;

- the creation of a new payments systems regulator, a proposal endorsed by the PCBS. The establishment of such a regulator is necessary to create a level playing field in access to the payments systems as the large incumbent banks, which own the main inter-bank payment system companies

- and their primary infrastructure provider, currently dominate the Payments Council. The Government will ask the new regulator to investigate the costs and benefits of account portability; and

- the introduction of a secondary objective to further support competition for the PRA.

The Government will also introduce further amendments on the following areas:

- the introduction of a bail-in tool as recommended by the ICB. This will enable the authorities to impose losses on a failing bank's creditors without the need for the bank to enter insolvency proceedings that would disrupt core services with serious repercussions for the economy.

- The Government initially proposed to pursue the introduction of a bail-in tool through European legislation, namely the Recovery and Resolution Directive. However, the EU negotiations have progressed to a sufficiently advanced state that the Government are confident that bail-in powers can be introduced without risking having to adapt to a radically different regime when the Directive is implemented;

- provision of competition powers to the FCA which they will operate concurrently with the central competition authority, the Competition and Markets Authority (CMA);

- the introduction of a limited rule making power for the PRA over financial holding companies (i.e. those holding banks) with respect to the operation of the bail-in regime and for group ring-fencing purposes;

- technical changes to the clause giving the Treasury power to make regulations requiring that ring-fenced banks, as far as possible, are not liable for the pension liabilities of other group members, to ensure all pension liabilities are in scope;

- a requirement for the PRA to include in their annual review information as to the extent to which ring-fenced banks are carrying out activities that have been exempted from the excluded activities and prohibitions defined under the Bill, such as selling simple derivatives;

- the introduction of a special administration regime to deal with cases where a payment and settlement system operator or key service provider to the payment or settlement system fails, or is likely to fail; and

- minor and technical reforms to the regulation of Building Societies in order to allow the sector to compete on a more level playing-field with banks.

The Treasury has produced a large number of separate, themed, policy documents to accompany the Lords amendments. These can be found here.

The rest of this paper highlights *some* of the discussion around these issues but does not provide significant background to the measures. For this readers are directed to the Treasury document above or the Banking Commission's final Report or the Bill's explanatory notes.

Lord Deighton and Lord Newby were the main government spokesmen. Other prominent contributors were ex members of the Commission such as Lord Lawson and Lord McFall, together with the Lords Turnbull, Eatwell, Barnett and Higgins.

Unless otherwise indicated:

- the 'Act' relates to the *Financial Services & Markets Act 2000 (FSMA)*.
- PRA - Prudential Regulation Authority
- the Bank – the Bank of England
- the Commission – the Parliamentary Commission on Banking Standards

1.2 Due process

The size and the scope of the amendments combined with the timetabling of the Bill has meant that the Bill's 'logistics' (aside from its content) has become something of an issue itself. In an unusual move, Lord McFall, a member of the Commission too, moved a 'motion to take note' after the committee stage, which complained about the complexity and volume of what the Lords had to consider. He said, "When introduced to the House of Commons in February 2013, the Bill was 20 pages and 25 clauses long. When introduced to the House of Lords in July 2013, it was 35 pages and 21 clauses long. Now, before us, we have 170 pages and 127 clauses".[3]

Lord McFall also drew attention to the chairman of the Banking Commission's comments that the Government was trying to "ram the Bill through the House of Lords".

It may or may not be surprising therefore to find that the committee stage only lasted three days. Report Stage, possibly partly as a result of Lord McFall's initiative was delayed to give further time for consideration of government amendments.

1.3 Day 1

Clause 4: review of the ring fence

Lord Turnbull moved an amendment which proposed a review of the working of the ring fencing proposals. His speech included the by now customary description of the complexity of recent financial services bills – "We are dealing with amendments to amendments to amendments which are in turn amending statutes that have already been amended more

[3] HL Deb 11 November c599

than once."[4] He also drew attention to those parts of the Commission's proposals which the government had ignored in its amendments, he said:

> There is also a long list of recommendations which the Government have rejected or simply ignored: recommendations on leverage, proprietary trading, special measures, a new regulatory decisions committee for banking, the strategic objective of the FCA, and so on. Of course, in Committee and at Report, I and my colleagues on the parliamentary commission will seek to work constructively with the Government to bring us closer to our recommendations so that we succeed in achieving the purpose of the title of the report, which was *Changing Banking for Good*.[5]

His amendment was designed to speed up the review of ring-fencing to ensure that the 'electrification' worked. Lord Eatwell expressed the view that what was needed was a 'virtually continuous review' of the ring fence which he said was "a leap in the dark... we have no idea whether it will work or not".[6]

Responding Lord Deighton outlined provisions in Clause 6 and amendments to it that would, he hoped meet the objections:

> As I stated, the Bill provides for regular reviews of the operation of the ring-fence. Clause 6 provides for the PRA's annual report to Parliament to cover the extent of banks' compliance with the ring-fence—a provision that Amendment 42 will strengthen, as I will discuss in a moment.
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> Subsection (3) of new Section 142J requires the PRA to carry out a review of ring-fencing rules every five years to assess how well the rules are framed in order to achieve the objectives set for the PRA in the legislation. Should the PRA identify areas where the rules need to be changed, it will have the power—indeed, the responsibility—to do so. Regular reviews of how the mechanics of the ring-fence are working are legitimate and necessary, so it is right that the Bill already provides for them.
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> On Amendment 42, in response to arguments made in the Commons, we are strengthening the requirement of the PRA to report each year on banks' compliance with the ring-fence. Amendment 42 requires the PRA to report annually to Parliament on how ring-fenced bodies have used any exemptions to excluded activities or prohibitions. As noble Lords will know, the Bill allows the Government to create exemptions from the exclusion or prohibition of certain activities, as long as the exemptions are not likely to threaten the continuous provision of core services—that is, retail deposit-taking. These exemptions are necessary to allow ring-fenced banks to enter into derivative contracts to manage their own risks. The Government also intend to use this power to permit ring-fenced banks to sell simple derivatives to their customers, subject to safeguards to ensure that this does not expose ring-fenced banks to excessive risks or undermine their resolvability
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> [...]
>
> It is right that any such exemptions should be closely monitored. We have therefore agreed with the suggestion from the Opposition, who in the other place advocated that the regulator should report on the sale of simple derivatives by ring-fenced banks. However, our amendment goes further, requiring the PRA to report on ring-fenced banks' use of all exemptions created now or in the future. These will include exposures

4 HL Deb 8 October c18
5 HL Deb 8 October c18
6 HL Deb 8 October c20

> of ring-fenced banks to financial institutions incurred for the purposes of risk management, providing payment services or trade finance services, as well as the sale of simple derivatives. This amendment will ensure that Parliament has sufficient information to make an informed judgment about whether the ring-fence fulfils its objectives and the exemptions remain fit for purpose.[7]

He rejected the need for continual review:

> Amendment 3 would effectively reconvene the ICB in perpetuity to ask afresh every few years whether we should continue with the ring-fence at all. I have two main objections to this. First, one of the original aims of establishing the ICB was to secure consensus and certainty over the future of the banking industry in this country. The Chancellor has memorably described how, before this Government took office, he heard four different proposals from the then Prime Minister, Chancellor, Governor of the Bank of England and chairman of the regulator. The ICB process brought together all these voices and others to produce recommendations, including for ring-fencing, that commanded wide consensus support. That consensus gave the industry certainty over the future regulatory framework, which is so important to enable businesses to plan and invest. Reopening that consensus every five years, or indeed even earlier, would undermine that certainty.
>
> If I have learnt one thing in my relatively short period in the Treasury as Commercial Secretary, it is that the one consistent request I get from businesses in every industry is, "Please provide us with a stable and certain framework so that we can plan and invest so as to sustain this recovery". As I have implied here, shortening the gap between reviews—as Amendments 4 and 5 would do—would add further to the uncertainty. I also question whether it would even be possible for a review to judge after only two years whether ring-fencing was working. Given the scale of the changes involved, any verdict arrived at before ring-fencing has had more time to bed down would surely be premature.
>
> My second objection is to this amendment's prescription that the terms of reference for these repeated reviews must include considering the case for full separation. This seems rather like requiring that reviews continue until they come up with the right answer. I do not believe that that is appropriate. Given this, I also see no case for delaying the commencement of the Government's provisions for a firm-specific power of separation until after a review, as Amendment 116 would require.[8]

A series of speeches followed which gave only half hearted support to ring fencing instead of full separation. For example, Lord Lawson said:

> What we are saying, which is surely much more reasonable, is that we will, of course, give Vickers a chance. Indeed, we will try to reinforce his proposal by means of the so-called "electrification" procedures. However, if it is seen not to be working, we will have to go to separation. One member of the Vickers commission is already convinced that we should go to separation without any intermediate step but I am quite sure that nobody on the Vickers commission wishes to see a failure. Let us give Vickers a chance and see how it works but if it does not work—it has to be kept under review—we should go to full separation. That must be sensible.[9]

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7 HL Deb 8 October c24
8 HL Deb 8 October c25
9 HL Deb 8 October c28

Lord Barnett said that "we are stumbling towards the only real solution [separation]".[10] Lord McFall quoted an unnamed member of the Vickers Commission saying that "John, we lost our nerve and advocated ring fencing".[11] Baroness Cohen linked the complexity of the Bill to the solution that it proposed:

> The very complication of the debate that we are having, the horrible complication of the legislation and the very real difficulty of the amendments all stem from the fact that we are trying to do something impossible. Ring fencing will not work. It does not matter how many people you place in charge of it, you need institutional separation. As my noble friend Lord Barnett says, we are going to have to come up against this one of these days.[12]

Government amendments 6 & 81
The amendments proposed two new sections for the Act:

> The first new section, new Section 192JA, gives the PRA a power to make rules over the parent companies of ring-fenced entities. Ring-fencing will require banking groups to make large structural changes to ensure the independence of the ring-fenced bank from other entities in its group. The PRA may need to make rules to ensure that the groups in which ring-fenced banks sit are structured and governed appropriately. Rules over parent companies may be needed to ensure that this is the case.

[...]

> New Section 192JB will give the PRA and the FCA, as appropriate depending on the nature of the firm, the power to impose rules on qualifying parent undertakings to require them to make arrangements which would facilitate the exercise of resolution powers in relation to the parent or any of its subsidiaries.[13]

Summing up Lord Deighton said:

> The simple way to look at the amendments is that they are to ensure that both regulators have the flexibility to address every aspect of the group structure to ensure that the ring-fence works. That is why we are trying to give as much flexibility as possible to address even the non-regulated entities within the group.[14]

The amendments were broadly supported and agreed to.

Government amendments 7,9,11 & 12: ring-fence enforcement powers of the PRA

During the course of the Commons stages amendments had been passed which gave the PRA the power to force banking groups to reorganise and divest themselves of bodies if the PRA thought that the existing group was a threat to the ring fence regime. This is the electrification proposal. It was argued that the proposed procedures were too long and subject to too many challenges to be effective. Lord Deighton said:

> The Government took these concerns very seriously. As noble Lords will recall, I committed at Second Reading to bringing forward amendments to simplify and streamline the process for exercising the group restructuring powers. These amendments do exactly that. Amendments 7, 9, 11 and 12 replace the requirements for three preliminary notices with just one [...].

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[10] HL Deb 8 October c29
[11] HL Deb 8 October c29
[12] HL Deb 8 October c34
[13] HL Deb 8 October c35
[14] HL Deb 8 October c37

> Amendment 8 removes the requirement for the Treasury to consent to a preliminary notice. Previously, Treasury consent was required for each of the original three preliminary notices. [...]
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> Amendment 15 clarifies that any notice of a decision by the regulator not to exercise its powers must be given in writing. Amendment 16 provides that a copy of such a notice be given to the Treasury.
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> Amendment 17 shortens the warning notice period from 12 to 18 months to three to six months. [...]
>
> Amendments 13, 18 to 20 and 38 are consequential on the other amendments being made to these sections. Amendments 21 and 22 remove the requirement that the regulator must allow at least five years for any restructuring or divestment to be completed. Now it will be up to the regulator to set whatever deadline it considers appropriate. [...]
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> As for the total time involved to require the separation of a group, following the Government's amendments, the minimum total time will be slightly shorter under the Government's provisions than under the PCBS's. Under the Government's amendments, the minimum time from the regulator's first notice of its intention to require restructuring to the actual imposition of a requirement to separate will be approximately four months, compared to approximately five months under the PCBS's amendment.[15]

The amendments were described as a "significant improvement" by Lord Eatwell and were agreed to.

Amendment 23: sector separation powers

Lord Turnbull moved an amendment to give government a power to order a full sector separation should any review provide indicators of systemic failure. The government position is that such an action is possible but should not be part of the Bill now. Several speakers reiterated their concerns about the halfway position of ring fencing. The Archbishop of Canterbury noted that "almost everyone who has spoken about the ring-fence has dammed it with faint praise"; he said that the amendment "increases vastly the voltage of the ring-fence".[16] Lord Eatwell argued that the amendment was a "contingent clause and a reserve power but if we really want the ring-fenced to work, the Government should embrace the amendment".[17]

Replying, Lord Deighton said that the amendment did not support the agreed ring-fence policy, it was an alternative to it. He did not think that it would encourage all banks to monitor each other as had been suggested. He gave two further reasons for rejecting it:

> let me set out two simple reasons why we do not support the amendment. First, if a future Government did decide to switch to a new policy, it could not be appropriate for that change to be effected simply by commencing a reserve provision. That would entail no more than a single order with a single brief debate in each House of Parliament. There would be no detailed scrutiny, no opportunity to consider amendments and no chance for Parliament to assure itself that the circumstances justified the new policy. There would be no development of an extensive evidence base, no cost-benefit analysis and no opportunity to build an extensive domestic and

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[15] HL Deb 8 October 2013 c39
[16] HL Deb 8 October 2013 c47
[17] HL Deb 8 October 2013 c50

now European consensus. This proposal may therefore be at odds with the desire expressed in both Houses to enhance the process of scrutiny.

Lord Eatwell: The point that the Minister seems not to have taken on board is that the arguments for review and this power have to be seen as a coherent package. The point is that there would be that review; there would be a continuous independent review providing exactly the information that he says is necessary.

Lord Deighton: Yes, there would be a review, but not a proper parliamentary process. The argument I am making is that this is such a switch from ring-fencing to full separation that it should benefit from that full process. While I obviously bow to the experience of my noble friend Lord Lawson, these things, if the circumstances dictate, can be done extremely rapidly, where the circumstance demand that kind of urgent move.

And

the Government's second and perhaps more powerful reason for rejecting this amendment. Let us imagine that a future Government decided that not ring-fencing, or full separation, but a third policy was appropriate. Imagine, for example, that it decided that a Volcker rule was the right policy, or a shift to full-reserve banking. In either case, a review that was limited to deciding whether to enact a reserve provision for separating ring-fenced banks from their groups would be no use at all, and the power would need to be repealed, along with much of the rest of the Bill. Coming back to Parliament would be the only way to give a future Government wanting to change policy the full range of options.

Therefore, on grounds of both substance and of proper legislative process, the Government continue to oppose a reserve provision for a move to full separation and I therefore urge the noble Lord to withdraw his amendment.[18]

The amendment was withdrawn.

Other government amendments were moved. Amendment 24 separating the pension liabilities of the group from the ring-fenced body was passed. Several amendments to clauses 5 – 8 and Schedule 1 were agreed to.

1.4 Day 2

Amendment 43: competition in banking

Lord Sharkey moved a 'probing amendment' which would require proposals to increase banking competition within six months of the Act coming into force. Lord Eatwell moved another competition-related amendment. He drew attention to the fact that "the regulatory system itself – has been a very effective barrier to entry."[19] Other peers talked about the advantages and disadvantages of regionalised banking. Responding, Lord Newby listed the measures taken to improve competition –

- removing too big to fail through the ring-fence;
- new seven day account switching requirement;
- rules favouring new entrant banks by requiring lower initial capital levels; and

[18] HL Deb 8 October 2013 c52
[19] HL Deb 15 October 2013 c361

- giving the PRA a secondary competition objective to strengthen its role.[20]

The amendment was withdrawn. **Clauses 9 to 12** agreed to without debate.

Government amendment 44: bail in stabilisation option.

These (very long) amendments are the subject of two of the Treasury briefings mentioned above. They are available here and here.

This, and amendment 105, introduce a new clause and Schedule that would give the Bank the power to require shareholders to lose the value of their equity and creditors suffer a reduction in their claims in order to stabilise a bank. Lord Newby indicated that this power predates an expected EU agreement on common resolution policies. The Schedule outlines the manner and conditions of use of the new power. New section 48H would impose duties on the bail in administrator to review the reasons for failure and to draw up plans to remedy the problems. New clause 48L gives the Bank power to modify and convert securities that fall within the bail-in. New clause 48P gives the Treasury order making power in relation to 'protected financial arrangements' caught in the bail-in. This clause is a damage limitation clause designed to deal with consequences of a bail in. The Minister continued:

> The Treasury will be required to put in place compensation arrangements for affected shareholders and creditors following an application of the bail-in powers. These will include a no-creditor-worse-off safeguard that broadly provides that no shareholder or creditor should be left worse off as a result of the exercise of the bail-in powers than they would have if the bank had simply failed and entered insolvency. In addition, the Bank of England may exercise the bail-in option in respect of a banking group company if certain conditions are met.
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> First, the authorities must be satisfied that a bank in the same group meets the conditions for resolution. Secondly, the authorities must be satisfied that acting only in respect of the bank itself is not sufficient to achieve the special resolution objectives. The actions should seek to minimise the effects of the exercise of the power in relation to group companies on other undertakings in the group. It should only be to the extent necessary in order to achieve the resolution objectives.[21]

Lord Eatwell raised several points on these amendments which were, he said, longer than the original Bill.[22]

- Was there a threat that bailing-in might spread bank weakness since about half of the written down securities might come from other banks?
- How would individual deposits that were temporarily over the depositor protection level be protected?
- If the ring fence was working why would a bail-in be needed at all?

Responding, Lord Newby said that all rescue options involved threats of contagion, as did the do nothing option; the Bank would have discretion about which liabilities to bail-in and this could deal; with the temporary high balance problem; and all banks could get into difficulty, not just retail banks and this measure gave the Bank powers to deal with it if it thought they were needed. Later, he summed up the new position after these powers:

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[20] HL Deb 15 October 2013 c371
[21] HL Deb 15 October 2013 c379
[22] HL Deb 15 October 2013 c379

> In terms of the scope of these provisions, they are the fourth of what are now four options in the Banking Act for dealing with a bank that is in danger of failing. One is sale to another bank; one is the bridge bank and the other is nationalisation. Those measures apply to all banks covered by that legislation. I believe that that extends the measures beyond the ring-fenced banks.[23]

Government amendment 45: conduct of persons working in the financial services sector

This amendment is derived from recommendations of the Commission as well as amendments to previous government amendments. It is the subject of a Treasury briefing note which can be seen here.

Lord Newby outlined the background:

> The commission's central recommendation in this area is for the creation of a senior persons regime applying to senior bankers. The regime for senior managers in banks will have the following features. It will reverse the burden of proof so that senior bankers will have to show that they did what was reasonable when a bank fails to comply with regulatory requirements in their area of responsibility, or face regulatory action for misconduct. It will have mandatory statements of responsibility, so that whenever someone is a candidate to be a senior manager in a bank, the bank will have to set out clearly what aspects of the bank's business they will be responsible for. There will be powers for the regulators to make conduct rules for senior managers in banks instead of the old system of statements of principles supported by codes of practice. There will be a requirement that the register kept by the FCA must state who is a senior manager in a bank and give details of regulatory action taken against them.
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> The new regime for senior managers will also retain the tools which the regulators have under the existing approved persons regime. The regulators will also retain their tough powers under FSMA to impose unlimited fines on, or publish notices of censure about, senior managers in banks. It may sometimes still be appropriate for the regulators to approve people to perform functions that are not senior management functions but which still involve important responsibilities. The Government have therefore chosen to retain the power for the regulator to pre-approve individuals to perform functions outside the senior managers regime. It is for the regulators to determine what functions, if any, should be subject to pre-approval outside the senior managers regime. I am confident that noble Lords will agree that retaining this power is a sensible safeguard at a time when concerns about individual standards in financial services remain acute.
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> In addition to the regime for bank senior managers, the commission also recommended the introduction of a standards regime that would apply to a wider class of individuals who work in banks. The Government have therefore provided the regulators with a new power to make conduct rules for anyone who is employed by a bank, even if they are not a senior manager or other approved person. This is an extension of regulatory power in relation to individuals, and gives the regulators the power to impose a single set of banking standards rules for all who work in banks. Employees of banks could face disciplinary action if they breach these standards rules or if they are knowingly concerned in regulatory breaches by the bank. The regulators will not be compelled to make conduct rules. They will be able, quite properly, to exercise their supervisory judgment to determine who in a bank should be subject to rules, and what standards to impose.[24]

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[23] HL Deb 15 October 2013 c385

[24] HL Deb 15 October 2013 c386-7

He described a series of non-government amendments as unnecessary as these provisions and existing regulations meant that there were no loopholes through which managers might escape sanction.

The debate that followed generally agreed with the Government's amendments. Some Peers thought that they did not go far enough and that certain activities should be singled out for specific mention in the Bill. Others thought it best to leave the detail to the regulator and therefore keep the Bill at a more general level of detail.

Lord Turnbull said that the current process was like a gateway, rather than a continual process of monitoring which therefore allowed bank leaders to claim that "they didn't know" about problems. He was glad that the Government had accepted many of the Commission's views, but there were gaps.[25]

- which banks were included
- no mention of a licensing regime
- no formal transitional note outlining responsibilities from retiring officer.

Peers expressed concern that the regime would be far stricter than in other financial centres; that the 'guilty unless proven innocent' character of the process was inequitable; and by focusing attention on a couple of named individuals the Boards would be less effective.

Lord Brennan, supported by Lord McFall, introduced a substantial amendment which would bolster the money laundering regulations and enforcement. Lord McFall outlined evidence given the Commission regarding HSBC's involvement with the Mexican bank which led to it being fined a huge amount by the American authorities.[26]

Baroness Noakes spoke in favour of leaving specific mentions of money laundering out. She made note of the many other regulatory problems and 'offences' that had the potential to harm the financial markets which were also not mentioned within the Bill.[27]

Replying to the debate Lord Newby clarified what 'bank' meant under the amendment:

> My Lords, perhaps I may start by dealing with the three points on which the noble Lord, Lord Turnbull, sought clarification. The first was on the definition of "bank" for the purposes of these amendments. The regime will apply to all UK institutions that have permission to take deposits. That covers ring-fenced banks, other banks, building societies, credit unions and some wholesale deposit takers, but it does not cover things which in popular parlance are called banks but which do not take deposits.
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> **Lord Turnbull:** If a bank divides itself under the new regime into a ring-fenced bank which takes deposits and puts its investment activities—derivatives, underwriting and proprietary trading—into a non-ring-fenced bank which does not take deposits, does it mean that that mass of activity will not be covered by the regime? Much of the manufacturing took place in that area.
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> **Lord Newby:** My Lords, I repeat: it is limited to banks that take deposits, because the view is that they are of a different order of significance in the system. I think that we have a difference of view.[28]

25 HL Deb 15 October 2013 c389
26 HL Deb 15 October 2013 c394
27 HL Deb 15 October 2013 c400

Lord Turnbull was not the only Peer to be alarmed by the narrowness of the definition:

> **Lord Lawson of Blaby:** May I reinforce what others have said? I am horrified by the Minister's explanation. He must take it back to the Treasury and get the Treasury to think again. I refresh his memory, for example, about the evidence that we took from UBS. Not only was it culpable to an extraordinary degree in the LIBOR scandal but its top management also said that it knew nothing about what its traders were doing. This was in spite of the fact that when it had its capital-raising exercise, it presented to all the funds that its great profit centre was trading in LIBOR derivatives. Then it said, "We know nothing about it". This made it immensely culpable. The Minister is saying that if you had a bank that was not taking retail deposits but was doing just that, there would be no individual responsibility at all under this Bill. I am afraid that he must look at that again.
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> **Lord Eatwell:** I would like to reinforce the position of the official Opposition on this. We are totally behind what the noble Lords, Lord Lawson and Lord Turnbull, have said. It is disgraceful to suggest that investment banks that are not deposit-taking but offer a wide range of financial services should not come under this senior persons regime.
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> **Baroness Noakes:** Was the Minister talking about retail deposits, as I believe my noble friend Lord Lawson has interpreted him saying, or, as the legislation seems to me to say, about deposit-taking more widely? Deposit-taking is not confined to retail banking on ring-fenced operations. Deposit-taking occurs across the whole range of banking activities, as far as I am aware. Will he clarify to what kinds of activity he intend this to apply?
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> **Lord Newby:** The definition relates to deposit-taking, retail and wholesale.[29]

Under heavy fire, Lord Newby said "It is fair to say that I have heard what the House has said and I will relay it with all force to my colleagues in the Treasury, who will not have had the privilege to hear it directly."[30] Despite this, the amendment was agreed to.

Government amendments 46 to 57 agreed to without debate.

Government amendment 58: reckless misconduct in the management of a bank

This amendment is derived from recommendations of the Commission. It is the subject of a Treasury briefing note which can be seen here.

Lord Newby introduced the clause. He said that there was a strong case for extending financial crime sanctions to 'mismanagement and failure to control'. He outlined its scope:

> In line with the commission's recommendations, the new offence will be applicable only to individuals who are covered by the new senior managers regime. Senior managers could be liable if they take a decision which leads to the failure of the bank or fail to take steps available to them to prevent such a decision being taken. The offence will apply only to behaviour that falls far below the standard that could reasonably be expected of a person in their position, which is a similar test to that for corporate manslaughter. In addition, at the time when the decision was taken the senior manager must have been aware of a risk that its implementation may cause the failure of the bank. Limiting the application of the offence to individuals who are covered by the senior managers regime, and the precise definition of when a bank has failed for the

28 HL Deb 15 October 2013 c403
29 HL Deb 15 October 2013 c404
30 HL Deb 15 October 2013 c405

> purposes of the offence, mean that those affected should be in no doubt as to their potential criminal liability.
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> The maximum sentence for the new offence will be seven years in prison and/or an unlimited fine on indictment. This is in line with the recommendation of the commission, which argued that the offence must carry the possibility of a prison sentence to be effective, as with other offences of similar gravity under FiSMA, such as misleadingly manipulating benchmarks such as LIBOR. The commission said that it,
>
>> "would expect this offence to be pursued in cases involving only the most serious of failings ... and not predominantly against smaller operators where proving responsibility is easier, but the harm is much lower".
>
> The Government endorse this position, and the offence will therefore apply to banks and building societies but not to credit unions.[31]

Lord Brennan (Labour) moved an amendment that would remove a defence that the individual was ignorant of the acts that would bring down the bank and another that would raise the standard of behaviour to be expected of a senior manager. Lord Phillips of Sudbury however, argued that the wording of the amendment undermined "that fundamental test of criminality - intent, bad faith, dishonesty or want of integrity – call it what you will ... there are cases that would fall within Amendment 58 that would not satisfy the normal test of mens rea in criminal offences.[32] Lord Lawson asked why the Commission's reference to 'reckless' was absent. Lord Newby replied.

> Yes, I hope I can. As I was just saying, we had to put in the Bill a form of words that would create a credible offence that could be successfully prosecuted. The two requirements that an individual's conduct had to fall far below what could reasonably be expected of them and that they were aware of the risk they were taking, would, in the view of the lawyers, capture recklessness. It is a definition of recklessness without the use of the word. The wording gives a greater chance of having a credible offence than using the word "reckless". It is an attempt to make sure that we have got something that we could use, while capturing the concept.[33]

The amendment, and connected amendments 59 and 60 were agreed to.

Government amendment 60A: regulation of payment services

This amendment is the subject of a Treasury briefing note which can be seen here. It provides a good summary to the background of the amendment:

> In March 2013 the Government published a consultation, Opening up UK payments, setting out its proposal to bring payment systems under formal economic regulation, and establish a new competition-focused, utility-style regulator for retail payment systems. This followed a report published in July 2011 by the Treasury Select Committee (TSC), expressing serious concerns about the governance of payment systems, and recommending that the Payments Council be brought into regulation. The Final Report of the Parliamentary Commission on Banking Standards also welcomed the Government's commitment to bring payment systems into regulation.

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31 HL Deb 15 October 2013 c421

32 HL Deb 15 October 2013 c426

33 HL Deb 15 October 2013 c427

The Government has considerable concerns about the market for UK payment systems. The combination of strong network effects, and the ownership of many of the key payment systems by overlapping groups of the big incumbent banks, gives rise to problems in three areas:

1. Competition: the structure of the industry gives the incumbent big banks the opportunity to erect barriers to entry, so that challengers and smaller players cannot gain access to the payment systems on fair and transparent terms. These issues occur both at the level of direct and indirect access to the payment systems.

2. Innovation: the network nature of payment systems (i.e. all major banks need to be connected for the system as a whole to be effective) means that innovations in the shared space do not give a competitive advantage to any of the banks. The banks also have the ability to slow the pace of development of new innovations. There is therefore a concern that new innovations are not being developed where they are in the wider social interest, but not in the narrower interests of individual banks.

3. Consumer responsiveness: the network nature of payment systems means that failing to respond to customer needs does not give a competitive disadvantage to any of the banks. Therefore, there is scope for the banks to take decisions about the provision of services against the strong wishes of consumers.[34]

Lord Newby outlined the main features of the amendment:[35]

- the regulator would be a separate legal body set up by the FCA
- it will oversee all domestic payment systems designated by the Treasury
- it will be able to change anti competitive charges and fees or terms and conditions of usage that restrict competition
- it will 'address underinvestment by the industry and the slow pace of innovation
- it could stop banks 'ignoring the legitimate needs of consumers ... by trying to abolish cheques

Lord Eatwell asked why it had to be a separate body; would it not be better within the FCA? Several Peers queried the need for a 52 page long amendment to set up another regulator.

Replying, Lord Newby said that the decision to put the regulator outside of the FCA meant that it could be more focused and not get 'lost' as just one division of many in the FCA. The cost of the regulator would fall on the 'regulated population' through the normal FCA fee structure. The Amendment was agreed to.

Further amendments regarding the Regulator (60B to 60YYV) were agreed to without debate.

Government amendment 61: Special Administration procedure for operators of certain infrastructure systems

This amendment is the subject of a Treasury briefing note which can be seen here. Lord Newby explained that: "these amendments establish a special administration regime that will

34 HM Treasury Policy Briefing
35 HL Deb 15 October 2013 c433

apply to operators of recognised interbank payment systems, operators of securities settlement systems and crucial service providers to those operators".[36]

The Treasury note outlines the special features of the scheme:

> The FMI administration has the following features which differ from a normal administration regime:
>
> Power of direction for the Bank of England over the FMI administrator
>
> FMI administrator is appointed by the court, nominated by the Bank of England, to manage the affairs of the company entering FMI administration. The Bank of England will have a power of direction over the FMI administrator. The power of direction will allow the Bank of England, in appropriate cases, to direct the FMI administrator to take a particular course of action where the Bank is of the view that it is necessary for those steps to be taken in order to achieve the objectives of FMI administration. One example of where the power of direction might be useful is for the Bank of England to be able to direct the administrator to prioritise certain payment types when a system in administration cannot continue processing all transactions. For example, priority might be given to Direct Debit transactions for Bacs rather than ancillary services.
>
> Transfer powers
>
> These powers give the FMI administrator the means to transfer all or part of the business to another company on an expedited basis. Transfers are made in order to achieve the overarching objective of maintaining critical services of the payment or securities settlement system. The transfers must be approved by the Bank of England and the Bank may modify transfers before approving it.
>
> Restrictions on early termination of third party contracts.
>
> Under FMI administration, there will be restrictions on the early termination of third party contracts to ensure that suppliers of particular categories of goods and services do not terminate supply solely because the relevant infrastructure company has gone into FMI administration. This will further strengthen the protection provided to the payment and securities settlement systems' provision of systemically important services.[37]

The amendment was agreed to.

Government amendments: competition objectives

Amendment 79 provides the FCA with enforcement powers set out in the *Competition Act 1998* and the *Enterprise Act 2002*. The amendment was agreed to. A further amendment provided the PRA with a 'secondary objective' of competition. This followed a recommendation from the Commission. Lord Newby introduced the amendment and spent a considerable time explaining why the Government had ignored another of the Commission's recommendations – that the FCA's strategic objective (ensuring that relevant markets function well) should be abolished. He said that the criticisms from both the Commission and the Treasury Committee were from before the FCA had been set up. Experience post-

[36] HL Deb 15 October 2013 c493
[37] HM Treasury Policy Briefing

establishment suggested that there was no conflict or hierarchical problem between the strategic and operational objectives.[38]

By contrast the Government accepted that the stability that the PRA was charged to create should also not prevent new market entrants and the amendment sought to enshrine this point in statute. The amendment was agreed to.

Bank of England Court of Directors

Lord Turnbull introduced his amendment which, he said, was fighting old battles all over again:

> For those who took part in proceedings on the Financial Services Bill in 2012 these clauses will be Groundhog Day—fighting old battles all over again. The arguments about accountability are familiar, were set out in great detail in the Treasury Committee's report *Accountability of the Bank of England*, and rehearsed again in the report of the banking commission. This is not surprising, given the overlap in membership of the two groups.
>
> The dispute can be briefly summarised. The Bank of England's responsibilities have been hugely enhanced, and its accountability has changed—one has to concede that—but not kept pace. Not only has the scope of the Bank's responsibilities grown but so has its nature. It is now not just responsible for generic policies such as monetary policy or financial stability; it also has powers over the lives and livelihoods of individual citizens and individual businesses. It is therefore important that its accountability keeps pace with those changes.[39]

He said that the key part of the amendment was:

> The amendment would abolish the Court of the Bank of England and replace it with a board of directors. This is the most eye-catching measure—after all, the court has existed for 319 years—but not the most important. In a sense, it is what you would do last, having made the other changes to signify that the Bank's governance had conclusively changed. The court has some desirable features, which were noted in earlier discussions. It is a unitary board and is no longer chaired by the governor. When I worked for the Treasury, I had to recommend appointments to the court. However, it has come a long way from the old 16-member court, which was like an in-house focus group on which every region or interest imaginable was represented. It has been replaced by a 14-member court with five executives and nine non-executives.
>
> The Financial Services Act 2012 genuflected in the direction of improving internal review by creating an oversight committee of non-executives. I would contend that that still does not go far enough. The central recommendation in Amendment 86 is not about whether the court should be a supervisory board or a board of directors; it concerns the abolition of the oversight committee and the transfer of its responsibilities from a committee of non-executives to the whole board—as I will call it—of the Bank.[40]

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[38] HL Deb 15 October 2013 c505
[39] HL Deb 15 October 2013 c511
[40] HL Deb 15 October 2013 c511

Lord Newby, replying, said that the new oversight committee had only been set up in April 2013 and that it was appropriate to give it time to settle.[41]

The amendment was withdrawn**. Clause 15 was agreed to**.

Remaining amendments

Lord Lawson moved an amendment that would make inappropriate lobbying a reason for the Governor of the Bank to lay a Report before Parliament. He made the point that the gradual erosion of the separation of functions imposed by the American Glass-Steagall Act had been achieved through continual; and extensive lobbying. Lord Newby, replying, said that the new role of the Governor included the duty to "raise the alarm" if lobbying threatened the security of the system. The amendment was withdrawn.[42]

Lord Phillips of Sudbury introduced an amendment that would review the current exemptions, dating from the *Financial Services Act 1986* which applied to certain City dealing contracts. The most affected of all groups are hedge funds. Lord Newby said that a review was unnecessary because the law had changed:

> However, the law has changed significantly in this area. Since the Gambling Act 2005 came into force, gaming contracts and wagers are now enforceable through the courts, except in Northern Ireland, and the effect of the exemption is therefore limited to Northern Ireland. In the rest of the United Kingdom, there is no difference in the enforceability of derivative investments and other gaming contracts and wagers. Much of the purpose of the review proposed has therefore, in the Government's view, gone.
>
> It is also unclear what action could be taken following such a review. Trading in financial instruments is subject to European law, and in particular the markets in financial instruments directive. This limits the extent of the action this country could take in relation to financial instruments falling within the scope of the directive. It is unclear what benefits such a review could bring and we suggest that the noble Lord withdraws his amendment on the basis that it is not proportionate or objectively justified.[43]

The Amendment was withdrawn.

1.5 Day 3

Non government amendments

Regulator and auditor meetings

Lord Lawson moved an amendment that would require regular meetings between regulators/supervisors and bank auditors. He said that his experience of the Johnson Matthey collapse alerted him to the lack of contact between the two groups. He noted that efforts to initiate meetings dwindled since provisions in the *1997 Banking Act* had been enacted to encourage them. By 2008 they were virtually non-existent. Both the Lords Economic Affairs Committee and the Commission had recommended a statutory duty. Both times the Government rejected it. He criticised this decision:

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41 HL Deb 15 October 2013 c513
42 HL Deb 15 October 2013 c526
43 HL Deb 15 October 2013 c528

The argument that the Government make is that there is a code of practice. Their response states:

"This means that there is an expectation set out in law, that there will be a regular dialogue between the regulator and auditor".

Expectation is not enough—we have been there before. We had the expectation before, following the 1987 Act. To begin with that expectation was fulfilled but increasingly it was not, and we know what disasters arose from that. I therefore ask the Government—there is no difference between us on the necessity of having this continuous, active dialogue much more than once a year; we probably should have it on a quarterly basis—whether there should be a statutory requirement. Given the lamentable history of the period when it was not a statutory requirement, I urge the Government to think again and make it one.[44]

He spoke also to an amendment that addressed the weaknesses, in the banking context, of the IFRS accounting framework:

Amendment 104D concerns the form in which bank accounts are prepared and the requirement—because we felt very strongly that the new accounting system, IFRS, was totally inadequate, certainly so far as banks are concerned; indeed, that proved to be so in the run-up to the crisis—that there should be a requirement in law for a second set of accounts. Those should not be prepared on the IFRS basis but in a way that the supervisory and regulatory authorities feel is necessary in order to give them the information they require. They should be for the benefit of the regulators and supervisors and should not be published in the first instance. However, if the PRA felt that it was in the public interest that the second set of accounts be published, it could require them to be published.

The difficulties with IFRS are huge. Noble Lords may have seen the interesting article in the *Accountant* by Emile Woolf—one of the best known chartered accountant—who writes from time to time. I commend the whole article: noble Lords might find it beneficial, although they will be glad to know that I will not read it all out. Woolf writes that:

"The lapse of accounting and auditing rigour that has allowed IFRS compliance to dissemble truth and fairness has brought shame on our profession and begs the question of exactly what is our purpose".

That is pretty strong wording, but it is well justified. The true and fair have effectively gone and the importance of prudence has given way to box-ticking. I understand why valuation by mark to market has come in. There were different difficulties with the historical cost basis but the result of mark to market has meant that in many cases, purely fictitious paper profits are in the accounts. Not only does that make the bank look stronger than it really is but, of course, these are then distributed in bonuses or whatever. It is a disaster.[45]

Again he set out the Government's rejection of the proposed reform, that there be a second set of accounts:

The Parliamentary Commission on Banking Standards has said, "Okay, we accept IFRS as it is but for banks there needs to be this second set of accounts for regulatory and supervisory purposes". What are the Government's grounds for rejecting this? The Government are saying: Okay, you have made a good point, but,

[44] HL Deb 23 October 2013 c1011
[45] HL Deb 23 October 2013 c1012

> "this needs to be balanced against the increased costs imposed by introducing a requirement for an additional parallel set of accounts".
>
> Compared with the massive costs of banks going belly up, the cost of having a second set of accounts which helps the regulators and the supervisors to do their job is peanuts—it is piffling. It is absurd to talk about it in the same breath.[46]

Lord Barnett picked up the theme of 'where were the auditors' before the crisis and the failures of communication:

> The noble Lord who just spoke asked where the auditors were. That question arose constantly, and understandably. If a bank gets into that kind of trouble, what were the auditors doing over the years? Never mind dialogue with the regulators; what about a dialogue with themselves or with the banks?[47]

Responding, the Minister, Lord Deighton said that legislating for more meetings was not the way to improve communication, instead he pointed to improvements made by the *Financial Services Act 2012*:

> FSMA now includes a new Section 339A—which deals with the powers to which my noble friend referred—requiring the PRA to have arrangements for sharing information and opinions with auditors of PRA-authorised persons, and to publish a code of practice setting out the way in which it will comply with this obligation. This code of practice, which we have talked about, sets out the principles governing the relationship between the regulators and bank auditors. The code has been laid before Parliament, so provision has already been made, both in and under FSMA, for a regular dialogue between the regulator and the auditor. These requirements mark a change in focus away from process—stipulating the number of meetings—to actual outcomes: getting them to do the job properly. This requires regulators to consider serious engagement with auditors and subjects their stated approach to scrutiny so we can see if they are complying with the code of conduct: it does not just fall away. This process is not only more rigorous in the short term, but gives the opportunity for parliamentary scrutiny when the codes of practice are laid before Parliament and provides a check on potential complacency in the future.[48]

With respect to the other amendment he said that there was a review of the accounting framework underway and the new CRD IV Directive will require banks to "disclose supplementary information which goes beyond the international financial reporting framework".[49]

The Amendments were withdrawn.

Amendment 93: leverage ratio

Another amendment with history behind it. Lord Lawson's amendment would require the Financial Policy Committee (FPC) to introduce a prudential leverage ratio for banks. Again, this was a proposal of both the Vickers Commission and the Banking Commission and again rejected by Government.

Lord Eatwell described the amendment (new clause) as "the most important in the Bill. It defines whether we are really serious. If we are not serious, we will reject the idea of having

46 HL Deb 23 October 2013 c1012
47 HL Deb 23 October 2013 c1016
48 HL Deb 23 October 2013 c1020
49 HL Deb 23 October 2013 c1022

a leverage ratio as one of the armaments of the FPC. If we are serious, the Financial Policy Committee must have this tool”.[50]

Responding Lord Deighton said that he thought the powers available to the FPC plus those due to come on line under the Basel rules were sufficient and there would be chances to review the situation:

> In order to address recognised problems with the system of risk-weighted capital requirements—which we have all talked about and acknowledged—the Basel III accord recommends a complementary binding minimum leverage ratio. Again, we have all agreed that the right way ahead is for the two to work together, so there is no dispute about that. That standard comes into force in 2018, following a final calibration of the leverage ratio in the first half of 2017 so that we get it right. Separately, at the European level the European Banking Authority will undertake a review of the leverage ratio with a view to the European Commission introducing legislation in 2017. The Government agree, and have consistently argued, that banks must be subject to the binding minimum leverage ratio requirement, which supplements the risk-weighted capital requirements as set out by the Basel III accord. Therefore the Government fully anticipate the development of internationally agreed minimum standards of leverage.
>
> The Government take the view—and we believe that the regulators agree—that the optimal approach to creating a lasting binding minimum standard is to work towards international agreement and its implementation through legislation. As Mark Carney wrote in the *Financial Times* on 9 September:
>
> “Yielding to calls for unilateral action to protect domestic systems would risk fragmenting the global system, slowing global growth and job creation”.
>
> Once that minimum is agreed domestically, the Government propose—and this directly addresses the point made by the noble Lord, Lord Eatwell—to furnish the FPC with a specific macroprudential tool to vary the leverage ratio, through time, obviously subject to it not falling below the minimum.[51]

Between now and 2018 he thought that the FPC had “broad powers to make recommendations to the regulators on a ‘comply or explain’ basis, including on leverage”. He continued:

> The killer fact, if I may call it that, is that on 20 June—interestingly, one day after the publication of the PCBS report containing this recommendation—the PRA announced that it would require eight major UK banks to meet a tougher leverage ratio than that prospectively required by Basel III. They have already done that. That action followed a March 2013 recommendation from the interim FPC to the PRA to consider applying higher capital requirements to any major UK bank or building society with concentrated exposures to vulnerable assets, or where banks were highly leveraged relating to trading activities. Put simply, the regulators already have the powers to do what the noble Lord appears to be suggesting in advance of international agreement.[52]

The amendment was withdrawn.

Amendment 94: review of proprietary trading

The amendment called for a review of proprietary trading by the PRA and FCA. Lord Lawson outlined the risky nature of the trading and its negative impact on banking culture.

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50 HL Deb 23 October 2013 c1023
51 HL Deb 23 October 2013 c1032
52 HL Deb 23 October 2013 c1033

The amendment would require a review in three years time, when the UK could benefit from the US experience of the Volcker Rule. Lord Deighton replied that ring fencing – proprietary trading was banned within the ring fence – was an alternative to such a ban. He also said that there was little trading done now in the City. However,

> monitoring and reviewing all risks to a bank constitutes an essential part of the PRA's work. The PRA's approach is to insist that firms adopt and follow a risk appetite that is consistent with the PRA's statutory objective to promote the safety and soundness of firms that it regulates. This will include regular monitoring and review of all risks, not limited just to those associated with prop trading. Therefore, to require the PRA by legislation to undertake such a review seems unnecessary. Should we legislate for a review of how reference rates are set, for example? Should we legislate for a review of mis-selling practices? Why, therefore, should we do it for prop trading? It is not apparent to me what problem a review would solve. While I think that reviews can play a useful role, in this case we are not sure that it is justified in advance.[53]

Amendments 94 and 95: remuneration

Two non-government amendments were moved; one to impose a duty on regulators to produce a further remuneration code, this time specific to banks, on senior managers in banks and a further power to claw back deferred remuneration of employees in banks that had state aid.

This produced a very long and wide ranging debate about all aspects of remuneration. Lord Turnbull argued that banks were special and so a code in addition to the general financial service firm code of the FCA and the company law based code for all firms was justified. He saw the clawback applying to things such as vested pension contributions. Lord Eatwell saw the main advantage of the amendments the fact that they de-incentivised risk taking. Lord Lawson stressed the point that the amendments did not try to interfere with the amount of pay, just the structure of the reward system. It would, he said, move back to the earlier age where investment houses were partnerships with significant personal investment from the owners.

Replying, Lord Newby said that the proposed code on top of "the rigorous current approach seems unnecessarily rigid"[54] He accepted the need for remuneration claw-back but said that regulators already had the power to cancel deferred remuneration and loss of office payments when it fails. However, he suggested that there might be a legal challenge to the specific measure of pension fund seizures under the European Convention on Human Rights.[55]

Both amendments were withdrawn.

Amendment 98: Whistleblowers compensation

Lord McFall introduced an amendment that would enable the regulator to force a firm to compensate any whistleblower who had suffered as a result of their actions. He noted that "during the whole financial crisis not one whistle was blown. Why was that?"[56] Several Peers commented on the experiences of whistleblowers, or their absence, during the crisis.

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53 HL Deb 23 October 2013 c1040
54 HL Deb 23 October 2013 c1054
55 HL Deb 23 October 2013 c1055
56 HL Deb 23 October 2013 c1076

Replying, Lord Newby said that the Government was currently in the midst of a review of the "whistle-blowing framework".[57] Consequently they would wait for that body to report before making changes. He also pointed out that the route for protection was surely through employment law protections rather than through a financial regulator.[58]

The amendment was withdrawn.

Amendment 99: UKFI abolition

Lord Lawson introduced an amendment to abolish UK Financial Instruments Ltd (UKFI).[59] Lord Lawson argued that UKFI was not independent in any real respect and its continued existence allows the Government to "get off the hook in a way that they should not".[60] Abolition had been recommended by the Commission and by the previous Governor of the Bank of England. The Minister said that UKFI "is working fine and the time and effort it would take to pull it back into the Treasury" would distract other government work, especially the review of RBS's future.[61]

The amendment was withdrawn.

Amendment 101: duty of care

This subject has been debated a number of times in previous banking reform Bills and during the Commons stages of this Bill. The general intention is to place a 'fiduciary duty' (towards customers) on either the directors of institutions or, in this case on the institution itself. This duty is above that of the normal common law duty of care and hence is seen as a way to establish higher standards within the industry.

The Minister, Lord Deighton noted that the Commission did not recommend this course of action and the Government, as it has said before, does not believe that imposing the duty will add anything to consumer protection which is protected by a number of specific duties and requirements and by, it hopes, increased market competition.

The amendment was withdrawn.

Amendments on the disposal of government shares in banks; portable bank account numbers; high cost credit and confidential disclosures by the FCA were briefly discussed and then withdrawn. Clause 16 was agreed to. Clause 17 was agreed to after some short technical government amendments were agreed to.

2 Report Stage

The Report stage lasted two days. A very large number of government amendments were agreed to; the overwhelming majority however were not discussed. A significant opposition amendment was agreed to surrounding the licensing and approval of banking staff.

The Treasury has produced its own guide to government amendments on Report stage here.

57 Information on this can be found here.
58 HL Deb 23 October 2013 c1084
59 UKFI is the body set up by the Labour government to manage its holdings of banks rescued during the financial crisis.
60 HL Deb 23 October 2013 c1088
61 HL Deb 23 October 2013 c1091

2.1 Day 1

Debate started with a reference to the fact that the Bill was now 170 pages long and with no opportunity for the Commons to have a second reading style debate on “a virtually a new Bill”.[62]

Peers debated opposition amendments to the ring-fence proposals. One would provide for a review of the ring fence and possible full sectoral separation of the banking industry. During the debate the Minister, Lord Deighton, outlined government amendments 11 and 16:

> On the specific subject of the independent review of the ring-fence, the Government have never opposed the principle of a future review. How could we when the ring-fence itself was the product of an independent review, the ICB? Indeed, my right honourable friend the Chancellor told the PCBS in February this year that,
>
> “we should have a review about whether the John Vickers reforms are working”.
>
> Therefore we have been more sceptical of the need to legislate for this review. After all, the ICB itself needed no legislation to conduct its painstaking research and rigorous, independent analysis. However, having listened to the arguments made, in particular in this House by members of the PCBS, we have accepted the case for a statutory review of the ring-fence in the interests of certainty, to determine, as my noble friend just pointed out, whether it is as robust as I have implied we would like it to be.
>
> Government Amendments 11 and 16 therefore provide for a review of the operation of the ring-fence, to be conducted by a panel of independent experts once the ring-fence has come into force. In drawing up these amendments, the Government have consulted closely with members of the PCBS. [...]
>
> Following those discussions, the Government believe that our amendments address the substance of the PCBS’s concerns. To reflect that ring-fencing is a bold new step, the review’s central task will be to assess how well the ring-fence is working. Its conclusions are not constrained; it can make any recommendations it sees as appropriate. If it believes that the ring-fence is in need of improvement or repair, it will be able to make recommendations as to what changes in the legislation or rules are required to fix it. Therefore I can give my noble friend Lord Lawson the unequivocal commitment which I think he asked for—I will test whether I have got this right—that if the review concludes that the ring-fence is irreparably broken, it will also have the scope to recommend an alternative approach altogether. That will, of course, include full separation.[63]

Lord Eatwell congratulated the Government for having “moved towards the Commission’s position”.[64] The amendments (11 and 16) were agreed to.

Lord Eatwell then moved amendment 21 which would insert into the Bill a new clause headed ‘Professional standards’. The amendment he said “seeks to capture the need for proper training, continuous development and the maintenance of proper professional standards via a licensing regime”. The ‘key issue’ in his amendment was “that of qualification: minimum thresholds of competence and continuing professional development”.[65]

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62 HL Deb 26 November 2013 c1302
63 HL Deb 26 November 2013 c1321
64 HL Deb 26 November 2013 c1324
65 HL Deb 26 November 2013 c1345

The Archbishop of Canterbury moved a parallel amendment which focussed on the licensing regime. He sought to focus the attention of regulators on "on those employees who could inflict the most significant and material damage on their institutions and on the banking system as a whole" and to move away from a system that "operates mostly as an initial gateway to taking up a post rather than serving as a system through which regulators can ensure the continuing exercise of responsibility".[66]

Lord Newby, responding for the Government indicated that the amendments put down by the Government were not the last word on the subject of licensing and personal regulation:

> The Government's amendments in Committee put in place all the essential features of the commission's licensing regime proposals in Clauses 22 and 23. These clauses give the regulator power to make rules of conduct imposing binding standards on employees and ensure that the regulators can take action when there is any breach of these rules. The relevant provisions would form part of FiSMA and confer powers on the regulators in the normal way.
>
> However, we recognise that this may not be seen as giving the full weight and impetus to the commission's proposals, so we are looking to see whether we can bring forward at Third Reading amendments which will highlight the proposals more and put beyond doubt the determination which we all share to see real change in this area. In the light of this, the Government are looking to introduce amendments at Third Reading to impose obligations on banks and PRA-regulated investment firms, first, to verify before appointing someone as a senior manager, an employee in a role that could do significant harm to the firm or another role requiring regulatory pre-approval, that the person is fit and proper to perform that role in the firm; secondly, to maintain up-to-date lists of such persons which could be made available to the regulators when required; thirdly, to notify the appropriate regulator when they take formal disciplinary action against such persons—formal disciplinary action could include giving a formal written warning, dismissal, suspension or clawing back remuneration; and, fourthly, to notify all such persons of the banking standards rules that apply to them. All these obligations will be regulatory requirements under FiSMA. Failure to comply with the obligations will be a breach of regulatory requirements, and actions could be taken against the bank concerned by the regulators. In addition, deliberately or recklessly submitting a materially false or misleading list of persons to a regulator will be a criminal offence.
>
> The Government will also look at tabling amendments requiring, rather than simply empowering, the regulators to set out those functions for which a bank must do the above. We anticipate that this class will match the category of staff defined in the PCBS report as being those whose actions or behaviour could seriously harm their employer, its reputation or its customers.[67]

He summed up by saying that:

> The regime we have legislated for cannot be called a licensing regime, but it delivers precisely what the parliamentary commission called for in its report. There will be a regime of regulatory standards for employees encapsulated in enforceable banking standards rules. Firms will inevitably have a role in ensuring their staff comply with those standards and taking action if they do not, while the regulator will be able to take action if needed.[68]

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66 HL Deb 26 November 2013 c1337
67 HL Deb 26 November 2013 c1342
68 HL Deb 26 November 2013 c1343

Lord Eatwell's amendment was agreed to. The amendment of the Archbishop of Canterbury was withdrawn. A further 50 plus government amendments were agreed to, most without debate.

Lord McFall proposed an amendment that would necessitate a review of the effectiveness of the regulators, based on amongst other things, the increased range of new duties imposed on them (e.g. payments regulation) and, again, the possible lack of Parliamentary consideration of so many, late changes to the current legislation. The amendment was withdrawn.

2.2 Day 2

Day 2 began with government amendments to the Payments System Regulator (Schedule 4) which had first been introduced in committee. Their purpose was to:

> ensure that the regulator is able to perform its functions effectively and that the right procedures apply to powers contained in the Bill.
>
> First, these amendments will introduce provisions modelled on measures in the Financial Services and Markets Act 2000 which prohibit the regulator and those working for or on behalf of it from disclosing confidential information without the consent of the information owner. The prohibition will be enforced by a new criminal offence. However, further provisions will permit confidential information to be disclosed to certain prescribed persons in specific circumstances, including the provision to the regulator of certain information held by the Bank of England. This will be an important element of the Payment Systems Regulator's regulatory regime. Without a prohibition on the disclosure of confidential information, people may be dissuaded from providing to the regulator important information which would assist it in the discharge of its regulatory functions.
>
> The Government are bringing forward a number of other amendments which mirror provisions that already exist for the FCA under the Financial Services and Markets Act. The FCA will be able to collect levies for the purpose of maintaining adequate reserves for the regulator, which will help it to meet any contingencies. Another amendment will require that the regulator uses a sum equal to its enforcement costs for the benefit of its regulated population by reducing their levy the following year. A further amendment will ensure that the FCA does not have to produce a cost-benefit analysis when drawing up fee-levying rules to govern the collection of fees to meet the costs of the Payment Systems Regulator.[69]

He stressed that the provisions, taken together, maintained the right to indirect access to payments systems which other smaller banks relied upon to offer banking services. Lord Brennan replied at length. He talked about the complexity of the regulations; that they covered in excess of 60 sections of the Act; the fact that card payment systems were included when there had been no problems so far and none were anticipated and, more worryingly, very little study of the impact that the new system would have on this sector. The amendments were agreed to.

Lord Phillips of Sudbury moved an amendment which would provide for a review of the current exemption from national gaming laws which the City generally enjoys. Whilst there is general acceptance that some City activities should enjoy exemption it was a question of degree. For example:

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[69] HL Deb 27 November 2013 c 1419

> Let us consider Merrill Lynch. It cornered, it is estimated, 50% to 80% of the world's copper in a series of purchases last year, I think it was. That was pure gaming. It was not to satisfy any of its customer needs; it saw potentially vast gains in moving into the world copper market and simply buying it up. Can you imagine: 50% to 80% of all the world's copper was purchased? That was pure gaming. In fact, I think that it went wrong and was part of the collapse, but I would not lay my life on that.
>
> These are extremely difficult issues. The cultural and ethical aspects are deep. The vast majority of people engaged in such trading are decent, good people. They are not all crooks, but the system in which they are trapped is one which, first, was at the root of the disastrous financial and banking collapse from which we are still suffering—and there is a long way yet to go. Also, we should be interested in the wider outfall. The noble Lord, Lord Lawson, coined a rather vivid phrase last night about the cultural contamination that can go on when one part of a system loses all contact with any ethical underpinning.[70]

Responding, Lord Newby listed several reforms agreed by the international financial community which would regulate the activities of, in particular, derivatives trading. In the light of those reforms he suggested "a formal Treasury review was not needed". The amendment was not moved.

Lord Eatwell moved an amendment which called for the imposition of a fiduciary duty to apply to "core services" within the ring fence. This repeated many of the arguments made at previous sittings and in previous Bills. It was defeated on a division.[71]

The Archbishop of Canterbury, supported by Lord Lawson, moved an amendment to give the Financial Policy Committee the power to make directions to banks to set their leverage ratios. The issue of how the ratio is to be set and the roles of the various organisations has suffered from a lack of clarity in the past. Responding, Lord Deighton outlined where the law was at present, before setting out new government proposals:

> Under current law, three bodies are concerned with the leverage ratio: the Treasury, the FPC and the PRA. Of course, the last two are part of the Bank of England group. Of those three, one has the direct power to set a minimum leverage ratio now. That is the PRA. Let me make it absolutely clear: it can do that not just on a firm-specific basis but on a system-wide basis. It can do that now; it has that power. It can set the leverage ratio directly, as it did back in June or on the basis of a recommendation from the FPC. When I replied to the noble Lord, Lord Turnbull, I talked about the June action of the PRA as the killer fact; it was obviously not as emphatic as I hoped.

He then set out the processes by which the setting of the ratio, and other recommendations, will take place:

> Under FiSMA, the FPC has two sorts of powers. First, there is a wide power of recommendation on any issue with regard to financial stability, which it makes to the PRA to exercise under its powers on a "comply or explain" basis. For that to work, the PRA must have powers to apply rules across the whole sector, which, as I have just explained, it does. It is envisaged that that is how most of the FPC's decisions will be enacted. Secondly, the FPC has a narrow set of macro-prudential tools, which are powers to direct the PRA to act. There are currently two powers of direction. Currently, they are a counter-cyclical capital buffer and sectoral capital requirements. The

[70] HL Deb 27 November 2013 c 1436
[71] HL Deb 27 November 2013 c 1447

> Government also committed—this was the original situation—to giving the FPC a third direction tool to vary the minimum leverage ratio once the minimum was set in 2017.

To conclude:

> For the avoidance of doubt, the Treasury plays no role here. If the PRA wants to set a leverage ratio either under its own initiative or under the recommendation of the FPC, it does not have to ask the Treasury, and the Treasury has no veto. The Treasury is the only body of the three that does not have the power or influence to set the leverage ratio. So the debate is essentially about how and when the Treasury grants the FPC that specific power of direction over the PRA, rather than the PRA retaining some discretion in the matter.[72]

He said that the Government would:

> give the FPC the power of direction to vary the leverage ratio through time in 2018, subject to a review in 2017, but, given progress internationally—all the transformational change that we just discussed—there is a case for such powers being given earlier, or specified in a different form. To settle this debate, the Chancellor asked the governor, who is the chair of the FPC, to review the matter and make a recommendation to him that he could take to Parliament.[73]

The amendment was withdrawn.

Lord Lawson introduced two amendments covering increased meetings between regulators and auditors and a review of individuals conducting proprietary trading. Both amendments were withdrawn.

Lord Newby introduced a government amendment which would affect claims management companies (CMCs). The regulation of CMCs is currently outside of the financial services orbit of regulation and sits instead within the Ministry of Justice. This is despite the fact that the overwhelming volume of work of these companies is, and has been for some time, within the financial sector – for example, mortgage endowment claims, bank charges, PPI etc. This might change, which is the argument for not bringing within the remit of the financial regulator. However, the Government has taken the opportunity of this Bill to give the CMC regulator the power to impose penalties. Currently, the regulator's commonest action is to cancel a CMC's authorisation. Recent enforcement actions can be found here.

At present a company that acts below the required standards but makes money in so doing only faces the penalty of being forced to stop. The power to impose penalties provides a different sort of deterrent to poor behaviour and is an alternative to the 'nuclear' option of banning a company. The Minister talked about future changes to the law intended (but not by this Bill):

> [T]he claims management regulator is also currently consulting on these rules in parallel to this amendment to further strengthen the consumer, business and third-party protections they offer. This ability to impose a financial penalty will be implemented by secondary legislation. It will be done by way of amendments to the existing regulations—the Compensation (Claims Management Services) Regulations 2006. A public consultation regarding the detail of the necessary changes to facilitate a claims management regulation financial penalty scheme will be launched in early 2014. Also, any changes to these regulations, including the measure of the financial penalties

72 HL Deb 27 November 2013 c1456
73 HL Deb 27 November 2013 c1457

> to be imposed, will be subject to the affirmative procedure, allowing for necessary scrutiny of the detail of the proposals in Parliament. It is critical that we tackle poor practice in this sector. These amendments, giving the Secretary of State power to permit the claims management regulator to fine claims management companies will mean that those non-compliant CMCs will have to pay the price of their poor behaviour.[74]

3 Third Reading

The Treasury has produced a note on Third Reading (government amendments) which can be found here.

The Third Reading was held on 9 December 2013. The most notable feature of the session was a series of government amendments that mirrored or interpreted opposition amendments which had been rejected during previous sessions. Government amendments included:

- Bringing forward of the review of the ring fence;
- Review of proprietary trading
- Senior managers licensing/certification regime
- Mandatory cost of credit cap
- Obligatory meetings between auditors and regulators.
- Regulatory costs of claims management company complaints to be recouped from the industry

3.1 Review of the ring fence

The Government had already implemented Commission proposals to hold a review into the functioning of the ring-fence after four years of operation. Now however it decided that:

> Two years is a long enough period over which to observe the operation of the ring-fence, and assess its effects. The knowledge that ring-fencing will soon be reviewed may also be a further encouragement to banks to comply faithfully with the ring-fence.
>
> This amendment therefore requires that the independent review of the ring-fence be held within two years of the ring-fencing taking effect, rather than four years. This is a sensible change and one that we hope illustrates the Government's constructive approach to reasonable suggestions from all sides.[75]

Since the transition to ring-fencing is scheduled for 2019, the review will have to take place by 2021.

3.2 Proprietary trading

Lord Deighton moved four government amendments which would require the PRA to carry out a review of proprietary trading activity and report to the Treasury. This report would be assessed by an independent body which would then report back to the Treasury and to Parliament. The review would take place in 2020; a year after ring-fencing was completed.

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[74] HL Deb 27 November 2013 c1477
[75] HL Deb; 9 December 2013, c661

3.3 Licensing regime

Collectively, amendments 9, 11, 12, 13 and 14 moved by Lord Newby were the Government's response to its defeat on Report with respect to a licensing regime for senior (non-managerial) employees in banks (see Report Day 1 above):

> In brief, these amendments make explicit the requirement on banks to certify staff and enforce banking standards in the first instance. Amendment 12 delivers the commitment to require banks and PRA-regulated investment firms to verify that people are fit and proper before appointing them to functions in which they could do significant harm to the firm. It also requires firms to review that assessment annually. This gives effect to the commission's recommendations in paragraph 634 of its final report. Indeed, the Government have gone further. Amendments 9 and 11 impose similar obligations on firms in respect of senior managers and other persons who have been approved by the regulators.
>
> Amendment 12 also imposes the obligation on these institutions to issue certificates to persons performing functions in which they could cause significant harm to the firm to confirm that the fitness and properness checks have been carried out. As I explained on Report, it would not be appropriate to describe these documents as licences—the commission's preferred term—but it is quite in order to call them certificates and they fulfil the same function. The amendment also imposes obligations on banks and PRA-regulated investment firms to maintain records of persons who have been issued with certificates. It is not, of course, necessary to require firms to keep lists of senior managers as their appointments will have been approved by the regulators and they are included in the financial services register kept by the FCA.
>
> Amendment 14 requires banks and PRA-regulated investment firms to notify the regulators of disciplinary action that they take against any of their staff, not just senior managers and persons who have been issued certificates. [...] This gives the regulators the ability to check up on how firms are policing the conduct of individuals and it delivers on the recommendations in paragraph 642 of the commission's report.
>
> Amendment 13 requires banks and PRA-regulated investment firms to notify individuals that banking standards rules apply to them. This delivers on recommendations in paragraph 643 of the commission's report. Amendment 13 also requires banks and PRA-regulated investment firms to ensure that the individuals concerned understand their obligations under banking standards rules. This includes by providing suitable training. Amendments 9 and 12 also provide that, in checking that someone is fit and proper, firms must have regard to whether someone has a qualification or has undergone training prescribed by the regulator in its rules.[76]

Lord Newby said that these amendments went way beyond New Clause 15 which had been introduced by Lord Eatwell on Report. Lord Eatwell said that the new system was "something of a tripartite muddle" since there were general rules, senior mangers' rules and the remains of the approved persons regime for things such as money laundering. The amendments were agreed to without a vote.

3.4 High cost credit

The government retreat from its very long held position of opposition to the imposition of a cap on the cost of high cost credit on the grounds of expert advice, continued. The *Financial Services Act 2012* had given the FCA the option to impose such a cap. Now the FCA was mandated to impose one regardless.

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[76] HL Deb; 9 December 2013, c670

The justification for the change in view was set out by Lord Newby, he stated that:

> FCA powers are already sufficiently broad to ensure that charges of all kinds can be covered in the cap. This Bill presents the ideal opportunity to ensure swift action to protect consumers from unfair and spiralling costs and to give the FCA a definitive parliamentary mandate to act now. That is why the Government are introducing this amendment to require the FCA to impose a cap on the cost of payday loans. Under this new duty, the FCA must use the powers given to it by the Government in the Financial Services Act 2012 in relation to such loans.[77]

The cap would come into effect at the latest by 2 January 2015. There was a division on a counter amendment of Lord Eatwell's which would bring forward the date of implementation to 1 October 2014. That amendment was defeated.

3.5 Auditor meetings with regulators

On Report, Lord Lawson had moved an amendment that would require meetings to be held between auditors and regulators. Amendment 24, moved by Lord Deighton would require similar contact to take place. He said:

> This issue has been subject to extensive debate. The Government have been clear throughout that the regulators should carry the full responsibility for managing an effective relationship with the auditors of banks they supervise, and be held to account for how well they deliver it.
>
> The reasons for this are strong. Before the crisis, regulators neglected their engagement with auditors while the auditors themselves signed off on the accounts of banks which we now know were, in some cases, in dire straits. The Government took action. There is now a requirement in the Financial Services and Markets Act for the PRA to lay its code of practice on auditor engagement before Parliament, meaning that the regulators will be held accountable for how well they deliver on the requirement to engage with the auditors of banks.
>
> However, it has become clear how strongly the PCBS valued the opportunity to go further and specify the number of meetings in statute, to ensure auditors' insights are used. For those reasons the PCBS is clear that, over time, this dialogue between auditors and regulators must not be allowed to lapse. The proposed amendment therefore includes two provisions to ensure that this crucial dialogue is preserved.
>
> First, the regulators must disclose in their annual report the number of meetings they have held with the auditors. This allows Parliament to hold the regulators to account for the frequency of meetings. Secondly, the regulators must meet at least once per year with the auditors of firms that the PRA, the leading prudential regulator, considers to be important to the stability of the United Kingdom economy. This is a minimum requirement. The Government believe that it is right to place the duty on the regulator to determine how many more meetings are required with the auditors of firms of particular types, consistent with its risk-based, judgment-led approach. This allows the regulators to focus their resources where the risks are highest. [...]
>
> For example, under the PRA's current code, for banks that could have the most significant impact on financial stability, the PRA code mandates at least three meetings a year. For other firms whose failure could still materially impact the UK financial system, the PRA code mandates at least one bilateral a year. The FCA meets at least

[77] HL Deb; 9 December 2013, c685

> twice per year with the auditors of the most significant banks and at least once per year with those in the next largest category.[78]

The amendment was agreed to.

3.6 Claims management companies: regulatory expenses

As stated above, regulation of claims management companies (CMCs) is outwith the financial regulation remit, despite the very close connection between the companies and the sector currently. Section 161 of the *Legal Services Act 2007* established a complaints mechanism against CMCs. The amendment moved by Lord Newby sets out the procedures for the recovery of the costs of that scheme from the regulated firms. He explained:

> In this case, the Claims Management Regulator, or CMR, is the designated regulator. The Legal Services Board, or LSB, will then levy the regulator for the OLC's costs and reimburse the OLC. To ensure that the Claims Management Regulator can recoup the OLC's costs, these amendments change the Compensation Act 2006 to enable the Secretary of State to make regulations to allow the Claims Management Regulator to charge CMCs, as part of their fees, for the OLC's costs associated with CMC complaint-handling. The Legal Services Act 2007 already provides for a levy on the Claims Management Regulator, if one is designated. This enables the LSB to levy the regulator for costs incurred by the OLC in relation to claims management costs.
>
> That mechanism is applicable only when there is a designated person as the Claims Management Regulator. When no person is designated as the Claims Management Regulator, as is currently the case, this role falls to the Secretary of State. The mechanism does not operate in this situation as the Secretary of State cannot be levied. To address this, amendments to the 2007 Act are needed. They will change the Act to give the Lord Chancellor a new power to make regulations to allow him to recover the OLC's costs associated with CMCs. These powers allow the Lord Chancellor to charge a periodic fee on regulated CMCs.
>
> Finally, in this situation further amendments are needed to address cross-subsidisation. The amendments will change the levy mechanism in the Legal Services Act 2007 to ensure that the calculation of the OLC's expenditure which is leviable on the legal profession excludes both its costs and its income in relation to CMCs.[79]

The amendment was agreed to.

[78] HL Deb; 9 December 2013, c701
[79] HL Deb 9 December 2013 c705