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GENERAL COMMITTEES

Public Bill Committee

FINANCIAL SERVICES (BANKING REFORM) BILL

Third Sitting

Thursday 21 March 2013

(Morning)

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Monday 25 March 2013

STRICT ADHERENCE TO THIS ARRANGEMENT WILL GREATLY FACILITATE THE PROMPT PUBLICATION OF THE BOUND VOLUMES OF PROCEEDINGS IN GENERAL COMMITTEES

The Committee consisted of the following Members:

Chairs: Mr Peter Bone, Mr Jim Hood, Dr William McCrea, †Mr Andrew Turner

† Ashworth, Jonathan *(Leicester South)* (Lab)
† Clark, Greg *(Financial Secretary to the Treasury)*
Doughty, Stephen *(Cardiff South and Penarth)* (Lab/Co-op)
† Durkan, Mark *(Foyle)* (SDLP)
† Evans, Graham *(Weaver Vale)* (Con)
† Hands, Greg *(Chelsea and Fulham)* (Con)
Jamieson, Cathy *(Kilmarnock and Loudoun)* (Lab/Co-op)
† Leslie, Chris *(Nottingham East)* (Lab/Co-op)
† Mills, Nigel *(Amber Valley)* (Con)
† Morris, James *(Halesowen and Rowley Regis)* (Con)
† Mowat, David *(Warrington South)* (Con)
Qureshi, Yasmin *(Bolton South East)* (Lab)
† Rees-Mogg, Jacob *(North East Somerset)* (Con)
† Sharma, Alok *(Reading West)* (Con)
† Smith, Nick *(Blaenau Gwent)* (Lab)
Stevenson, John *(Carlisle)* (Con)
† Thornton, Mike *(Eastleigh)* (LD)
Williams, Stephen *(Bristol West)* (LD)
Wright, David *(Telford)* (Lab)

Neil Caulfield, *Committee Clerk*

† attended the Committee

Public Bill Committee

Thursday 21 March 2013

(Morning)

[Mr Andrew Turner *in the Chair*]

Financial Services (Banking Reform) Bill

11.30 am

The Chair: As the Committee may be aware, Peter Bone is indisposed today for family reasons, and Dr McCrea has constituency commitments, so I shall be stepping in for today's sitting. I understand that the Minister had just finished speaking, but that he may well wish to add to his remarks, after a very brief word from Mr Leslie, who will still has the opportunity to wind up the debate.

Clause 4

Ring-fencing of certain activities

Amendment proposed (19 March): 20, in clause 4, page 9, line 21, at end insert—

'Power to order full separation

142JC Power to order separation in case of particular groups

'(1) Where—

(a) the members of a group include one or more ring-fenced bodies and one or more other bodies, and

(b) it appears to the appropriate regulator that the conduct of any one or more of the members of the group is such that there is a significant risk that the appropriate regulator will not be able to advance the objective in section 2B(3)(c) (in the case of the PRA) or the continuity objective (in the case of the FCA) otherwise than by acting under this section,

the appropriate regulator may give a notice to each of the members of the group.

(2) The notice must state that the appropriate regulator proposes to require the taking of relevant steps in relation to the group before the date specified in the notice.

(3) In this section "relevant steps" means steps to secure one of the following results—

(a) that there is no member of the group with a Part 4A permission to carry on a regulated activity of a description specified in the notice;

(b) that no member of the group is a ring-fenced body;

(c) that there is no member of the group with a Part 4A permission to carry on a regulated activity which is not a ring-fenced body.

(4) The notice must—

(a) specify a period, of not less than 3 months, during which any member of the group may make representations to the appropriate regulator in relation to its proposal, and

(b) name an independent reviewer who is to report on the conduct of the members of the group and the appropriateness of the proposal made by the appropriate regulator.

(5) A person may not be named as the independent reviewer without the consent of the chairman of the Treasury Committee of the House of Commons; and the reference in this subsection to the Treasury Committee of the House of Commons—

(a) if the name of that Committee is changed, is to be treated as a reference to that Committee by its new name, and

(b) if the functions of that Committee (or substantially corresponding functions) become functions of a different Committee of the House of Commons, is to be treated as a reference to the Committee by which the functions are exercisable;

and any question arising under this paragraph (a) or (b) is to be determined by the Speaker of the House of Commons.

(6) After receiving any representations made in relation to the proposal by members of the group and the report of the independent reviewer, the appropriate regulator must decide whether it intends to implement the proposal.

(7) If the appropriate regulator decides that it does intend to implement the proposal, it must publish notice of the proposal, and of its decision to implement it, at least 60 days before it is implemented.

(8) A person who is aggrieved by the decision of the appropriate regulator that it intends to implement the proposal may refer the matter to the Tribunal.

(9) The proposal may not be implemented without the consent of the Treasury; and the Treasury must publish their decision on any application made by the appropriate regulator for consent, together with their reasons for the decision, at least 60 days before it is implemented.

(10) Once the Treasury has consented to the implementation of the proposal and either—

(a) any reference to the Tribunal under subsection (8) has been dismissed, or

(b) the period for making such a reference to the Tribunal has expired without a reference having been made,

the appropriate regulator may implement the proposal by giving notice to the members of the group requiring the taking of the relevant steps specified in the proposal before the date so specified.

(11) If the relevant steps have not been taken by the specified date, the appropriate regulator may—

(a) in a case where the relevant steps are aimed at securing the result in paragraph (a) of subsection (3), take the action specified in subsection (12),

(b) in a case where the relevant steps are aimed at securing the result in paragraph (b) of subsection (3), take the action specified in subsection (13), or

(c) in a case where the relevant steps are aimed at securing the result in paragraph (c) of subsection (3), take the action specified in subsection (14).

(12) The action referred to in paragraph (a) of subsection (11) is—

(a) to cancel the Part 4A permission of any member of the group to carry on the regulated activity specified in the notice, and

(b) to refuse to give a Part 4A permission to any member of the group to carry on that activity.

(13) The action referred to in paragraph (b) of subsection (11) is—

(a) to cancel the Part 4A permission of any member of the group that is a ring-fenced body to the extent that it relates to a core activity, and

(b) to refuse to give any member of the group a Part 4A permission to carry on a core activity.

(14) The action referred to in paragraph (c) of subsection (11) is—

(a) to cancel the Part 4A permission of any member of the group that is not a ring-fenced body, and

(b) to refuse to give a Part 4A permission to any member of the group that is not a ring-fenced body.'.—*(Chris Leslie.)*

Question again proposed, That the amendment be made.

The Chair: I remind the Committee that with this we are discussing amendment 21, in clause 20, page 21, line 23, at end insert—

'( ) No order may be made appointing a day for the coming into force of section 4 so far as it inserts section 142JC of FSMA 2000 unless the day is later than that on which the report of the first review under section 142J of that Act is published.'.

Chris Leslie (Nottingham East) (Lab/Co-op): It is a fantastic pleasure to serve under your chairmanship, Mr Turner. Welcome to the Committee. I wonder whether the Minister, on reflection, might want to elaborate on his earlier comments and seek to clarify those remarks.

The Financial Secretary to the Treasury (Greg Clark): I am sure that my remarks were very clear, but I am certainly happy to add to them. I welcome you to the Chair, Mr Turner—seeing off two Chairmen in a single day's sittings is some going, but I hope that you will be able to join us again at some point if it proves appropriate.

We were discussing an important amendment on the power that the Parliamentary Commission on Banking Standards recommended, and which the Government accepted, that should be available to force the separation of banks if they breach the ring-fencing rules. As we left it on Tuesday, the hon. Member for Nottingham East was asking why the Government had not tabled their amendment for debate in Committee. Let me explain that before I go on to the purpose of the amendment before us. When we responded to the Commission's report, we accepted a significant change that it proposed. We made a commitment to bring to Parliament a Government amendment to implement the split requirements while the Bill was still in the Commons. It is still our intention to do that on Report.

However, let me say something about the amendment and the procedure. We had the very welcome and somewhat novel decision by the Parliamentary Commission to publish its own amendments last Monday. That was not something that we necessarily expected to happen when the report was made just before Christmas, but it is very helpful to have the Commission's amendments. As I said, we were intending to publish a Government amendment before the Bill leaves the House of Commons, but it makes sense to take into account the Commission's amendment. If we were to have tabled a Government amendment at this stage, it would not have been able to reflect the Commission's amendment. We are looking closely at its amendment, and on Report, I hope that we will be able to take the best of that amendment and address some of the questions that we have about it.

Chris Leslie: This is all very convenient from the Government's perspective, but we are in the Bill Committee in the House of Commons today. I would have thought that, given that we had the draft amendment from the Commission a while before the Committee began, the Government could have made a decision about either backing it or saying where it was deficient. There is a rather lackadaisical attitude towards the fact that we should be legislating properly in Committee, rather than treating it as a seminar in advance of the proper phase of the legislative process further down the track.

Greg Clark: The hon. Gentleman is being a little ungenerous, in the sense that at the time the Parliamentary Commission on Banking Standards report was published, we made the commitment—it was welcomed by the members of the Commission—to bring forward a Government amendment before the Bill left the House of Commons. That was clearly a signal that it might be on Report, and it is absolutely our intention to do that. From memory, I believe that the Commission published its proposed amendment on a Friday, and we would have had to table the Government amendment to reflect it on the Monday. I think the hon. Gentleman will concede that even with the calibre and Stakhanovite working practices of my officials, drafting a Government amendment during a weekend would not be right.

Chris Leslie: The Chancellor announced on 4 February, during his seaside speech at Bournemouth, that he was going for the firm-by-firm separation back-stop and did not want the full separation process. The Treasury knew then that that was the intention. Weeks and weeks have passed since then, and I do not understand why the Treasury's policy intentions have not been manifested on the amendment paper.

Greg Clark: The policy intention, as the Chancellor explained, was to introduce a Government amendment before the Bill left the House of Commons, so it could be debated by the House, and the indication was that that was likely to be on Report. That is perfectly well understood. Having now had the advantage of an amendment from the Commission, it is sensible to reflect on it. I think we are proceeding in a reasonable way.

Let me address the second part of the hon. Gentleman's point: consideration of the proposed amendment. The power is important and new. It was not part of the original Vickers recommendations, which were extensively consulted on. It has arisen from the Commission's scrutiny and recommendations. It is not only reasonable but incumbent on the Government to consult the regulator about how the power should be drafted and captured given that we have not had the two-year scrutiny process that the Vickers Commission had. We have consulted the regulator, and the triggers for the power, the steps that the regulator needs and the consequences of using the power must be clear. We will consult the Bank of England and the Financial Services Authority on the shape of the power.

As the hon. Gentleman said, it was the beginning of February when the Chancellor made his speech. I think that he and everyone would consider that just over a month's close collaboration on such an important power, given the years of detailed policy development for the rest of the Bill on the basis of the Commission's recommendations, is reasonable and that the opportunity for rigorous consideration by the bodies that will be responsible for implementing it is appropriate.

The hon. Gentleman has done a helpful and useful service in tabling the amendment so that we can have this debate and conversation about the Government's views and intentions. We must consider what would trigger the power. Amendment 21 proposes that the power to separate a firm would not come into force until after the first independent review of ring-fencing, and we have debated that in the Committee.

The hon. Gentleman will correct me if I am wrong, but he seemed to suggest that it is necessary to stiffen the regulator's sinews in the exercise of the power, but

[Greg Clark]

we must be careful when considering the review. At our previous sitting, it was proposed that the independent review would be a review of ring-fencing and of the case for full separation of the system. Why should a power to ensure that firms comply with ring-fencing be related to and perhaps stayed by a view on whether ring-fencing still stands? It is important that the exercise of the power is open to the regulator when considering whether it is necessary to use it.

Let us imagine that such a review took place, and recommended full separation. That would rather render the regulator's power in this case—this particular institution-by-institution power—redundant. There is certainly agreement on the principle on both sides of the House, and between the Government and the Parliamentary Commission, and in preparing the powers for the regulator we will consider whether there should be a period for the powers to settle down. However, it would not be quite right to have a connection to the proposed review of the whole of ring-fencing.

Let me say something about the contribution of the PCBS to the debate. In the time we have had to consider the amendment that the PCBS proposed and the hon. Gentleman has tabled, there have been a few questions to consider. With any power such as this one, we must consider what the power does, what would trigger the exercise of the power and what procedure must be followed to ensure that the exercise of the power is fair and transparent.

We are seeking to make progress with the regulator and the Bank on a couple of outstanding points. The first of those is what the power does. The amendment as proposed by the Parliamentary Commission would give the regulator a power to require a group to take steps that would lead to it no longer having a ring-fenced bank within its group. That drafting would create a couple of problems. The term "take steps" is rather unclear, and could lead to problems with interpretation. As we have already discussed, there is likely to be litigation over these matters, and, as always on such matters, a great deal of lobbying will take place, so it is important to be clear. I would not want the phrase "take steps" to provide any kind of loophole that might prevent the exercise of the power.

Secondly, it is not clear in the amendment as drafted that the power would allow the regulator to require groups to divest themselves not only of a ring-fenced bank but of a non-ring-fenced bank or indeed of specific business lines or divisions that may cause a problem in the regulator's view. The Parliamentary Commission recommended that the group separation power that it proposed do precisely that; the Government agree but we are not convinced that the expression of that view in the amendment gives enough of the powers that the Commission itself proposed.

There is also a question about procedure. There are some omissions from the Commission's proposed amendment that I believe a Government amendment should address. For example, no minimum time frame is set within which a firm may be required to take action to effect a split. In that case, once more, we would not want to have a situation in which the lawyers got to work and sought to use the absence of a reference to a required timetable in order to frustrate the regulator's intention to produce a split. It will be important to set that out in legislation to provide greater certainty. Otherwise, an action could be inordinately long or, equally, unfeasibly short for an orderly separation.

Nigel Mills (Amber Valley) (Con): Will the Minister comment on what timing he thinks is appropriate here? I presume that we are talking about a situation in which a ring-fenced bank in a group is doing something that endangers the stability of the banking sector; that is why the power would be used. I have a perhaps naive feeling that any such separation should happen really quite quickly, to avoid the risk getting worse or the risked eventuality actually taking place. However, the amendment offers a three-month period followed by a 60-day period, which is a long time. We are talking about nearly half a year before any action can take place.

Greg Clark: My hon. Friend makes an acute point. That is exactly why we need to conclude the discussions with the regulator and the Bank of England on what the right period of time is. That is the basis of the discussions that are taking place. He is right that the intention is that the process should not be dragged out over an excessively long period of time, but equally, requiring something that cannot actually be done under the requirements of systems and resolutions within the bank would also be wrong. We are consulting the regulator on that issue, and it will be reflected in the amendment that we table. It is important that we avoid those adverse consequences.

As things stand, we need to address some of the amendment's technical deficiencies and develop it further. I will bring forward a Government amendment to give the regulator that power on Report in the House of Commons, as was proposed by the Chancellor.

11.45 am

Jacob Rees-Mogg (North East Somerset) (Con): Before my right hon. Friend finishes, will he consider the point that I made at the end of play on Tuesday regarding amendment 20, specifically proposed new section 142JC(5) of the Financial Services and Markets Act 2000, which would bring parliamentary procedure into statute? I urge him in any Government amendment to leave the power for the House of Commons, but to leave the House of Commons to set its own procedures.

Greg Clark: That is something that we will be returning to later, but in general it is right to have that separation. We will consider that recommendation when we draft the amendment, and I hope that on Report, my hon. Friend will be satisfied.

Chris Leslie: The Minister's second attempt managed to delve into some deeper questions than his first attempt a couple of days ago, and I am grateful for that because it has added some colour to the Government's thinking on these things.

First, let me address the issue raised by the hon. Member for North East Somerset. I really do not think that amendment's provision on the Chair of the Treasury Committee in any way binds parliamentary processes in a legislative context. After all, it is simply a consultative

feature and, if the amendment were adopted, nothing would bind House of Commons procedures in any way, shape or form. It is merely about who should be consulted in certain circumstances.

Jacob Rees-Mogg: The problem is that if we brought parliamentary processes into legislation, they would become justiciable, and therefore the courts would be able to determine who the House of Commons had deemed to hold a particular role. That is against the Bill of Rights. There are many good points in the amendment, and it would certainly be proper for the amendment to say that the House of Commons must be able to advise, or to give its consent, but how the House of Commons does that should be within our Standing Orders and not within statute.

Chris Leslie: I disagree with the hon. Gentleman. I know that is the only thing that is preventing him from supporting the amendment, which is why I labour the point. Essentially, that was his earlier comment, and I want to convince him about this. If he looks at the how the clause is set out, he will see that it is not impossible to make reference to the views of the House of Commons. Nor, as has historically been the case in some legislation, is it impossible to refer to the consultation of a particular Committee, or a particular Chairman of a Committee in the House of Commons. There is no particular precedent in the amendment in that way. It is simply about who might be consulted. I do not think that is a reason for not opting for a power of separation and ensuring that Parliament is consulted along the way.

It is tempting to test in a Division the Government's view on the Parliamentary Commission's drafting, but I understand the Minister's point about ensuring that we get the details of this particular issue correct. He raised an interesting point about the interplay between an independent review and the firm-by-firm, institution-by-institution separation trigger. It does not need to be either the regulator or the reviewer making all the decisions; there can be interplay between the two. The regulator might want to urge the Government to bring forward the independent review process to facilitate a deeper inquest into whether a specific firm should be subject to that provision. None the less, I accept that there are some issues that need to be ironed out. The Minister also made an interesting and not unreasonable point about the "take steps" concept.

My general concern about the Government's approach of having only one half of the back-stop power is that if there were systemic failures, and the Government needed to make a change on a firm-by-firm basis, the risk of litigation and judicial review on all sorts of matters would potentially become manifest. It might simply be necessary to make a judgment about the behaviour of the sector and the market as a whole, and to require separation between retail and investment banking across the board. That would be a cleaner way of requiring full separation in the sad and sorry circumstances of a failure of the ring-fencing regime. It is right for the Minister to be careful about the potential legal pitfalls, but he should think again about having in his back pocket the power to require full separation in the sector as a whole. That would be a real way of ensuring that strong action could be taken.

The Minister's points about the elements of a banking group that might need to be divested were certainly worth while. He also made quite reasonable points about whether non-ring-fenced sister organisations or other banking assets would need to be considered, and about the minimum time frame. However, I still want to put on record my general frustration—I mean this genuinely—about the fact that we are going through this process in a topsy-turvy manner. I accept that we will examine these matters on Report, but whether we can seriously test the drafting of the amendments on them will depend on how much time we have. As all hon. Members know, proceedings on Report are likely to be subject to a programme motion and a set of knives. If other matters are crammed into the couple of hours we have, we might even find that we cannot talk about the amendments that the Government have tabled.

It worries me that we have approached the Committee stage in that way, which is exactly why the Parliamentary Commission recommended a three-month gap between the Government's decisions on these issues and the Committee stage. I realise that we would have the Finance Bill and other things going on at the same time—Ministers always have to be in several places simultaneously—but that short-term operational reason was not good enough grounds for rushing the Bill through the Committee in this way.

Having said that, I will not push the amendment to a Division. I accept that it is probably wisest to withdraw it at this point, notwithstanding my full support for its spirit. I do not want anyone to think that I am withdrawing it because I disagree in any way with the principles set out in it, because I support them very much. At this point, however, I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Chris Leslie: I beg to move amendment 22, in clause 4, page 9, line 21, at end insert—

'Full separation

142JD General requirement of separation

'(1) Where the members of any group include one or more ring-fenced bodies and one or more other bodies, the members of the group must, before the end of the period of five years beginning with the relevant commencement date, take steps to secure that there are no members of the group that are ring-fenced bodies.

(2) If in the case of any group steps to secure that there are no members of the group that are ring-fenced bodies are not taken within the period specified in subsection (1)—

(a) at the end of that period the Part 4A permission of each member of the group that is a ring-fenced body shall be treated as having been cancelled to the extent that it relates to a core activity, and

(b) after the end of that period the appropriate regulator must refuse to give any member of the group a Part 4A permission to carry on a core activity.

(3) At the end of the period specified in subsection (1)—

(a) section 142H(1)(b) and (4) to (7), and

(b) section 142JC,

cease to have effect.

(4) In subsection (1) "the relevant commencement date" means the day appointed for the coming into force of section 4 of the Financial Services (Banking Reform) Act 2013 so far as it inserts this section.'.

The Chair: With this it will be convenient to discuss amendment 23, in clause 20, page 21, line 23, at end insert—

'( ) No order may be made appointing a day for the coming into force of section 4 so far as it inserts section 142JD of FSMA 2000 unless—

(a) the day is later than that on which there is published the report of a review under section 142J of that Act containing a recommendation that section 4 should be brought into force to that extent, and

(b) a draft of the order has been laid before, and approved by a resolution of, each House of Parliament.'.

Chris Leslie: We are now at the crux of the issue of how strong the back-stop power needs to be in relation to the Bill's ring-fencing arrangements, as envisaged by the Vickers Commission and taken forward by the Parliamentary Commission, and whether we need that firm back-stop power to ensure that we electrify the ring fence in the way the Chairman of the Parliamentary Commission described.

We have taken advantage of the Parliamentary Commission's drafting of its amendments; it recommended having a full separation power, covering all banks in the sector, in this legislation at this point in time. It recommended that the power be triggered by the Bill's commencement clauses following a review and, obviously, a vote in Parliament, with the Treasury's consent. The Minister needs to explain a little more effectively why the Government will not legislate to include that full reserve power for the total separation of retail and investment banking, in case ring-fencing does not work.

The amendment would put in legislation a specific recommendation of the carefully thought-through and clear opinions of the Parliamentary Commission. We feel it would be sensible to legislate now not just for if one or two individual banks misbehave, but in case ring-fencing fails the sector as a whole. The Government rejected that view; the Chancellor stated on 4 February that the power was based on an assumption that ring-fencing might fail, but the Government believed ring-fencing would succeed. Well, hoping that the best will happen is one way to travel through life, but sometimes it is best to be prepared for eventualities that we might not want to think about, but that we may have to confront.

The Parliamentary Commission has said that it wants the back-stop power as an incentive for the banks to comply with the new rules, and the Commission operates on the assumption, perhaps more pragmatically, that if we have this particular back-stop arrangement, it will make failure less likely.

Amendment 21 would have provided that no steps could be taken towards full separation unless an independent review recommended it, and unless it were approved by both Houses of Parliament. Amendment 22 would build on that power. The Government argue that there is no need to legislate now for a reserve power to abandon ring-fencing in the future. They say that that is a decision best made by Parliament at the time, but the power cannot come into force until it is recommended by an independent review and a resolution is approved by both Houses. That in no way deprives future Governments or Parliaments of the ability to decide whether to implement full structural separation.

Given the pace at which situations can arise—the Cyprus situation is one recent example of that—it is clearly prudent to have such provisions in place before they are needed, rather than attempting to pass an identical power in primary legislation when it is too late; that is the point I really want to make. Preparedness is absolutely essential, but there also has to be a genuine prospect of a response by regulators, Ministers and Parliament to systemic failure across the board. The banks are very familiar with that, because they are replete with public affairs officials and lobbying support. They know that parliamentary procedure can be laborious and slow, and that a high threshold has to be met if primary legislation is to be started from scratch in such circumstances, whereas the triggering of a legislative provision that is already on the stocks and just requires a commencement procedure is a far more readily available tool. It is important that the genuine prospect of a response from policy makers is held over the banks to ensure that they behave and follow the ring-fencing rules.

If the Government are correct in believing that ring-fencing will be adequate, the amendment, of course, does no harm to their policy, but if they are wrong and the back-stop power is not in place when it is needed, there could be serious consequences. The Parliamentary Commission on Banking Standards was quite scathing about the Government's attitude. It accused the Government of constructing a straw man in arguing that the regulators should not have the power to require industry-wide separation. We agree that regulators should not have that power on their own, which is why the amendments would allow the provisions to come into force only in certain limited circumstances.

12 noon

Perhaps the Chancellor felt that accepting and absorbing half the recommendation—the firm-by-firm reserve power—was a cunning ploy to make it appear as though the Government were constructing a back-stop behind the ring-fence. Most people will realise, however, that if the Government stop short and introduce only half the provision, rather than giving Parliament and regulators a much broader-brush power, that will simply make it unlikely that the power will be used, because of the risk of corporate litigation. Clever and affluent city lawyers may get their hands on the particulars of why a firm should not be separated in such a way, and I am sure they would love to have a crack at the regulators on a case-by-case basis. It would be safer to follow the precautionary principle.

It would be better for us to think through the balance of risks. I do not believe that the harm of putting such a power in statute outweighs the benefits that might accrue from including it—the benefits of ensuring that the banks stick to their new task and keep their word. We hope that the banks would agree, in the spirit of our rules, that it is far better to address the matter in this way. It would be nonsense for us to ignore the risks, which is why even if we are defeated on the issue in Committee or on the Floor of the House of Commons, I suspect that the House of Lords will want to consider including that strong power in the Bill during their scrutiny. Instead of the Government dragging their feet, it would be better if they simply accepted the case for the inclusion of such a power in the Bill, and thereby signalled that they were in favour of serious, thorough reform. I urge the Minister to consider making a strategic retreat now, rather than constructing reasons not to

include the provision and finding that during the Commons consideration of Lords amendments in 10 or 11 months' time he has to make entirely different arguments from those he is about to make.

Greg Clark: We are far from dragging our feet on the matter; we take a very different view. On the recommendation of the Vickers Commission, the Government have adopted a policy of ring-fencing, on which the Bill is based. There are alternative policies, such as the full separation of banks throughout the system, which is the Glass-Steagall model. That is a different policy. It is not the Government's policy, it is not the policy that was recommended to us, and it is not the policy in the Bill. It is open to a future Government to adopt a different policy, but it would be eccentric, not to say paradoxical, to have a Bill that contained the Government's policy and a different policy.

It is worth reflecting on the development of the two policies. The ring-fencing policy that we are debating came directly from the Vickers review, which was initiated as an independent commission in 2010. The commission has produced three successive reports. It engaged in two rounds of public consultation, and the Government also responded to it. It took 1,500 pages of written submissions, and it had 300 separate meetings with people giving evidence to the committee. It took the considered and advised view that while it was open to one of the potential solutions, Glass-Steagall, which would see full separation, it recommended against that on the basis of its rigorous work and consultation.

The Government responded to the commission's recommendation: we published a White Paper, which again we consulted on, and there was a full cost-benefit analysis of the policy. The development of the ring-fencing policy was, by any standards—certainly by the House's standards—exhaustive and rooted in independent analysis, and it sought to build the clearest possible consensus. That is why the policy we are debating is reflected in the Bill in the manner that it is.

The alternative policy of structural separation of the banking system was considered but rejected by the Independent Commission on Banking. It was rejected successively and repeatedly at every stage—through its deliberations, its consultation process, and the Government's consultation process on its recommendations.

The Parliamentary Commission, in scrutinising the legislation, took another view and came to another conclusion, but I have not seen in its work any overwhelming new evidence that suggests that the Vickers Commission missed something that it ought to have considered and that required a totally different policy to be adopted. It made some useful criticisms, and we will be positive about many of the amendments that come from its recommendations, but, in this case, the consensus achieved for ring-fencing has not been established for these other measures. Nevertheless, the amendment would require us to legislate for a different policy just in case. That would make redundant the three-year process of consensus-building, consultation and parliamentary scrutiny of these measures.

The hon. Member for Nottingham East says that the requirement under the amendment to have an independent review and a statutory instrument—a resolution of both Houses of Parliament—would address some of those concerns. However, one of his points was that there may be circumstances in which it is necessary to move quickly to make policy changes, so to tie any future Government to a cumbersome review that could take years to conduct, rather than allowing them the freedom that all Governments have to bring legislation before the House as expeditiously as is necessary, seems not to be the right approach to a new situation that may present itself.

As for the recommendation that a statutory instrument be presented to both Houses to separate totally the banking system, that would have nothing like the exhaustive scrutiny that the Vickers proposals had. At various points the hon. Gentleman has been critical of the adequacy of a statutory instrument as a basis for introducing changes to practices; in fact, we had a debate on whether a statutory instrument was rigorous enough to empower bodies to make rules, so to have qualms about the adequacy of statutory instruments, even with the affirmative procedure, yet allow such a major change to our banking system to take place on the turn of a statutory instrument, with no ability for either House to amend it, would be an extraordinary constitutional step; there would not be the degree of scrutiny and possibility of amendment that we have discussed.

When it comes to the advice that we have consistently taken, Sir John Vickers gave evidence and has commented on the recommendations of the Parliamentary Commission. He was clear. He said that he would

"pause before putting in this Bill the"

so-called

"'second reserve power', to have a sectoral split".

He went on to say that

"if you had a sectoral split then you would be creating a standalone UK retail banking sector which might be very highly correlated within itself."

It could therefore add to the risks that his recommendations were designed to avoid:

"This would mean that, in the event of a UK rather than global financial crisis, you could not have the rest of the bank rescue the UK retail banking sector".

He went on to say:

"If I was proved wrong, and a sectoral split did prove necessary, my constitutional feeling would be that that should require fresh legislation."

He therefore supports the Government's view.

We have taken the advice of Sir John's commission and extensively considered it. It is right that we debate the argument the hon. Gentleman put forward, but to amend the Bill in a way that could have profound importance for the future of banking in the country, without the possibility of anything like the degree of scrutiny, including parliamentary scrutiny, that the current proposals have, would be a retrograde step. We cannot recommend it to the Committee and the House. I therefore cannot support his amendment.

Chris Leslie: I am sorry that the Minister takes that view. I will have to look back at how carefully he chose his words, but I suspect that he will argue something different in about 12 months. Nevertheless, to say that the power could not be used at a future date in the way I set out is to misunderstand the whole concept of the back-stop reserve power. We are scrutinising and legislating for the principle of the back-stop power now and, I had

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hoped, will adequately scrutinise—in Committee, on Report and certainly in the other place—the general principles, to overcome the legislative qualms and queries, and to consider all the issues that need to be considered, in terms of the letter of the legislative provisions and how full separation might come to pass. It is being done now through the Bill.

We do not in anyway want to short-circuit the scrutiny of the provisions, which is why I tabled the amendments now—to ensure that we have the opportunity in primary legislation to scrutinise how they would work. It would be feasible to ensure the effective and realistic prospect of the arrangements being triggered, albeit in a parliamentary context, and to ensure that the banks realise that it is a genuine prospect, which is why the connection between a review and the parliamentary process is perfectly balanced.

Nigel Mills: I am trying to follow the hon. Gentleman's argument, but the one scenario in which we might want to use an emergency power to split the ring-fenced and non-ring-fenced bank would be a banking crisis that threatened the stability of the economy again. In that situation, we would have the power in the electric ring-fence to take apart the big banks one by one anyway. If there was a real threat to core stability, we would not need such a collective punishment power. I am not very attracted by it.

Chris Leslie: That is exactly the Government's view. The hon. Gentleman takes the idea that somehow we have to consider the rationale firm by firm and institution by institution, rather than for the sector as a whole. One of the key lessons not just from the financial crisis, but from more recent events such as LIBOR is that the banking system acts in an interconnected manner. The system is wired together. A reflective back-stop power for full separation as way of structuring the market needs to be writ large. That is the point that we and the Commission are making, in that both options must be available, both firm by firm and across the sector.

12.15 pm

Jacob Rees-Mogg: Will the hon. Gentleman answer the point made by my right hon. Friend the Minister about the matter being for secondary legislation? The amendment allows five years for the transition to take place, so it is not something that happens urgently. There is therefore plenty of time for primary legislation, which would be the right approach for a change in banking of such magnitude.

Chris Leslie: I can see that the hon. Gentleman sitting is in his usual place in the room. Perhaps adding on that extra year or two of primary legislation may contribute to the elongation of the proceedings in a way that he is sometimes prone to cause. However, given that we need to provide realistic time for the actual extrication of the retail and investment elements of institutions—we have set out a time frame in the amendment—the ability to start that process earlier is necessary.

I am slightly confused by the Government's argument, because they say, "The process may need to be a lot quicker and should not be fettered because we may need to move quickly," and the Minister says that a review could take an awful long time. Curiously, however, the Minister also says that a parliamentary procedure in a statutory instrument could be too quick and that things may need to be slowed down. He has got himself into a bit of twist on the various time frames.

Greg Clark: This goes to the heart of the matter. Were we to accept the amendment, we would be laying down now specific provisions for something that might happen in 10 years' time, into which we would be bound but which may turn out to be unsuitable. They could not be amended at that time, because they would require a statutory instrument. Even if we adopted that approach, the likelihood is that primary legislation would be required to make the power workable. It seems eccentric to pass legislation now that may actually slow down and impede the ability to act at the appropriate time.

Chris Leslie: That is all the more reason to introduce amendments—even if the Government do it—and to get right the theory of how the process ought to work, ironing out any legislative wrinkles and having it on the statute, fully scrutinised and ready to go. Of course, if full separation were envisaged in 10 or 20 years' time, because we cannot bind our successors, nothing would prevent a future Government from introducing further primary legislation at that time.

The Minister almost assumes that primary legislation is bound to be necessary. It might not. The banks will be keen on his argument that we must not put this provision in legislation because of some unknown circumstances. It would be better to include a power at this stage to reinforce and electrify the ring fence, which was something that the Commission felt strongly about. It is not impractical to have proper scrutiny of the provisions at this point in time. We have primary legislation before us now.

It is necessary to walk through the amendment's provisions and ensure that they are fit for purpose, but I did not hear the Government picking holes in the provision in the way that they studiously did with our previous institution-by-institution amendment. We need to scrutinise the power now and get it right in the Bill, to ensure that we have the capability to act boldly and so that policy makers can respond appropriately and swiftly.

I also disagree with the red herring that somehow a review process needs to be cumbersome or long-winded. If the Minister had said, "Well, let's make the provision subject to the Inquiries Act so that there can be more flexibility about how that review would operate", he might have had a point, but he did not make that particular case. Reviews can be flexible, and if there is a need for swift action we can cut our coat according to our cloth to fit the circumstances at the time, but it would be better to ground any decision on a full separation in a review process that was evidenced and solidly based, as a prelude to the actions and decisions of Ministers and then Parliament.

Greg Clark: Of course, the point of the Vickers review by the Independent Commission on Banking was to advise on what that legislation would be. I think

the hon. Gentleman would concede that we have benefited from the commission's expertise, consulted upon over a period of time, in getting that legislation right.

The review that the hon. Gentleman wants, to trigger full separation, would not benefit from the advice—no doubt sagacious—of the very review that he would set up, as the legislation will have been completed now. If we, or our successors, wanted in future to consider the question of full separation, surely it would be better for our successors to establish, as it has been possible for us to do, a commission led by someone of the eminence of Sir John Vickers to advise them not only on the principle but on how the principle can be expressed in legislation.

Chris Leslie: I am not quite sure that it is right to characterise the commissioning of the Vickers review as simultaneously commissioning exactly what the legislation would look like. The Vickers Commission was examining the principles of policy, and public policy at that. However, the Parliamentary Commission, having looked at this issue and having included a different set of people with different backgrounds and different experience, who are perhaps more ingrained in the legislative process and more familiar with what the legislation should look like, has thought about the nature of enacting change in a way that the Vickers Commission was not set up to. The Vickers Commission was looking, from a perspective of economic and financial services expertise, at the general principles. That process was then taken forward by the Parliamentary Commission, and additional thought about the legislative nature of these things was in a helpful and useful way.

Greg Clark: I assume that the hon. Gentleman is not suggesting that the recommendation of the Parliamentary Commission in this respect is simply a matter of the transposition of the Vickers recommendations. This is a different recommendation from Vickers, not a question of translation. I have read out a few quotes from Sir John Vickers saying that he disagrees with the policy intent in the amendment, so it is not quite right for the hon. Gentleman to suggest, as I think he was, that this is a question of experienced parliamentarians finding the language that Sir John was somehow incapable of finding himself. They are taking a different view from Sir John.

Chris Leslie: Of course they have built on the recommendations that Sir John Vickers made, having reflected on the careful recommendations that were put forward in the ICB report. They examined the matter from the perspective of how best to ensure that those objectives are achieved. There is no point labouring the issue; it is quite clear that the Parliamentary Commission takes a firm view that a full separation back-stop power is necessary. The Minister has not said what the harm would be of having the amendment in the Bill. I just do not see that his argument stands up.

Greg Clark: Well, let me explain some of the harm. I have addressed the fact that we would be bound into a set of legislative provisions that may be inadequate without having the ability to change them. However, let me give some more reasons. Presumably the power of full separation would be exercised because the ring-fencing regime had failed in some way, triggering the alternative. Might it not be the case, however, that there could be alternatives other than full separation—a Volcker rule, for example, or a narrower definition of banking? Other options might be relevant to the circumstances in which the arrangements we are putting in place through the Bill were found to have failed.

To adopt the approach in the amendment would be, extraordinarily, to specify now, 10 years in advance, that the only possible solution to the failure of the arrangements that we are putting in place, which we do not expect, is a certain specific and narrow power. It is surely right for Parliament to consider what the right response would be to the circumstances that the hon. Gentleman paints of a failure of the ring-fencing system. We should not constrain our successors to considering only full separation.

Chris Leslie: I am genuinely worried that the Minister does not understand the ability of legislation to make particular provisions now without binding this Parliament or its successors so that they cannot amend or vary those provisions in the future. Should a future Parliament wish to opt for a Volcker rule or some other way of addressing systemic failure across the banking system, it would of course be free to do so. When we are faced with powerful institutions in the banking sector—we all know that they are incredibly powerful; heavens knows, on their balance sheets they often have many multiples of the UK's GDP—we need to ensure that policy makers have the ability to respond to and confront that power with a firm capability to act in the way proposed, but not necessarily only in that way. I genuinely do not think that the Minister's argument that other things might need to be done in the future, and that the arrangements may need to be amended at a later stage, is an argument for not putting the power in question in the Bill at this point in time.

Greg Clark: The hon. Gentleman is right that future Parliaments will have the ability to consider other alternatives, but he wants to put in place a particular provision—in effect, to introduce a Glass-Steagall power. If he wants to have a contingency available, why does he not favour introducing a Volcker rule, for example, should it be needed? Why pick one, rather than the other possible solutions to the problem he sees?

Chris Leslie: We can obviously debate the Volcker rule now that we know that the Parliamentary Commission has published its short report on that. We do not have an amendment on that on the amendment paper, but perhaps we should table one to allow the Committee to go through that particular issue. However, the Minister is arguing against his own preferred route. He has supported a policy of firm-by-firm separation on a Glass-Steagallesque split of retail versus investment. That is the preference of the Chancellor. The amendment would provide an extension of that for the sector as a whole. I am not quite sure whether the Government are saying that they now want a Volckeresque approach on a firm-by-firm basis in their array of back-stop powers as well.

The Minister has not quite grasped that although the power we are debating is the key back-stop power that should be available and put on the statute books now, that does not bind future Governments, who will be able to consider other options at a later date as well. It is

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not and either/or. We should recognise that this power is a necessary tool and that we need to stand up to the sector, partly on behalf of our constituents, who are absolutely fed up with the behaviour of the banks and who are very sceptical that ring-fencing will do the job. They hope it will, as do we, but we cannot be certain that it will.

Greg Clark: Let me ask the hon. Gentleman this question one more time: if he considers that it is open for the authorities and for Parliament to have different ways of addressing the problem, why has he chosen to table an amendment that would put just one of those provisions in the Bill, rather than any of the others?

12.30 pm

Chris Leslie: Well, because, like the Chancellor, we feel that ring-fencing, as a first step towards a degree of separation, could then need reinforcing with full separation as the next logical step in such an approach. Although we are grateful to the Chancellor for at least conceding that principle on a firm-by-firm basis, he has not yet agreed, but probably will agree, to do that for the sector as a whole, and we feel that that is the necessary back-stop arrangement. We are not necessarily saying our proposal is the one and only way of dealing with system-wide failure, but it seems like the device most likely to garner consensus, especially as the Treasury already accepts that it would do the same on an individual-business basis. The Minister's argument is not, therefore, a reason for not accepting the amendments. I do not wish to withdraw the amendment, because it is important that we test the view of the Committee on this matter.

Question put, That the amendment be made.

The Committee divided: Ayes 2, Noes 8.

Division No. 4]

AYES

Ashworth, Jonathan	Leslie, Chris

NOES

Clark, rh Greg	Morris, James
Evans, Graham	Mowat, David
Hands, Greg	Sharma, Alok
Mills, Nigel	Thornton, Mike

Question accordingly negatived.

Chris Leslie: I beg to move amendment 5, in clause 4, page 12, line 22, at end insert—

'(4A) If the appropriate regulator is satisfied that—

(a) a relevant body has contravened a requirement under subsection (1)(a) or (1)(b) and knew or could reasonably be expected to have known it was contravening such a requirement; or

(b) has at any time attempted to contravene such a requirement and knew or could reasonably be expected to have known it was contravening such a requirement,

it may impose a penalty on the institution of such amount as it considers appropriate.'.

The amendment relates to new section 142M, in which we begin to look at loss absorbency requirements and at an exciting set of acronyms, such as PLAC, which stands for primary loss-absorbing capability or capital—some people interchange those concepts. We are looking, essentially, at banks' ability to have a buffer to absorb losses so that something stands between banks failing and the taxpayer having to bail institutions out.

The Opposition are concerned that new section 142M, on the concept of loss-absorbing capital, does not appear to have a fully formed enforcement process behind it. It is, of course, a good concept that the Treasury can ensure that all the bodies mentioned in the Bill have relevant debt and capital arrangements and that those arrangements, particularly in the ring-fenced bodies, are sturdy and capable of withstanding difficulties.

New section 142M creates an order-making power enabling the Treasury to require compliance with a set of capital rules that the regulators will set out, which will be largely informed by international capital arrangements. The Minister will no doubt explain that the regulators can monitor bank balance sheets as a way of testing compliance, but of course that is different from ensuring that we have the powers to deal with any attempt at contravening the spirit of those rules if new financial innovations come in, accounting practices on capital definitions change or a bank decides to blur the edges of the regulations in some way.

The amendment's purpose is to ask the Minister what sort of enforcement arrangements the Government envisage and what sort of penalty system may be applicable if loss absorbency rules are not complied with. There is an assumption that because the regulator says how balance sheets should be structured, all institutions will comply. The Minister may well connect the new provision to enforcement powers that regulators already have, but that is not clear in the Bill. Will he Minister tell us whether, in the orders envisaged under new section 142M, the enforcement or consequential penalty arrangements will be set out? I would be grateful if he would tell us what sort of penalty system is envisaged, what the existing nature of the penalty system is, and whether there will be any changes.

No doubt the Minister will cling to the wondrous European directive on recovery and resolution, which is not fully negotiated yet. We do not really know where that will end up—the Minister does not really know either—but it would be inadequate simply to delegate the issue to European policy makers to look after on our behalf. It is important that we look at it first and foremost from a UK perspective. Although I understand that the recovery and resolution directive is expected to be completed at some point this year, or perhaps by the middle of 2014, it would be helpful if the Minister updated the Committee on how that process is going.

Although the PCBS did not go into the issue in much detail, it made it clear that we need to have explicit provisions about how a regulator will oversee some of the safeguards and powers. Rules that require minimum levels of debt to be held or extra capital to be retained need to be policed and enforced. The Committee would benefit from a clearer exposition of the Government's intentions and the teeth that the process will have. Anything else would fall short of being a full and proper loss absorbency regime. We should not make these rules without ensuring that they can be enforced.

Greg Clark: This is an odd amendment. It would give power to the regulator to fine firms if they contravened, or attempted to contravene, the debt requirements introduced by this section of the Bill.

Let me first address contravention of the debt requirements. The regulator already has extensive powers to deal with any contravention. The Bill introduces the PLAC requirements into the Financial Services and Markets Act 2000, and a contravention of new section 142M of FSMA, or a contravention of any other requirement, will have consequences, possibly draconian: the regulator can impose unlimited fines and statements of censure and, ultimately, remove the licence to operate. Any breach of the capital requirements would bring down the full force of the regulator's sanctions.

We are left with the novel aspect of the amendment: to introduce the concept of attempting to contravene the requirements imposed by the regulator. We have already had discussions in Committee on attempts in financial services legislation, but, on this matter, if the hon. Gentleman thinks about the logic and consequences, he will agree that the concept is particularly inappropriate here. How can anyone attempt to breach a regulatory requirement to issue debt? Either the debt is issued, or it is not. If it is not issued as required by the regulator, there is a contravention, but if it is issued, the requirement is complied with. I do not understand how it is logically possible not to issue the debt as required. The concept is wholly without meaning.

If the hon. Gentleman's thinking is that there may be an attempt to mislead the regulator by giving a false position of the circumstances to reduce the required level of capital that the Prudential Regulation Authority is imposing, the available offences are much more serious. It is a criminal offence under the Financial Services and Markets Act 2000 to mislead the regulator, but the amendment would introduce a much weaker sanction. Either way, it is otiose and I hope that the hon. Gentleman will withdraw it.

Chris Leslie: The Minister's comments were supplemented by an interesting invention from the Treasury Whip, which, like a little cherry on the top, added to the Minister's argument.

The Minister made a fair point about how new section 142M would connect with other provisions in the 2000 Act. It is important to put on the record the reassurance that any failure to abide by those loss absorbency requirements would be subject to penalties imposed by the regulators, although we are creating a new order-making power for the Treasury and it is reasonable to try to establish whether the order will contain any additional penalties, given the importance of the capital buffers and the loss of absorbing capability of the new arrangements.

The Minister is right in saying that we want to consider in the amendment attempts to contravene the ring fence. I accept that issuance of debt is clear in terms of whether it is or is not issued, but we are trying to legislate for circumstances many years hence, and he is familiar with the wondrous nature of financial innovation and the way in which certain financial instruments can sometimes seem to supplement existing international regulatory requirements. They may fall outside the categorisation of debt and capital set out in the rules as they are fixed at one point in time, so it is not entirely impossible to envisage circumstances in which there could be, as a result of financial innovation, grey areas that need to be clarified.

I accept the point that the Minister makes. It is reassuring that he has set out for the Committee the fact that there are strong powers for the regulators. I am happy to accept that, but we are in an era in which the banks have put up many arguments against some of the capital requirements that regulators are asserting, whether loss absorbency or leverage ratio, and we will come to those issues later. Phenomenally powerful forces will try to test the rules, and to play and gain the system, so it is important to spend a little time ensuring that the Minister is absolutely certain that the rules are watertight and can be enforced. I accept his assurance, and I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Chris Leslie: I beg to move amendment 32, in clause 4, page 12, line 22, at end insert—

'( ) If an order under this section includes provision for the grant by a regulator of any exemption from the requirements imposed by such an order, the order must—

(a) require a relevant body claiming the exemption to satisfy the regulator that the exemption should be granted;

(b) require the regulator, in deciding whether to grant the exemption, to have regard to all reasonably foreseeable circumstances;

(c) include provision for reviews of, or appeals from, any decision not to grant the exemption;

(d) require the regulator to make to the Treasury a report setting out any decision to grant the exemption and the terms of the exemption granted, and

(e) require the Treasury to lay a copy of such a report before Parliament and to publish it in such manner as they think fit.'.

Making sure that the banks have adequate primary loss-absorbing capital is an important feature of the Vickers proposals. A bank can still be a going concern as long as its losses do not exceed the capital and equity, which means that the buffers are essential to the resilience of the banking institutions. While the Government have agreed that regulatory rules on PLAC should be subject to the affirmative resolution procedure, some issues still need to be tied down.

In particular, and importantly, there will be occasions when some banks make a case for exemptions from the UK's higher standard of loss-absorbing capital rules, which should be tighter and higher than the Basel minimum standards. It is therefore vital that banks are made to prove why any exemption is necessary and also why it should be regarded as feasible.

12.45 pm

The Parliamentary Commission on Banking Standards has quite rightly suggested that the burden of proof should be placed on the banks, rather than on the regulator, in making the exemption. The amendment is important, in particular to ensure that any exemptions to the important capital buffer regulations are properly thought through and that the case has to be made in a positive way. A bank should need to satisfy the regulator that there is no risk to stability from an exemption from the loss-absorbing capital requirements. It should not

be left to the judgment and analysis of the regulator alone. In other words, the bank should be assumed to need the full PLAC buffers unless it can prove otherwise. That is why we are discussing where the burden of proof should lie. Given that, ultimately, there is a potential risk to the taxpayer and taxpayer resources, the onus should be on the bank to provide all the necessary assurances. That is the logic of the amendment.

While we are sceptical of the banks over-utilising that exemption potential, which should be extremely rare, the Minister needs to accept the principle set out in the amendment. Will the Minister explain the Government's thinking on the issue? How will effect be given to the exemption process? Does the Minister agree with the Commission? Will the Government accept the thrust of the recommendations set out in the amendment?

Greg Clark: As the hon. Gentleman says, whether exemptions from bail-inable debt requirements should be made for the overseas operations of UK banks has been debated extensively. Both the Vickers Commission and the parliamentary Commission have accepted that exemptions are reasonable when there is no risk to the UK taxpayer from the failure of the overseas parts of a group. The important questions therefore are how such exemptions can be provided and who makes the decision. The issue is of significant concern and much thought has been given by me, my colleagues and our advisers in the regulatory institutions to how we can get it right. We listened to what the regulators and the Parliamentary Commission on Banking Standards have said and we have proposed some changes to the Bill.

Essentially, the solution is that the decision to exempt a particular part of a group should follow the resolution strategy for managing the failure of that bank. There are two possible resolution strategies for these global groups. Where a whole-group resolution is envisaged, which is to say that the UK parent would be responsible for providing support to overseas operations, the regulator in this country must quite rightly ensure that the parent company has loss-absorbing capital held against the entire group. That is sensible.

Where the agreed resolution strategy is for overseas subsidiaries to be resolved locally—in other words, with the funds of other jurisdictions—the UK authorities should not reasonably place such a requirement. In fact, it may be counterproductive to do so, because it may create an expectation in litigants or authorities in other countries that, having made provision, there is some liability in this country for those overseas subsidiaries. It is important to be clear about that.

We will bring forward an amendment to new section 142M in clause 4 on Report to implement these exemptions through the resolution strategy. We will give a power to the Treasury to make orders on limiting the amount of PLAC required. We will introduce an amendment to require the Bank of England to produce resolution strategies for UK global banks. It will require that the exemption decision follows directly from the required resolution strategy. It is better to do it systematically across all UK global banks than on a case-by-case basis. We want to be satisfied that all UK banks that have overseas operations have thought about the consequences in advance.

The burden of proof is clear. The firm needs to convince the Bank of England that some or all of its overseas activities can be resolved overseas without relying on or posing a risk to the parent, if it is to be exempted from holding PLAC against those overseas activities.

Nigel Mills: Just a quick question: when the Minister is talking about overseas operations, is he talking about overseas everywhere, or overseas outside the European Union or the European economic area?

Greg Clark: It applies to everything outside the jurisdiction of the UK authorities, wherever that is, and it follows the plans agreed by the Bank of England. I am advised that it applies only outside the EEA, on the basis that arrangements within the EEA have to be co-ordinated with other member states.

We will make the amendment on Report. It is important that the burden of proof is clear. It has been clarified that the bank has to prove to the Bank of England and the Treasury that this measure should be in place. The resolution strategy is credible, so I hope the hon. Member for Nottingham East will withdraw his amendment.

Chris Leslie: I understand that the heavy traffic on this issue is largely related to the question of overseas operations and UK banks. Will the Minister put on record that he does not envisage exemptions from capital requirements for any other purposes? I do not think that this is the point at which we talk about non-plcs or building societies. We are simply talking about UK overseas operations with these exemptions.

Greg Clark: I confirm that the hon. Gentleman is exactly right. It is about the holding against overseas operations. On that basis and in anticipation of our amendment, which will reflect the sensible agreement on this important matter, I hope that he will withdraw his amendment.

Chris Leslie: This issue was particularly pressed by HSBC and other larger banks that are structured in a way that will be affected by the PLAC arrangements. It is important to ensure that we get the regime right. I understand the logic of the Minister's approach in looking at how, if a parent company has ultimate liability, that parent company will need loss-absorbing capabilities to deal with any failings in those overseas arrangements. However, he is suggesting that where there are overseas subsidiaries that do not, in circumstances of insolvency or failure, have recourse to bail-out from parent companies with the UK jurisdiction there will be an exemption from the loss-absorbing arrangements. I want to have a proper understanding of whether he feels that that might in any way distort the existing structures of those banks that do not follow the HSBC model: where companies that are operating in overseas jurisdictions do not have that subsidiary arrangement, are we not likely to be implicitly giving an incentive to banking groups to restructure on that model? I ask him to consider that question; did the Treasury think about that at all?

I welcome the fact that the Government will bring forward an amendment on this point. That is very helpful, although I have to say that we take some wry satisfaction from the fact that the Minister talked about needing to look at the issue systematically across all

banks rather than on a firm-by-firm basis. However, I will put that to one side. The operation of overseas subsidiaries is not something that we should simply wash our hands of. We know that the UK's reputation, albeit not necessarily its capital liabilities, can be put on the line by the behaviour of banking subsidiary companies with a UK brand, which perhaps are trading off that UK brand implicitly in other jurisdictions and have found themselves in great trouble and in deep water.

I think, for example, of some of the recent and very serious money laundering allegations made against UK banks. The public here—never mind around the world—and regulators around the world make an assumption that the UK has some regulatory oversight of the activities and behaviour of those overseas subsidiaries, if they enjoy that UK brand. It is legitimate to use the amendment to ask the Minister to say a word or two about where we are in our thinking about the UK regulator's role in overseeing or governing the behaviour, culture and standards of overseas subsidiaries that are ultimately owned and controlled by UK parent organisations, albeit not for capital liability purposes. The American regulators have taken firm steps to clamp down on money laundering and semi-corrupt or corrupt practices. It has been an obvious lacuna, I feel, in the rules that our own regulators did necessarily take as tough a stance as foreign regulators took on those things; I would have expected that, in many cases, UK regulators would also frown on the behaviour of those UK banks and the behaviour of all of their various arm's length entities that was going on elsewhere, especially given that any profits from that behaviour can ultimately move back here.

This is an issue of the culture, standards and behaviour of some banking groups, and, ultimately, of the reputation of London and the UK financial services. The amendment gives us a good opportunity to debate that point, and I would be grateful if the Minister will tell us what he thinks about how it is best to tackle those particular issues. It would be useful if he could reflect on that for a moment or two before we have our lunch. I will try to make sure that we can properly address those issues when we reconvene in the near future. At that, I should like to ask the Minister to come forward with his thoughts on this matter.

The Chair: Order. Before we adjourn, I advise the Committee that Mr Hood will chair this afternoon's sitting.

Ordered, That the debate be now adjourned.—*(Greg Hands.)*

1 pm

Adjourned till this day at Two o'clock.