



# HM Treasury

## **Financial Services (Banking Reform) Bill**

### **Bill Overview**

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The Government published the draft Bill on 12 October 2012, to implement the recommendations of the Independent Commission on Banking (ICB) chaired by Sir John Vickers. The Bill will establish a more resilient, stable, competitive banking sector. It will protect taxpayers and reduce the severity in the event of a future financial crisis. The Bill will:

- ring-fence the deposits of individuals and small businesses to separate important everyday banking activities from volatile investment bank activities;
- give insured depositors preference if a bank enters insolvency; and
- give the Government power to ensure banks are more able to absorb losses.

Key ICB recommendations on higher capital requirements for large ring-fenced banks are being pursued at European level.

#### **ICB recommendations in the Bill**

##### **Ring-fencing**

Ring-fencing will require 'core' banking services, in particular the taking of deposits from individuals and small and medium-sized businesses, to be undertaken in a separate legal entity, insulated from wholesale and investment banking activities. A temporary disruption of core banking services would have a significant direct impact on the domestic economy. Ring-fencing will support continuity of provision of vital services and reduce the perceived implicit Government guarantee that comes from the presumption that the Government will be compelled to step in to support failing banks.

##### **Depositor Preference**

Depositor preference makes deposits that are protected under the Financial Services Compensation Scheme (FSCS) preferential debts. Such deposits benefit from preference in the insolvency hierarchy if a bank enters insolvency. This means the FSCS can recover more of the sum it pays out to insured depositors from the bank's assets.

This form of depositor preference will improve financial stability, by reducing the risk of contagion to other financial services firms, and the contingent liability for the taxpayer, should a bank fail or if a bail-in tool is used.

### **Primary loss-absorbing capacity (PLAC)**

Banks should be required to hold sufficient primary loss-absorbing capacity (PLAC). This comprises regulatory capital plus debt instruments that can reliably bear losses (be 'bailed-in') if a bank fails. This will improve the resilience of major UK banks and means that if a bank does fail, it can be resolved without recourse to taxpayer bail-outs.

The Bill enables the Government to establish the framework through which loss-absorbing debt requirements will be imposed on systemic banks by the regulator.

## **Other policy measures in the Banking Reform Bill**

### **The Financial Services Compensation Scheme**

The Bill imposes new statutory duties on the FSCS and makes provision for the statutory appointment of the Chief Executive of the FSCS as an Accounting Officer.

### **Fees**

The Bill gives the Treasury power to require the Prudential Regulation Authority (PRA), the Financial Conduct Authority (FCA) and the Bank of England to impose fees on members of the financial services industry in order to cover relevant expenses incurred by the Treasury in connection with UK membership of, or Treasury participation in, specified international organisations, such as the Financial Stability Board.

### **Accounts of the Bank of England**

The Bill enables the Bank of England to exempt by way of direction its wholly owned subsidiaries (except the PRA and "bridge banks") from accounting requirements under the Companies Act 2006 if necessary to meet the Bank's Financial Stability Objective.

## **Recommendations by the Parliamentary Commission on Banking Standards (PCBS) and subsequent amendments to the Bill**

The draft Bill was subject to pre-legislative scrutiny by the PCBS, which was set up in the wake of the LIBOR and other scandals, primarily to investigate culture and standards in the UK banking sector. The Government made a series of amendments based on their recommendations before the introduction of the Bill to Parliament on 4 February 2013:

- the objectives of ring-fencing are fully reflected on the face of the Bill, and the continuity objective is part of the PRA's general objective;
- the elements that constitute operational independence of the ring fence are fully reflected on the face of the Bill;

- a requirement for the PRA to conduct annual reviews of the operation of the ring-fence was introduced; and
- provision was made for much greater use of the draft affirmative resolution procedure with respect to secondary legislation.

The Government made further amendments to the Bill at Commons report stage to reflect other recommendations made by the PCBS, the most prominent being the 'electrification' of the ring fence. Other amendments included:

- as recommended by the PCBS, a requirement on the face of the Bill for the Treasury to consider competition when creating *de minimis* exemptions from ring-fencing; and
- a requirement for a report on ring-fencing transfer schemes, to establish an additional safeguard against abuse of the ring-fencing transfer provisions by banks looking to reduce or evade their obligations or liabilities to third parties, under the 'cover' of restructuring to comply with ring-fencing.

The Government made two other amendments at Commons report:

- a clarification of the statutory objective of the regulator to require it to minimise the risk that failure of any member of a ring-fenced banks' group might affect the continuity of core services; and
- a schedule of amendments that correct a series of minor and technical points in connection with the Financial Services Act 2012, the most substantial of which deals with the scope of the complaints scheme in relation to the PRA and FCA.

## **Amendments introduced in the House of Lords**

The PCBS produced its final report on banking culture and standards on 19 June 2013. The Government responded on 8 July. The Government made a series of amendments at Lords committee stage to reflect the proposals made by the PCBS in this report, including:

- 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;
- 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 also introduced 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, 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.

More detailed policy briefs on each of the above amendments are available from [www.gov.uk/government/publications/banking-reform-bill-government-notes-on-amendments](http://www.gov.uk/government/publications/banking-reform-bill-government-notes-on-amendments).

## **ICB recommendations taken forward through other channels**

### **European legislation**

The ICB's recommendations on capital are being pursued at a European level as the Government believes that in these areas, the UK's approach should be consistent with progress across Europe.

Higher capital requirements for large ring-fenced banks (beyond the Basel III minimum standards) will be delivered through powers in the Capital Requirements Directive (CRD) IV and Capital Requirements Regulation (CRR).

## **Competition**

A number of recommendations to improve competition in the banking sector both by the ICB and the PCBS are taken forward through non-legislative channels. In particular, following a request from the Treasury, the Financial Services Authority published a review of barriers to entry and expansion in UK banking. As a result of this the regulators are introducing significant changes to make it easier for new banks to enter the market and grow.

The Government also fully supports the new seven-day switching service for customers wishing to transfer their accounts that was launched on 16 September 2013.

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## **Further Enquiries**

1. For further information, please contact the Bill Manager Tom Wipperman (020 7270 6180, [tom.wipperman@hmtreasury.gsi.gov.uk](mailto:tom.wipperman@hmtreasury.gsi.gov.uk)) or the Bill Team Leader Ian Ginsberg (020 7270 5967, [ian.ginsberg@hmtreasury.gsi.gov.uk](mailto:ian.ginsberg@hmtreasury.gsi.gov.uk))
2. For access to publications please go to [www.gov.uk/government/policies/creating-stronger-and-safer-banks](http://www.gov.uk/government/policies/creating-stronger-and-safer-banks)