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GENERAL COMMITTEES

Public Bill Committee

FINANCIAL SERVICES (BANKING REFORM) BILL

Fourth Sitting

Thursday 21 March 2013

(Afternoon)

CONTENTS

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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: Dr William McCrea, Mr Peter Bone, †Mr Jim Hood, 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

(Afternoon)

[Mr Jim Hood *in the Chair*]

Financial Services (Banking Reform) Bill

Clause 4

Ring-fencing of certain activities

Amendment proposed (this day): 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.'.—*(Chris Leslie.)*

2 pm

Question again proposed, That the amendment be made.

The Financial Secretary to the Treasury (Greg Clark): It is a pleasure to see you in the chair, Mr Hood. The hon. Member for Nottingham East asked for clarification on a couple of aspects of the primary loss-absorbing capacity requirements. He asked whether having different arrangements might be to the competitive disadvantage of certain groups, but the choice lies with the firm. A firm can elect to have either a whole group resolution strategy or, through arrangements with the national supervisory authorities in other countries, a regional resolution strategy. Firms with different structures will not be penalised, therefore; a banking group can elect to have whichever is most suitable.

The hon. Gentleman raised an important point about whether banks that are headquartered in this country can extend other aspects of regulation to the culture of overseas banking.

Chris Leslie (Nottingham East) (Lab/Co-op): I am sorry to interrupt the Minister, but before he moves on from the relative advantages or disadvantages of a regional or UK loss-absorbing arrangement, I want to clarify that my concern was not so much that there would be a comparative disadvantage. I am more concerned that if a universal bank with a parent-child corporate structure has to bear quite a lot of capital requirements, and it sees under the new arrangements that more exemptions are available for overseas activities, it might be tempted to change its structure to reduce its capital requirements. Does the Minister think that universal banks will gradually be tempted to shift to more regionalised arrangements to get out of the capital requirements?

The Chair: Order. May I say that that intervention represents the exception rather than the rule? I expect them to be a bit shorter than that.

Greg Clark: Thank you, Mr Hood. I will try to respond to the intervention with the alacrity that you seek. The exemption is not an exemption from capital; it is a question of where that capital is carried. The Bank of England would be persuaded to grant the exemption only if it was satisfied that another regulator in another jurisdiction had made adequate provision to ensure that the consequences of failure would not fall on the UK regulator. It is important to establish that. The concern of banks in this position was that they would be required to hold two sets of capital requirements, which would amount to a form of double taxation, so it makes sense to address the matter in that way.

In terms of conduct regulation, a firm's decision to be headquartered in the UK carries responsibilities, including some cultural expectations, and it is right for the regulator to have an influence over the whole group. The Financial Conduct Authority, which will come into being in April, will be principally responsible for that. The FCA will assess whether a firm has the right systems and procedures in place not only in its UK operation but across the whole of the group's activities, and ensure that they are sufficient to generate confidence. In order to discharge its prudential responsibilities, the Prudential Regulation Authority will also want to satisfy itself of that, through its relationship with other jurisdictions. The Bank of England can be exacting in its resolution requirements, and it can, in effect, insist on them, because the burden of proof lies with a firm to demonstrate to the Bank's satisfaction that our local requirements are in place.

That move was recommended by the regulator and the Parliamentary Commission on Banking Standards. It solves the double requirement of capital problem in a way that is absolutely consistent with the purpose that—this goes to the heart of the Bill—the UK taxpayer will not pick up liabilities for the prospective failure of any of these banks.

Chris Leslie: Welcome to the Chair, Mr Hood. I feel that I am under close watch already, having made merely one intervention, but I appreciate your firm guiding hand on these issues.

The Minister helpfully set out the expectations on capital provision by banks, regardless of whether they take a more delegated or a more consolidated approach to their corporate structure. It will be interesting to see if those arrangements have any particular effect on corporate structure; I got the sense that he does not think that there will be a vast amount of change, but it was important to ask about that.

It is interesting that the Minister underlined his understanding that the FCA has responsibility for some of the behavioural questions, even though they will

apply in other jurisdictions where the banking subsidiaries operate. I welcome that, because I want to see a regulator that can make sure that what are perceived to be UK financial services are held in the highest regard globally.

Ultimately, if we are to rebuild our financial services sector sustainably, those reputational questions will be at the core of winning new business and the sector going on to a renaissance after a difficult period when other jurisdictions have undoubtedly looked to see whether there are opportunities to pick up business because of the unfortunate stain on the character of UK banking that hit in recent years. I hope that we can move on from that. Ensuring that we have a Financial Conduct Authority that is able to keep a close eye on the behaviour of banks and their foreign subsidiaries is a really important principle. We will watch to see how this proceeds.

With the assurance that the Government will bring forward an amendment essentially to that effect, hopefully on Report for consideration in the Chamber, I am satisfied, so I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Chris Leslie: I beg to move amendment 1, in clause 4, page 12, line 29, at end insert 'and

(ba) section 142C.'.

The Chair: With this it will be convenient to discuss amendment 19, in clause 4, page 13, line 7, at end insert—

142NA Enhanced scrutiny procedure for certain affirmative procedure orders

(1) This section applies if—

(a) an order under section 142A(2)(b) exempts a class of UK institutions from being ring-fenced bodies,

(b) an order under sections 142B(2) or 142B(5) makes provision for a regulated activity to be or cease to be a core activity or varies the circumstances in which a regulated activity is a core activity,

(c) an order under section 142D(2) varies the circumstances in which the regulated activity of dealing in investments as principal is an excluded activity,

(d) an order under section 142D(4) provides for an activity to be or cease to be an excluded activity or varies the circumstances in which an activity is an excluded activity, or

(e) an order under section 142E varies the scope of what ring-fenced bodies are prohibited from doing by virtue of that section (including by varying exemptions or conditions),

(f) an order is made under section 142M,

and the order is not made in reliance on section 142N(4).

(2) The Treasury must, before laying a draft of the order before either House of Parliament for approval, consult such persons as the Treasury considers appropriate in relation to the proposed draft.

(3) If, after the consultation required by subsection (2), the Treasury considers that it is appropriate to proceed with the making of an order, the Treasury must lay before each House of Parliament a draft of the order together with an explanatory document—

(a) explaining the provisions in the draft order, and

(b) giving details of the consultation under subsection (2), any representations received as a result of the consultation and any changes made to the proposed draft as a result of the representations.

(4) If a joint committee of both Houses of Parliament is charged with reporting on the draft order—

(a) the chairman of the Treasury Committee of the House of Commons is to be the chairman of the joint committee, and

(b) the Treasury must have regard to any recommendations of the joint committee made during the 60-day period.

(5) If, after the expiry of the 60-day period, the Treasury wish to make an order including material changes from the draft order, they must lay before Parliament—

(a) a revised draft order, and

(b) a statement giving details of the revisions

(6) After the expiry of the 60-day period (and, if subsection (5) applies, after complying with that subsection) the Treasury may make the order in the terms of the draft, or revised draft, if it is approved by a resolution of each House of Parliament (as required by section 142N(2)(a)).

(7) In this section "the 60-day period" means the period of 60 days beginning with the day on which the draft order is laid before Parliament under subsection (3).

(8) In calculating the 60-day period no account is to be taken of any time during which Parliament is dissolved or prorogued or during which either House is adjourned for more than 4 days.

(9) The references in this section 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 paragraph (a) or (b) is to be determined by the Speaker of the House of Commons.".'.

Chris Leslie: Amendment 1 is short and pithy. As hon. Members can see, it would amend line 29 of page 12 in new section 142N, which outlines the matters that the Government propose should be considered by the affirmative procedure. The list includes a number of order-making powers that are set out elsewhere in the Bill, although most of them are in clause 4. The Government have moved already by accepting that many of the quite substantial regulations that we have debated so far, which are enabled by order-making powers, ought to be considered by an affirmative procedure. Our concern, however, is that some improvements still need to be made to the scrutiny process.

Amendment 1 would ensure that orders made under proposed new section 142C about the definition of "core services" for the purposes of the Financial Services and Markets Act 2000 and ring-fencing would be by affirmative resolution. The Treasury are to be given a power to broaden the definition of services beyond accepting deposits, offering overdraft facilities or withdrawing money, which are the definitions already in the Bill. Given that the basic nature of what is at the heart of banking will be set by such orders, it is worth Parliament having the chance to debate and confirm them. We hope that the process will be relatively uncontroversial, but it would be better to add this to the list of order-making powers that use the affirmative procedure.

However, hon. Members will be delighted to know that amendment 19 is a slightly longer and more detailed suggested improvement to the Bill. I cannot claim the

[Chris Leslie]

entire credit for it, as the Parliamentary Commission suggested the change, but we have tweaked a couple of elements. The amendment is about the scrutiny given to the key secondary legislative powers set up by the Bill. As anyone will know by now, the Bill is largely a shell to be populated by detailed secondary legislation, a few examples of which have already been published by the Minister and others are to follow. It is important that sufficient attention is given to such matters.

It is not the case that Parliament will have a full opportunity to go through all those arrangements under the affirmative procedure. Although it is a step in the right direction, that one-and-a-half-hour rubber-stamping debate in Committee—usually at the beginning of the day, when, dare I say it, hon. Members may, naturally, not have switched their full attention to the contents of the orders—will be the device that Ministers will use to get the proposals on to the statute book. Both we and the Parliamentary Commission think there is a problem with that, so it suggested what some have called a super-affirmative procedure for secondary legislation. If the Committee will bear with me, I will try to explain what it would be.

The amendment sets out a range of order-making powers that should be subject to the super-affirmative procedure or some form of enhanced scrutiny. The first step would be the Treasury laying a draft of the order before either House of Parliament for approval and consulting those whom it feels should be consulted. If, having gone through that consultation period, the Treasury feels that it is appropriate to proceed with the making of that order, it will then lay before each House of Parliament a draft of that order together with an explanatory document that gives details of the consultation process. The first step therefore is more effective consultation for those statutory instrument proposals.

Nick Smith (Blaenau Gwent) (Lab): On the wider consultation, what sort of bodies does my hon. Friend think ought to be consulted to try to ensure that such important legislation receives greater scrutiny?

Chris Leslie: That is an important question. We have not specified that in the amendment and have left it up to the Treasury to determine. It is fairly self-evident, however, that if matters relate to the banking sector, it would be those who would be affected by the orders. It would be important to engage with those who have had a close interest in either the Vickers Commission or the Parliamentary Commission.

The key is that if the House of Commons, having seen the draft order and the consultation, felt that it needed more time to look at the order, the amendment would give Parliament the time and space to create a Joint Committee of both Houses charged with reporting on it. We suggest that the Chairman of the Treasury Committee should be the Chairman of such a Joint Committee and that the Treasury should have regard to any recommendations that Committee might make within a 60-day period. In other words, we would have two months to think through properly what those mega-statutory instruments would be doing, and could give them more attention than a cursory one and a half hours.

2.15 pm

It would not be obligatory for such a Joint Committee to be set up, but if the Treasury or others felt it necessary, Parliament would have that right. After that 60-day period had finished, if the Treasury still wanted to make the order it would be able to include in it material changes from the draft order, lay the revised draft order before Parliament and give a statement of the details of any revisions. The Treasury would then be able to make the order if it were approved by a resolution of each House, reverting to the affirmative procedure.

The reasons behind amendment 19 are, I hope, quite clear. It would ensure that statutory instruments enacted downstream of the Bill were properly scrutinised and improved and that Parliament was given the proper time and space to do that in a considered fashion. It would add order-making powers under new section 142A, on exempting some banks from the ring fence; under new section 142B(2), on excluding the accepting of deposits from the ring-fence rules; and under new section 142N, on loss absorbency requirements. We feel that those areas should be scrutinised under that enhanced scrutiny procedure.

The amendment would also remove the exceptions for the first such orders, which the Parliamentary Commission, for reasons that I do not particularly agree with, thought did not need to be subjected to the enhanced procedure. We feel that the first orders should also go through that process. It could be truncated by the Treasury Committee and by Parliament, but it would be an important rinsing-through process that would ensure that we have the checks and balances we need. All the secondary legislation needs proper attention, including the first iterations of those powers.

The Government's draft Bill initially applied the negative procedure to all but one of the powers created by clause 4, but after the Delegated Powers and Regulatory Reform Committee in the other place criticised them for a lack of appropriate parliamentary control and the Parliamentary Commission said that the scrutiny standards were unacceptably weak, they moved to the affirmative procedure. Our amendment would provide what the Parliamentary Commission described as a "parliamentary bulwark" against erosion of the ring fence. The arguments in favour are fairly self-explanatory, and the Commission set them out in paragraph 152 of its report, stating that that level of scrutiny would secure

"far greater transparency about the purpose and likely effect"

of orders made under clause 4. The Commission also points out in paragraph 150 of that report that

"even if the ring-fence is faithfully implemented at first in accordance with the firm commitment of the current Chancellor of the Exchequer, it risks being eroded over time."

This is therefore an extremely important matter.

The parliamentary scrutiny provided by the amendment would be vital to the success of the ring fence as a long-term solution. It is to be hoped that the Government will acknowledge that and agree with the Commission that secondary legislation capable of varying the height and location of the ring fence is of such importance that it "necessitates enhanced parliamentary scrutiny." That scrutiny would be provided by amendment 19. I urge hon. Members to support a process that is part

and parcel of the downstream consequences of a Bill that contains merely enabling powers, not the detail—the real meat—that needs proper consideration.

Greg Clark: Let me take first amendment 1, which would require any order creating new core services in new section 142C to be subject to the affirmative procedure. It is worth reflecting on the Government's response to the Delegated Powers and Regulatory Reform Committee, which has considered all these matters exhaustively. Members on both sides of the Committee have noted how important it is that when a piece of legislation sets out a framework for future powers, the statutory instruments that implement them should be adequately supervised.

The PCBS recommended that the following powers be made subject to the affirmative resolution procedure:

"Define a class of institutions that should not be regarded as 'ring-fenced bodies', even if they otherwise met the definition; Define circumstances in which accepting deposits is not to be regarded as a 'core activity'; Define circumstances in which a regulated activity other than accepting deposits is to be regarded as a 'core activity'; Circumstances in which dealing in investments as principal is not to be regarded as 'an excluded activity'; Add any other activity to the definition of 'excluded activity'; Impose prohibitions on what a 'ring-fenced body' can do in relation to specific categories of transaction".

The Government changed the procedures in response to all those recommendations. In addition, powers in relation to pensions in new section 142K and powers for the Treasury to require further rules, as well as powers in relation to the loss absorbency requirement and provision for building societies, are all subject to the affirmative procedure.

As it happens, the Delegated Powers and Regulatory Reform Committee did not recommend that new section 142C be made subject to the draft affirmative procedure; I have a note here that suggests that it would be "disproportionate" to use that procedure in the case of such orders. However, I have very much taken to heart the remarks made by the hon. Member for Kilmarnock and Loudoun on Tuesday when, in welcoming a concession that I had made in promising to bring back an amendment at a later stage for greater technical perfection, she chided me by saying that there should be at least some occasions, however unprecedented it may be, when a Minister should be able to accept an amendment.

Having looked in close detail at amendment 1, as other Members will have done, I have to say that it is "pithy", as the hon. Member for Nottingham East put it. I could not say with a straight face that it needs to be taken away for further technical consideration. So, on this occasion, for the purposes of completeness—if we require the affirmative resolution procedure for the power in question, all the relevant powers on ring-fencing will be subject to it—not only will agree with the request that we should respond in spirit, but, with the permission of the Whip, who is sending a note in anticipation, accept this amendment when we come to it. I am grateful for the help and advice of the hon. Member for Kilmarnock and Loudoun.

I think amendment 19 goes too far. I hope that the hon. Member for Nottingham East will accept the compliment when I say that his amendment is better than the Tyrie Commission's amendment in that regard. Its amendment requires a particular Joint Committee of both Houses to be established, following a 60-day delay. It goes further even than the super-affirmative procedure laid down in the Legislative and Regulatory Reform Act 2006.

The amendment is curious in some ways, in that it seeks to require that a Joint Committee should be established, whose Chair should be the Chair of the Treasury Committee, and that it should be composed of eminent representatives of both Houses of Parliament. It looks suspiciously like the PCBS—I am only surprised to find that there is no reference to an ex officio place for the Archbishop of Canterbury. Much as we love the PCBS and admire its work, giving a similar body a permanent, standing capacity to consider any proposal in ring-fenced banking would certainly be novel, but it would not be the right way to go.

The nature of any Committee established by the House to consider a draft statutory instrument, including the identity of its Chair, should be a matter for Parliament. My hon. Friend the Member for North East Somerset made the point earlier that it would be wrong for the Government to specify through legislation the composition of Committees of the House. That is a decision for Parliament to make when matters require scrutiny.

The use of the procedure set out in the amendment would be a step too far. In any case, the provisions of the 2006 Act require super-affirmative orders to be made when such orders could make extensive amendments to primary legislation or change the constitution of statutory bodies, neither of which applies here. The nature of the Committee is a matter for Parliament to decide, so I hope that, after I indulged the hon. Member for Nottingham East amendment 1, he will not press amendment 19.

Chris Leslie: On the specific point about the super-affirmative or enhanced procedure, while I accept that the Parliamentary Commission took a particular approach to the drafting of the provision, the Minister does not deny that the enhanced procedure may apply to these complex and significant orders. Would it be applicable?

Greg Clark: The orders do not fall into the rubric of the 2006 Act about legislation that is set out to make extensive amendments to primary legislation. When that provision was made—I do not think that the hon. Gentleman was in the House at the time—it was intended to provide a fast-track way of changing the law, particularly primary legislation, and of changing the constitution of statutory bodies. That is the not the case here. We have not only adopted all the recommendations of the Delegated Powers and Regulatory Reform Committee, which is keen and exacting in such matters, but gone further and committed to accept the hon. Gentleman's amendment 1, so it will be up to Parliament to avail itself of the procedure at any time. If, in future, Parliament decides to set up a House of Commons Committee, it is open for it to do so.

Nick Smith: I must say that I am a little disappointed with the Minister's response to the amendment, because when we met on Tuesday I got the sense that he was proceeding carefully and was being thoughtful in his approach to the development of this new financial architecture. The amendment suggests some important opportunities and has a decent timeline in which there

[Nick Smith]

could be an opportunity for Parliament and others to offer input into potential problems. Does the Minister have any alternative ideas or is he just going to slap the amendment down?

Greg Clark: There is an important point here. If we adopted an amendment of this sort, we would be legislating for Parliament's future scrutiny of various statutory instruments. It is always open to Parliament to convene a Committee of inquiry. I am not in any way opposed to exacting and rigorous scrutiny of such powers and procedures, but it is right that Parliament should be able to convene a Committee with a membership and chairmanship that it decides at the time.

Throughout the passage of the Bill, including in my response to amendment 1, I have certainly shown that I am willing to consider ways in which we can be sure that that adequate scrutiny is taking place. I do not think that amendment 19 would do that. I say that without prejudice to considering other suggestions—from the Committee, from the House on Report or from the House of Lords—on matters of scrutiny. We have shown ourselves to be willing to listen to such suggestions. We are being asked, however, to approve an amendment that would establish the rebirth of the Parliamentary Commission in standing form, which is not something that I can recommend to the Committee.

2.30 pm

Chris Leslie: As my hon. Friend the Member for Foyle said at one point, I thought I saw some pigs flying past the window, but no, I think the Minister has indeed agreed to accept an Opposition amendment. As somebody once said, this is not the time for soundbites, but I feel the hand of history on my shoulder. This is a momentous occasion, and I would like to put on record my appreciation to the Minister for responding to the debate in such a thoughtful way.

I think the Minister has been persuaded of the importance of orders under the Bill being subject to the affirmative procedure. I wish I could take full credit for that, but I suspect that my hon. Friend the Member for Kilmarnock and Loudoun did all the persuading. Although I may be here giving thanks, she has more powers of persuasion than I could ever dream of. Thank heavens for small mercies; for a small window of time the Minister has been wise and shrewd. We will have to see what else we can get from him during our deliberations on the Bill.

I wish I could also persuade the Minister of the virtues of amendment 19, which suggests the affirmative procedure. I do not know the year of the Legislative and Regulatory Reform Act that he mentioned—

Greg Clark: 2006.

Chris Leslie: No, I was not in the House of Commons at that time—perhaps fortunately. I had other matters to attend to, but I am glad to be back among good friends. That is not the only example of an enhanced scrutiny process, and it was not that process that I was thinking about. There are other instances in existing legislation where Parliament has deemed certain issues to be sufficiently important to require the enhanced scrutiny process. The tests that the Minister mentioned for that process in the Legislative and Regulatory Reform Act are not quite the be-all and end-all. I believe that the Localism Act 2011 contained some sort of generic procedure, and that certain other Acts of Parliament dating back as far as 1921 involve some form of enhanced scrutiny procedure, but I will come back to him on that on Report.

I accept the Minister's argument that the amendment seems suspiciously to be oriented around whoever is the Chairman of the Treasury Committee, whether that is the hon. Member for Chichester (Mr Tyrie) or some other august individual. Who knows, perhaps even the Minister might aspire to be Chairman of the Treasury Committee, although that might take some time and require the accrual of some seniority.

It is important for Parliament to have some breathing space to look through the line-by-line detail of these orders. My hon. Friend the Member for Blaenau Gwent and others made some good points about that. I think it would be reasonable for me to take the matter away and think about other examples of enhanced scrutiny processes that might be more applicable to the orders under the Bill. Given that the Minister is so much in listening mode, perhaps we will have a chance to persuade him again. I did not get the sense that he was turning his face against the idea entirely. Ultimately, we are simply looking for a little bit of a consultative process. The principle has already been established in other Acts of Parliament, so it would not necessarily be such a big ask. With that, I think I should take what I can get and bank it, if the Committee will pardon the pun, and not press amendment 19.

Amendment 1 agreed to.

Cathy Jamieson (Kilmarnock and Loudoun) (Lab/Co-op): I beg to move amendment 2, in clause 4, page 13, line 7, at end add—

'(7) A Treasury statement referred to in subsection (3) may only be made if the Treasury considers that the statement is necessary—

(a) to protect the continuity of provision in the UK of core services; or

(b) to secure an appropriate degree of protection for depositors, or

(c) to ensure the continuing stability of the UK financial service market.'.

It is a pleasure to serve under your chairmanship, Mr Hood, on such a momentous day. I am not sure which is the more momentous—the fact that it is now only 547 days until the independence referendum in Scotland which, it has been announced, will be held on 18 September 2014, or the fact that, after many attempts and notwithstanding the stony stare of the Government Whip, we have actually persuaded a Minister to give us a minor concession during proceedings on the second of the Financial Services Bill Committees on which my hon. Friend the Member for Nottingham East and I have served. The Minister has set a precedent. I suspect that he will not be allowed to do so very often; indeed, I suspect that he is already being reined in and told that he had better not do it again. None the less, given that, aided and abetted by my hon. Friend the Member for Nottingham East, I have been able to push the Minister in the right direction and tempt him once, I hope that we might be able to do so again.

We have already moved a number of amendments that were recommended by the Banking Commission; amendment 2 is one of our home-grown amendments. That may or may not influence the Minister. We are seeking to add some safeguards, as we see it, at the end of proposed new section 142N of the Financial Services and Markets Act 2000.

I hope that hon. Members will bear with me, because at one point I will have to quote directly from the Bill. Essentially, proposed new section 142N provides that certain orders made under the provisions in clause 4, such as those defining the height of the ring fence or imposing prohibitions on ring-fenced bodies, be subject to the affirmative resolution procedure. Proposed new section 142N(3) allows exceptions to that rule if the Treasury says that there are reasons of urgency. The Bill makes that clear, stating that the exception applies if

"an order under 142D(4) or 142E contains a statement that the Treasury are of the opinion that, by reason of urgency, it is necessary to make the order without a draft being so laid and approved."

Will the Minister give us a definition of the circumstances that would allow for exceptions, and what "urgency" would mean in that provision? In a previous debate, we discussed the difference between adverse circumstances and significantly adverse circumstances. It would be helpful if the Minister could say something on the circumstances and the definition of "urgency" in his summing up.

I ask that question specifically because, hoping that we would not have to table an amendment on this matter, we went to the explanatory notes to gain some enlightenment. The explanatory notes say:

"Subsections (3) to (6) provide for the application of the made affirmative resolution procedure to apply to orders made under sections 142D(4) (new excluded activities) and 142E (prohibitions), where the Treasury consider that the matter is urgent so that it is not appropriate to proceed by the draft affirmative procedure."

Have we heard those exact words somewhere before? It appears that the wording of the Bill has simply now been put in the explanatory notes, and I am not entirely sure that it sheds any more light on the subject. The explanatory notes then go on to explain the procedures. What we seek to do here is to get an explanation, have some words on the record and ensure that we understand what the circumstances will be. We do not disagree with the need for such an emergency provision. Clearly, there may be circumstances in which a parliamentary procedure takes too long for a fast-moving financial change or some sort of crisis scenario, and we understand that.

We also note that section 165(c) of the Financial Services and Markets Act 2000 contains similar provisions to those set out in proposed new section 142N (4)—if people are still following all these complex clauses—without the limitations provided for by the amendment. However, the orders that are excluded from parliamentary scrutiny by that clause are merely those relating to the categories of people who are required to provide information or documents to regulators. The order-making powers here seem to be of much greater importance and, therefore, we believe that it is appropriate that parliamentary scrutiny of them would not be bypassed without some very serious consideration being given to that. That is why we have suggested an amendment here to prevent parliamentary scrutiny being bypassed, so we want to probe exactly what the urgency criteria will be, because, as I have illustrated, the Bill and the explanatory notes seem to leave that undefined at present.

We have suggested that the Treasury's urgency statement is made only when there is a need to protect the continuity of core services in the UK, when depositors need to be protected for some reason or if stability of the financial services sector is at stake. That is consistent with some of the debates and arguments we have had on other clauses. I hope the Committee will join with me in urging the Minister to explain what the Government have in mind here and to put some assurances and information on the record for future Ministers. Notwithstanding the helpful Minister who is here at the moment, other Ministers in the future might not know what was in his mind, so it would be helpful to have something on the record. I look forward to hearing what the Minister has to say.

Greg Clark: I can start by reassuring the hon. Lady that the fact that the amendment comes from the Opposition rather than the distinguished Tyrie Commission in no way reduces its prospects in my eyes. As the last one that I accepted came from the Opposition rather than Parliamentary Commission, there is a good precedent. However, I understand the point that the hon. Lady wants to make here. It is reasonable to ask how we can be sure that an urgent parliamentary procedure is not a loophole through which measures that the House would not be content with could somehow be introduced.

Proposed new section 142M (3) refers to circumstances in which it is urgent for the Treasury to make orders—either imposing new prohibitions on ring-fenced banks or preventing new types of activities from being carried out. I will explain a little more clearly than the explanatory notes what this made affirmative procedure is all about. It essentially allows an order to come into effect immediately, but then it lapses if it is not approved by a resolution of the House within 28 days. The scrutiny is built in and reflects the urgency. The procedure is to be deployed only if the Treasury considers that necessity for urgency is required. We all know that the lessons of 2008 were such that very urgent measures were needed, sometimes over the space of a very short number of days, and it is right to have powers to deal with fast-moving situations.

Amendment 2 is unnecessary and actually risks putting a brake on that ability. In effect, it would restrict the Treasury to making a statement of urgency only when it believed that it was necessary to protect the continuity of core services, to protect depositors or to protect the financial stability of the UK system.

2.45 pm

The crucial measure to look at is proposed new section 142D(7), with which the test of even the urgency powers that the Treasury has—everything that the Treasury wants to do, even in an emergency—must conform. That is to say that they can only be made if the Treasury is of the opinion that the order is necessary or expedient for the purposes of protecting the continuity of provision in the UK of core services. Amendment 2 is, in effect, a recapitulation of the core services that are set out right at the beginning of the Bill; we talked about the internal, external and resolution purposes. They are captured in this continuity objective. In effect, amendment 2 would

simply proliferate a different expression of the test that the Treasury already has to consider, as set out in the Bill.

It is not that this order-making power can be used in an unfettered way. It is constrained to be used, in effect, in exactly the way that the hon. Lady's amendment would require, which is where it is necessary to maintain the purposes for which ring-fencing was introduced. They are referred to in the continuity objective. So the spirit of what the hon. Lady was probing through amendment 2 is already there, and I can reassure her that it is clearly in the Bill.

Cathy Jamieson: I thank the Minister for giving us that explanation. He is, of course, correct, and I did not read out the whole paragraph of the explanatory notes, but they go on, of course, to explain that the order can be come into force without each House of Parliament having approved it, as long as they do so within 28 days. Obviously, it was helpful to point that out.

It was also helpful that the Minister made the connection, and indeed confirmed the connection, with the earlier clause in the Bill in relation to the continuity objective. We were seeking to ensure—as the Minister has understood—that we would not have a situation in which an urgent procedure became a loophole. That is always our concern. The Minister has not suggested any circumstances outwith those captured in the earlier part of the Bill in which anything could, if you like, be pushed through. That is helpful.

It was certainly not our intention to proliferate and add additional clauses or wording where they were unnecessary; quite the contrary. Sometimes it can be difficult enough with the number of clauses, explanations and so on that we have in the Bill, and indeed in the explanatory notes. However, we felt that it was important that we had that information.

Since we are trying to work reasonably co-operatively this afternoon, at least in discussing some of these clauses, and in the spirit with which the Minister has given those particular assurances, which we now have on the record, I do not feel the need to press the amendment to a vote.

I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

The Chair: I have to say to hon. Members that I think the clause and the amendments to it have been fairly well discussed.

Chris Leslie: On a point of order, Mr Hood. I understand entirely why, considering the number of amendments that we have discussed, you might come to that conclusion, but we have not yet had an opportunity to discuss proposed new sections 142B, 142H and 142K, about which I have a few specific questions to put to the Minister. There are no amendments to those proposed new sections. I do not want to repeat the discussions we have had on other amendments, but we have not touched on some elements of the clause.

The Chair: I am persuaded by the hon. Gentleman. If he wishes to raise issues that have not been discussed in the debates on the 14 amendments and he does not repeat debates that have gone before, I will allow a debate on clause stand part.

Question proposed, That the clause, as amended, stand part of the Bill.

Chris Leslie: I am grateful, Mr Hood. I entirely understand why it is a difficult judgment to make because we have debated at length some aspects of clause 4, but not all of them. Essentially, for those looking at the provisional selection of amendments and so forth, it is clear that most of the meat of the Bill is in this clause; once we have discussed that, many of the other issues are downstream and consequential to that.

We have discussed some of the broader principles, but I still have a few questions for the Minister on areas that we have not touched on in the debates on amendments. The first is proposed new section 142B, in respect of core activities. Those are set out on page 4 of the Bill, and relate to order-making powers that the Treasury can take to set out the purposes of what a regulated body will be able to undertake.

Depositors will still be able to make deposits in banks that are not ring-fenced. Even though with ring-fencing we will have retail banks and investment banks, we should not be under the impression that deposit-taking will be exclusively an activity for retail banks; investment banks will still be able to take deposits. As I understand it, the Government envisage that those individuals who want to put their money into an investment bank will have to sign certain waivers. Such people will typically be what are known as—Ministers are familiar with these—high net worth individuals. That declaration will have to say something like, "We, the undersigned, understand that the money that we are investing with these non-ring-fenced banks will not come under the same level of protection or resolution regimes or ring-fencing arrangements."

There may be some in the Committee who find themselves in that circumstance and invest with investment banks. I would be interested to know whether any members of the Committee have more insight or experience in these matters, because on my humble IPSA means—I am very grateful for them; they are much more generous than what many of my constituents have at their disposal—I have not been able to bank with Coutts, or J. P. Morgan or any of the other large investment banking institutions over the years. Perhaps there are already waiver provisions in place.

As I understand it, the Minister has put forward some draft orders, which I know that hon. Members—possibly even the hon. Member for North East Somerset—may want to take a look at, because they contain suggested waiver wording. My question for the Minister therefore flows from that concept of high net worth individuals. Will he give us an insight into what exactly the definition of high net worth might be, and what are the Government's assumptions for those individuals? Some constituents may be tempted in the quest for a real rate of return to vest their life savings in a non-ring-fenced retail banking capability in the hope of obtaining more than the low rate of return that they can achieve at the moment. The Minister may or may not have calculated whether he expects a ring-fenced bank, because of its particular circumstances, naturally to provide a lower rate of return than investment banks outside the ring fence.

I am slightly worried that temptation will be dangled in front of those with substantial savings, and perhaps even those with substantial savings accounts—individual savings account accumulations have grown into substantial pots over the years. In the quest for a higher rate of return, and with a flick of a pen to sign off various rights, certain people with such sums might be able to obtain a 4% or 5% rate of return compared with a 1.5% rate in the current ISA environment.

Nigel Mills (Amber Valley) (Con): I can see the argument the hon. Gentleman is making. We discussed a further situation at our previous sitting, which was that some new entrants—smaller banks—may be left out of the ring fence to allow them to compete more favourably. It is unlikely that I will join him in having the wealth to go to Coutts, but if a new, smaller bank on the high street looked attractive I might be tempted to put my deposit there, and unwittingly into a bank that is not ring-fenced.

Chris Leslie: That is precisely the sort of point I am trying to test the Minister on. Conventional wisdom is that that if an investment bank with various elements of proprietary trading or whatever can generate attractive rates of return, it might find itself in an environment where it desperately wants to suck in deposits, and might begin to get into the business of taking deposits more effectively. I would like the Minister to address that aspect of new section 142B, because we have not done so yet in Committee.

The corollary issue relates to small businesses, because small firms must obviously put their money in a banking environment. I would welcome some clarification about what will happen if a large bank is at risk of going under, but is a major deposit-taker for small firms throughout the country. Are those small firms expected to accept a different level of protection? Treatment of small and medium-sized enterprises is important, and I would be grateful if the Minister clarified the ring-fencing arrangements as they will apply to normal deposit-taking and deposit-accepting activities involving small businesses.

I also want to ask the Minister about new section 142H, which covers some basic principles of the ring-fencing rules enforced by the regulator. Has any thought been given to contingency planning and preparedness in case service disruption in the investment banking sector or elsewhere adversely affects the core activities of a ring-fenced retail bank? The notion that a ring-fenced bank will not be reliant on interdependent with other banking networks is clearly unlikely, so who will be responsible for scenario planning or modelling mock events that test the durability or endurance of the ring-fenced regime?

We are not going for full separation, and we will obviously have an environment that recognises that ring-fenced banks will have relationships with investment banks. Clearly, there are specific rules about what happens in the event of service disruption within a ring-fenced bank arrangement, but I am imagining a scenario where a particularly large investment bank has a lot of activities that impinge on the core service continuity of a ring-fenced bank. If that investment bank went under and failed—Lehman's is the most recent example in people's minds—that will clearly have a ripple effect on the ability of core services to continue within the ring-fenced banking environment. I want to know who would be responsible and what preparedness is being undertaken in the new arrangement to deal with such issues.

3 pm

Proposed new section 142K is a smaller, downstream provision concerning pension liabilities for occupational pension schemes. Given that we are teasing apart some banking groups with a ring-fenced and non-ring-fenced relationship, I want to ask the Minister for some assistance. We have been drafting provisions on separation. If ring-fencing failed, we would have to have separate retail and investment banking arrangements, but the provisions in new section 142K clearly apply to the ring-fencing environment. Has he given any thought to whether the provisions would need to be changed if we ended up with fully separated banks? Perhaps the Banking Commission, in suggesting the institution-by-institution separation back-stop power, has not thought through the consequences for pension liabilities. When the Minister tables his own amendment on institution-by-institution separation, does he also intend to introduce changes to the section on pension liability? Obviously, we advocate full separation across the board, and I assume that we could replicate any such draft provisions.

I have asked some specific questions about the elements of clause 4 that we had not yet had a chance to debate. Clearly, from our point of view, the clause does not go far enough, and it does not yet contain the amendments that the Government said they would introduce. We want a comprehensive full separation power that can work firm by firm and across the sector as a whole. We have already debated many of the issues—exemptions, the impact on competition, questions about derivatives and so forth—but I would be grateful for the Minister's response to those questions.

Jacob Rees-Mogg (North East Somerset) (Con): It is a pleasure to serve under your chairmanship, Mr Hood. I want to raise some fundamental questions about clause 4 and whether the ring fence is the right idea at all. The ring fence as a concept—the separation of investment and commercial banking—has come to be seen as a panacea for preventing a financial crisis such as that of 2008, but I wonder whether that is the right analysis. When we look at what caused the financial crisis, underlying it all was, essentially, low-quality mortgage lending, which started in the United States. There were regulatory requirements to lend to people who did not, in fact, have any money, and there were self-certified mortgages where people represented things that simply turned out not to be true. They were essentially fraudulent applications for mortgages.

Such banking was the most bread-and-butter type imaginable. It consisted of people buying relatively low-cost properties in the sub-prime market, and people self-certifying at a slightly higher level. Those mortgages were packaged and sold into the market. They were a way of providing people with cheap capital with which to buy their homes, which I believe would be an objective of most Government policy. Indeed, the Budget yesterday included proposals to lower the cost of borrowing for individuals so that they can buy properties. That is a worthwhile aim. It was the investment banking part that lowered the cost of capital to people who were applying for mortgages, so when we look at the ring

[Jacob Rees-Mogg]

fence, my first question is whether it will raise the cost of capital for people who are looking to buy homes. If it does, I think that that is unsympathetic to a major aim of both parties, or perhaps of all three parties—*[Interruption.]* I may be in agreement with the hon. Member for Nottingham East on that particular hand gesture, but we will leave it at that for the time being. No, I will rephrase that slightly, because I have the greatest respect for my hon. Friend the Member for Bristol West, who is my near neighbour in Bristol, and for my hon. Friend the Member for Eastleigh, whom I congratulate on his victory. Let us not be too partisan about this and get distracted from the main point. May you come down on me like a knife if I depart from it, Mr Hood.

The first question is whether we are increasing the cost of capital for people who want to buy properties, and whether that is actually a bad thing to do. The second question is whether the investment banks were at the heart of the problem that we are now trying to solve. In the case of the UK, they were not. The Royal Bank of Scotland disaster was down to a wrong-headed commercial transaction. That is to say that it bought another bank that it could not afford.

At this point, I will declare a non-declarable interest. I was given dinner by the chairman of RBS on Tuesday evening in the Drummonds branch of said bank. It was a fine and enjoyable dinner, but not sufficiently fine for me to change to my view on any banking issues, so I declare that non-declarable culinary interest just for the delectation of Committee members.

RBS fundamentally failed in its purchase of ABN AMRO by paying too much for it. Circumstances in which a ring-fenced bank buys another ring-fenced bank that it cannot afford could still happen under the new regulations. When a boom has turned to bust, it is easy to see that it was a commercial decision that was wrong, but when a boom is going ahead, those judgments of valuation are difficult for companies to get right—they do not deliberately want to overpay—and therefore difficult for regulators to get right as well.

At the heart of the problem was a misunderstanding of capital, risk capital and of liquidity, because we reached a situation, which was encouraged by the UK regulators, where mortgages were deemed to be base bank capital. The domestic mortgage counted as 100% towards bank capital, ignoring the fact that a mortgage is an illiquid asset, whereas a deposit is a liquid liability. When Northern Rock had people trying to get their deposits out, they had plenty of mortgage assets against which those deposits could be capitalised, but of course the mortgages are not repayable on demand, so they cannot be used as a liquid asset to be repaid as a deposit. It was a misunderstanding of capital that got Northern Rock into trouble, not whether it was ring-fenced.

It seems that Northern Rock is the classic example. I divert here from the Vickers report, which asks on page 31 whether the ring fence was the issue and gives one tick to Northern Rock. I do not think that that is correct. The only way that you can argue that is by saying that the packaging of mortgages made them part of investment banking. Actually, packaging mortgages is a perfectly intelligent thing for a ring-fenced bank to do to be able to lend more, but also to offload some of the potential risk of its lending. We should not view the packaging of mortgages as anything different from insurance companies using underwriting to lay off some of the risk of their day-to-day business.

That leads me to another complication with the ring fence. Some hon. Members occasionally accuse me of being old-fashioned, and I accept that charge on occasions.

Chris Leslie: Has the hon. Gentleman considered joining Twitter?

Jacob Rees-Mogg: There is somebody tweeting on my behalf who is so splendidly amusing—I do not know who he, or possibly she, is—that I could not compete. I feel that it is best to let the imposter carry on.

My point is that I do not on this occasion think that the lesson of history is the right one. Glass-Steagall is not the right answer to the much more complex banking that exists now. Indeed, why did President Clinton get rid of Glass-Steagall? It was because the interconnection between investment and ordinary retail banking was so close that it could not be diverted.

Let me put the issue in very simple terms. All of us may have foreign exchange transactions with our bank. When we are abroad, we may use our credit card. The bank will have millions of those transactions taking place every day. It will therefore bring them all together and be trading in foreign currency markets. It may have a pause between the transaction taking place and the need to settle. It therefore may be out of the market nominally in terms of the foreign currency it needs, and it may need a derivative of some kind to protect itself and reduce the risk of the banking transaction.

I represent a rural constituency. Let us imagine that there is a farmer who wishes to sell the crop that he is expecting to get in the harvest. He goes to his bank, wishing to carry out a forward transaction. The bank will have a number of those transactions that it wants to deal with. Will it be prevented from doing those transactions, and therefore be unable to provide complex financial services to customers who need them? Will the bank tell the farmer, or the person buying foreign exchange, to go to another bank, or will the ring fence be so wide that in fact we will be bringing some speculative element of investment finance into ordinary banking?

The example of foreign exchange is particularly important, because international banks are going to have loans and deposits in a variety of currencies on their balance sheets. If we look at HSBC, the Hongkong and Shanghai Banking Corporation, the reason it did not need to go to Her Majesty's Treasury to get bailed out was because although its loan to deposit ratio in the United Kingdom was above 100%, its loan to deposit ratio in Hong Kong was significantly below 100%—from memory, I think it was around 80%, but I have not checked the figure recently. That meant that HSBC could transfer Hong King dollar deposits, translated into sterling, back to the United Kingdom to shore up its balance sheet in the United Kingdom.

That was hugely beneficial for us in 2008, because it meant that one of our most important international banks did not require any help from the Government. HSBC it had been making mortgage and consumer loans in the United Kingdom that were almost—but not quite—as aggressive as those of its competitors.

It was bailed out by its rather more complex banking elements. Likewise, Barclays, which did the deal to buy up the assets of Lehman Brothers, made £1 billion to contribute to its capital and its ability to carry on its ordinary banking business.

There is no need to worry. I am not going to do anything radical such as voting against clause stand part. I simply want to refer the Committee to the fact that the reports have come down only cautiously in favour of ring-fencing. Those reports are not saying that it is an absolute certainty. We ought to remember that there is a risk of higher cost to ordinary bank customers if we have a strict ring fence. There is also a risk of higher risk in banking, because it limits the ability of banks to lay off their risks by using more complex products, and a risk of an inability to give certain types of service to ordinary, fairly normal retail clients, who may not even know the complexity of what happens in the bank in providing them with the service that they need because the bank is putting together hundreds, if not thousands, of those transactions, and therefore needs to lay off the risk in the derivative market. I simply want to put in a note of caution: when there is widespread agreement that it is right to do something, it is occasionally sensible to question that.

Stephen Doughty (Cardiff South and Penarth) (Lab/Co-op): It is a pleasure to serve under your chairmanship, Mr Hood. I am afraid I am unlikely to match the eloquence and fluency of the comments of the hon. Member for North East Somerset, but I have a few points and questions for the Minister.

I found it intriguing that the hon. Gentleman was commenting about bad policy in relation to mortgages when the Government have just introduced a spare home subsidy; that is a different area, but still a wrong policy. I do not disagree with him on some of the roots of the crisis, but I question his view that the ring fence might not be needed. I think that it is needed: we need a full back-stop power to stop contagion spreading in the future. Next time, it might not be mis-packaging of mortgage debt; there could be some other risk factor that we cannot allow to spread through the system. As my hon. Friend the Member for Nottingham East said earlier, the real meat of the Bill is in this clause.

3.15 pm

It was generous of the Government to accept the amendment on one of the process issues, but I am disappointed that they have not accepted some thoughtful and well-considered amendments that were moved by my hon. Friends as a result of our own careful considerations and the drive from the recommendations from the PCBS. At many points, I have wondered what interesting comments the hon. Member for Chichester (Mr Tyrie) would make on our debate here. I hope that he has been carefully reading the proceedings of the Committee. I, like other members of the Commission, am looking forward to his comments on Report.

Let me refer briefly to my previous interventions on why the Bill is necessary. Hopefully, it is to introduce clear responsibility, powers and procedures into the banking system to prevent contagion spreading again in the future. Fundamentally, it is to reassure our constituents that the chaos that was created in the financial crisis, which took us to the brink and caused real concern for many constituents, is far less likely to occur in the future. I have listened carefully to the responses of the Minister to each of our amendments, particularly to those relating to this clause. At times I fear that he has demonstrated a too trusting approach, and I want some reassurance from him that he feels that the measure goes far enough and will reassure our constituents. I reiterate my strong support for the case that my hon. Friend the Member for Nottingham East made for a full back-stop separation power, which will provide the ultimate power to respond to difficulties in the future.

I have two specific questions. One is in regard to proposed new section 142B and the definition of high net worth individuals. Further to the point that my hon. Friend made, how many high net worth individuals are we talking about in the country and what is the size of the market there? That would be useful for us to understand. Furthermore, I want to underline the point on the "ordinary" investor or customer—whether individuals or businesses—tempted into structures that they do not fully understand. We only have to look at the example of Icesave and the Icelandic products to see what risks were caused by local authorities investing their pension funds in products that they did not fully understand. We must accept that that has a lot to do with how such products are advertised and promoted rather than people necessarily understanding whether they are investing in a retail or an investment bank or some other kind of set-up. It is really important that we understand the risk involved and the structures that are behind such products.

Secondly, I have a small clarificatory question on proposed new section 142H(5)(d), which is the provision requiring the boards of ring-fenced bodies to have members who are treated by the rules as being independent. Forgive me if this is explained elsewhere in the Bill or in the explanatory notes, but will the Minister explain more clearly the definition of independence? Obviously, one of the crucial issues with the whole Bill is the blurring of boundaries. We need to ensure that there is separation and not a blurring of boundaries between individuals or bodies within the sector that could draw future conflicts of interest or problems. Will the Minister help with some clarification on that point?

Nigel Mills: I just want to make a few brief remarks. I preface this by saying that I am not a bank expert, so I speak as a layman and therefore do not have the knowledge or eloquence of my hon. Friend the Member for North East Somerset. I think I might have come to the opposite conclusion to the one that he came to, which is a little concerning. He seemed to conclude that ring-fencing might be going too far. Before I ever looked at any of this detail, I probably assumed that the only solution to the mess we got into was to go for strict separation. I felt that we should say that for some banks, which are key to our economic success and health and in which people put ordinary amounts of deposits that are guaranteed by the taxpayer, there are things that are too risky for them to do. There is no way, I thought, that we could allow them to do some of those more outrageous casino things and that actually trying to fix it any other way than banning them completely was just too risky in the short or the long term. Having listened to people who actually know about banking, I find that I have been convinced that ring-fencing is the way to go, and that we can actually take away the worst excesses of

[Nigel Mills]

those risks, but leave the advantages of having the same entities doing the same activities in some kind of co-ordinated way, so if it is investment banking that does not go wrong, then perhaps it can prop up the stuff that we value more.

There are some questions about where ring-fencing leaves us, and about the various clauses and orders before the Committee. We all want the ring fence to be in the right place. I told some constituents that this week I would be talking about the electric ring-fencing of bankers, and they were keen on the idea. They thought, "That is many years overdue. We ought to have shoved them behind a powerful electric ring fence a long time ago." They envisage the electric ring fence as literally crackling and spitting with power, and immediately frying anyone who goes near. I had to persuade them that, actually, it is about ring-fencing banks and that it will be structural and long term, rather than a quick punishment.

The Commission raised the question of what happens as the years go by and the bankers' lobbying becomes powerful: "Look, this is really damaging our chances of competing. It is not fair in the international market. The restriction here goes a bit too far, and we should leave it a little bit." Or "We should be allowed to do this, but we are not currently allowed to do so." We might end up slowly creeping back and moving the nice, powerful electric ring fence back a bit too far, thereby allowing too many things back in. We must be careful that we do not accidentally let that drift as the years go by and that we do not end up with a level of risk that is too high.

Alok Sharma (Reading West) (Con): I understand my hon. Friend's argument on ring-fencing, but the fundamental question is whether he believes that, as a result of this legislation and the ring-fencing that it will put in place, we will never have another banking crisis.

Nigel Mills: Someone would have to be very foolish to make such a prediction. Many people made such predictions in the past because they thought that things cannot change enough for a crisis to happen, but that is clearly not the case. I am not sure of the logic of my hon. Friend's argument, because if we are saying that somehow there will be a banking crisis at some point in the future, that does not mean that we cannot have a ring fence or that we should just go for separation to ensure that all the ordinary retail, depositing and small business trading—all the things that we do need—can never be taken down by the riskiest forms of banking. I am not sure that is the right conclusion, or the one reached by the great minds that have thought about this.

The question I am posing on ring-fencing is whether the balance of powers in the Bill means that either this Government or a Government in 10 or 15 years' time can change the boundaries of what is excluded, or of what is core, in a way that might end up with the ring fence not being in the place that we now think it should be. I am sure that if a Government ever did that, it would be done for the right motive.

David Wright (Telford) (Lab): I find myself in broad agreement with the hon. Gentleman. One of the key points from our debate earlier in the week is that that is why the review process is so important. It is important to have timely reviews of the scope of the ring fence, and of where it is going to sit, because the business and the scope of the business change so rapidly.

I do not expect the hon. Gentleman to say that he agrees with me, but I hope the Minister hears what I am saying. The scale, scope and timing of a review are crucial. The Opposition are not pressing that for no reason; we are pressing it for the very reasons the hon. Gentleman is setting out.

Nigel Mills: I agree with the hon. Gentleman. I read the Commission's review, and I can see the logic for all those arguments. We have to find the right drafting for the right powers to make the process work. That challenge is probably beyond us mere Back Benchers. Reading through the clause, there are occasions where we think, "Why on earth are we doing that?" or "Why is it written in this way?"

We do not want to see ordinary depositors' money, which they think is relatively low risk, being used again to fund risky casino activities, especially where those deposits are guaranteed by the taxpayer. We certainly do not wish to see that happening overseas with the UK taxpayer somehow ending up being the back-stop for things that are not even happening within our regime.

Proposed new section 142E will allow the Treasury to choose to prohibit a ring-fenced bank from

"establishing or maintaining a branch in a specified country or territory".

It is interesting that the Treasury may choose to do that, because I wonder why we are not being a bit stronger. Do we really want to end up guaranteeing deposits that are being used for risky activity in Jersey, Guernsey or the Isle of Man, or in some random other strange institution that is not really engaging in normal retail banking? I suspect that most of what happens in those territories is good commercial activity, and some of them may have been more robust in their regulation than we were, but I wonder whether, with matters such as that, we should be stronger and say that, actually, a UK-registered bank cannot set up a branch in these random offshore territories and risk that activity being underwritten by the UK taxpayer if they are engaging in such strange activities.

Jacob Rees-Mogg: That raises the obvious question of whether, under European Union law, the Treasury would be able to ban a branch being opened in a fellow EU member state, which immediately brings Cyprus to mind.

Nigel Mills: Absolutely. My hon. Friend may have left this morning before I raised a question with the Minister on whether an aspect relating to another part of the Bill applied outside the EEA or everywhere overseas. That is an important point: we do not want UK taxpayers' money accidently guaranteeing Cypriot banks, Irish banks or whoever might be in some sort of chaos.

I make these comments in the spirit that that I have been persuaded by greater minds than my own that ring-fencing is the best answer in the long run for the UK economy. I just want to make sure that we are not putting the ring fence in the right place now, but with the risk of it creeping along. On Tuesday, we had a long debate on where small new entrant banks would not have to apply the ring fence. I can see the great advantage of getting more competition into the market—we clearly need that—but I am not sure about the logic that says we are trying to stop innocent people putting deposits in banks, which is used for riskier things than we ever thought it would be and that leads to some sort of crisis. Where is the logic in saying that small new entrant banks that do not have the same size and, therefore, the same resistance to risk, should be allowed to do some of those things that we think are too risky for the large banks? I am not convinced by that but it is for greater minds than mine.

I will not vote against the clause because I am convinced that it is the right answer, but we need to keep a watching brief over the years to make sure that a nice, powerful, sizzling, crackling ring fence that fries people who try to get out of it does not end up being too far away from where we thought it ought to be.

Greg Clark: We have had a lurid and evocative description of the purpose of the ring fence that goes beyond even what the Parliamentary Commission had in mind in terms of the electrification. I am certain that the Chairman of that commission will be reading and attending with interest the proceedings of this Committee; I only hope that my hon. Friend has not given him ideas for amendments on Report.

Let me respond to the comments made in the debate on the clause, which, as members of the Committee have said, is at the heart of the Bill. It establishes the ring fence that the Independent Commission on Banking recommended by inserting these important and extensive new sections into FSMA. I will not go through the whole clause, but I will address the points on which comments were made.

First, I remind the Committee that of all the problems in our banking system that require solutions, ring-fencing is not the answer to them all, nor is it intended to be. The Vickers Commission, in its report, made a whole set of recommendations, some of which are included in the Bill in ring-fencing, but some of which are not. My hon. Friend the Member for North East Somerset referred to various ticks in boxes that Vickers had given. That references a useful table on page 31 of the report in which Sir John and his commission deal directly with the question as to whether the ring-fencing proposals, and indeed all the other proposals, would have prevented some of the notorious failures of the past. From looking at the ticks in that table, it is clear that ring-fencing would have made a variable contribution: it would have been at its strongest in the case of the RBS failure, but it would have had the most limited impact in the case of Northern Rock.

So let us not regard ring-fencing as a panacea. It requires the different measures that we are introducing in other pieces of legislation and, indeed the regulator's discretion. It is, nevertheless, an important provision. It is one of the central recommendations of the report, so, quite naturally, some of the questions about the exemptions and exclusions from ring-fencing are apposite and relevant.

3.30 pm

Let me deal first with the questions of the hon. Member for Nottingham East about the exclusion of high net worth individuals and others. It is perfectly possible for high net worth individuals to maintain their deposits within a ring-fenced body. It is a matter of choice that is proposed to be given to them—if they meet the tests that I will go on to discuss—to be able to maintain deposits outside the ring fence. They are not being pushed into a risky situation or a set of risky arrangements for their deposits; it is a question of active choice.

It was curious to hear the hon. Gentleman's concern as to the rapaciousness of some of the firms he mentioned. J.P. Morgan came to mind and I do not know whether the involvement of Tony Blair adds to his ire against that particular institution. Perhaps it is part of the continuing dispute there.

The proposal is for high net worth individuals, so why might they choose to bank outside a ring-fenced body? Well, the hon. Gentleman is concerned on their behalf that they might be exposed to risk and that they may lose their savings. However, it is in the nature of investments that have higher prospective returns that they will take on higher risk. We should not be banning that. We should at least ensure that those individuals who are sophisticated and capable of making such decisions do so openly and on the basis of clear intentions.

Jacob Rees-Mogg: To help me understand exactly how the ring fence would work, is the reason for allowing high net worth people outside the ring fence because all deposits in a ring-fenced bank will be guaranteed by the Government? That seems to underlie the principle of the ring fence, but I was not aware that that was Government policy.

Greg Clark: No. The protection on deposits is for the first £85,000, which is insulated, as we discussed under clause 1, from various activities that might put at risk those deposits. In return for higher prospective yields outside, some of the activities that the banks may engage in would put high net worth individuals' funds at greater risk than if they were in the ring-fenced bank. Of course, the Vickers Commission itself explicitly proposed that there should be an exemption for high net worth individuals and the Parliamentary Commission also proposed such a definition. In common with the Bill's other aspects, this particular exemption will be defined in secondary legislation and debated in the House, which is consistent with the Bill's purpose. The Bill sets out the architecture, which is that there will be ring-fenced banks and the possibility for exemptions.

We have published a draft statutory instrument, to which the hon. Member for Nottingham East referred, and we will be consulting over the summer as to the definition of high net worth individuals. Our proposal, which reflects some of the Commission's discussions, is that a high net worth individual will be someone with between £250,000 or £750,000 of free and investable assets. That definition coheres with other uses of the term "high net worth individual", such as in conduct issues, where it is assumed that people of a certain level of assets have the sophistication to make decisions for themselves. Those assets do not include housing assets, for example. They are cash, liquid securities and so on. That proposal is a matter for consultation.

Chris Leslie: Will the Minister confirm that he is not proposing an upper limit? Is he saying that the starting limit would be between £250,000 and £750,000?

Greg Clark: The hon. Gentleman is right. It is a question of where the limit starts; so it is everyone above that level. We anticipate that we will restrict that definition to capture the wealthiest 1% of the population.

Chris Leslie: I am grateful to the Minister for bearing with me. Do the Government intend that an individual with those free assets—they might be, for example, a windfall or life savings—would have to prove that they had received independent financial advice, and be certified as having done so, before they signed the waiver and entered the non-ring-fenced environment?

Greg Clark: That is one of the matters on which we will consult, and the regulator will have the power to direct it. We discussed this in an earlier clause. The rules that the regulator will be empowered to make will describe how an individual could demonstrate to a bank's satisfaction that they met the criteria. We are likely to propose in the consultation that there should be a certificate signed off by a chartered accountant, so it would not be advice per se but it would be certified by an independent, qualified person. That will be a matter for consultation, and people might have different views on it.

Small and medium-sized enterprises' deposits must be in the ring-fence, but such deposits are not investments. They are there to support the continuity objective, and they are essential to ensure that services continue to be provided. SMEs that want to speculate are free to go and buy shares, and to make investments using their funds. It is important to return to the definition that we propose to make using the powers, namely, that individuals' and SMEs' deposits and overdraft facilities will be covered by the measure.

Chris Leslie: That is a helpful clarification, but many SMEs will have quite a lot of cash-flow management and might accumulate considerable reserves compared to ordinary individuals—not necessarily compared to the size of their business—so they may want to seek a higher rate of return, even for overnight deposits. Will they also be required to sign a waiver to indicate that they understand that there might be a threat if they bank in a non-ring-fenced body?

Greg Clark: In the case of SMEs, our proposed definitions follow on from definitions of SMEs in other areas. As with an individual, if an SME's deposits are below the threshold, it would be required to hold them in a ring-fenced bank. Large firms would have to certify that they were above that limit. That applies in other regulations dealing, for example, with reporting standards.

Chris Leslie: What limit is envisaged? We know the definition of a high net worth individual, but what is the equivalent for a business? Are we talking about a small firm that has £500,000 of capacity? That would be equivalent, probably, to a company of around 15 employees. What sort of level are we talking about for the size of a small firm?

Greg Clark: There is a race to provide me with inspiration. We propose that the definition will be aligned with other legislation that affects the distinction between small and large SMEs. In the Companies Act 2006, a large company is defined as having more than 50 employees, a turnover greater than £6.5 million or a balance sheet greater than, curiously, £3.26 million. That is the proposal: that we should follow the standard practice in company law. Part of the consultation will be to ask whether there is any reason not to follow that approach.

We have had a brief discussion and I made mention, with regard to the Vickers report, of the different solutions and tools available to the regulatory authorities, other than ring-fencing, to deal with the problems that might arise in non-ring-fenced banks. The resolution authorities are responsible for scenario planning for failures across the different institutions. The responsibilities of the new Prudential Regulation Authority, for example, do not extend just to ring-fenced banks; the resilience of the financial system generally is the responsibility of the regulatory authorities, and they must be satisfied that arrangements are in place that will not bring contagion to the rest of the financial system. The PRA monitors those matters as part of its responsibility and reports to Parliament annually on that.

On pension arrangements, the principle is to ensure that the ring-fenced bank cannot be dragged down by a failing non-ring-fenced bank through a last man standing liability for whatever pension arrangements are there. The proposed arrangements give powers to the regulators to monitor the pension situation. That obviously differs greatly from institution to institution, so it is right that the regulator should have bespoke powers to assess what the risk should be. It is not possible—nor is it, I think, desirable—to capture very strictly defined criteria in the Bill; we need the flexibility to make the judgment as to whether the prospective pension liabilities would be a risk for the ring-fenced bank.

I made mention of the further suggestions that the Vickers report made of other remedies for loss of resilience in the banking system, including, for example, bail-in, depositor preference and higher capital requirements.

Whether my hon. Friend the Member for North East Somerset tweets or not, I have always regarded him as inimitable. I have not seen the Jacob Rees-Mogg tribute act, but I cannot imagine that it is a patch on the real thing. He raised some important points. He is right to put on the record the importance of perspective. Ring-fencing is not a panacea; it is part of a suite of remedies, and we should not look to ring-fencing per se as the answer to all of the problems in banking. He is also right to raise the other side of the equation, in terms of the cost, ultimately, to the customers of banks—our constituents—and of their access to services. We need to consider that. At various times in our debates on the measures in clause 4 and on earlier measures—the de minimis exemption for smaller banks, for example, or the proposal for a required sibling structure—we have been careful to avoid provisions that would add cost for no particular benefit or advantage, so that we do not produce a system that is blind to the potential costs.

It is fair to say, however, that, in terms of the cost of capital, one of the problems we have had in the non-ring-fenced banking world to date is the use of the deposits of individuals and small businesses for pretty lucrative prospective purposes in very risky areas of activity,

which deprived mortgage lenders and lenders to small businesses of access to funds that they might have usefully deployed for the benefit of our constituents. The linkage between the investment arms and retail arms of the banks may well have been to the detriment of the prospective lenders in the retail side. The Independent Commission on Banking and the Parliamentary Commission have noted the potential for cross-subsidy, and ring-fencing is partly about giving us an opportunity to deal with that.

3.45 pm

Jacob Rees-Mogg: I am grateful for my right hon. Friend's considered response, but I would just raise a question on that issue. It seems to me that the crisis was effected by a large amount of wholesale money being cheaply available. That is why the banks that got into trouble—I think particularly of Northern Rock, HBOS, and RBS—had very high loan to deposit ratios. They funded the excess loans that they were making through the wholesale market and through the very low rates that were being charged, at a premium to base rate, for overnight money. That was not really the retail side of it—they were not using their retail deposits so much, because they were actually short of retail deposits.

Greg Clark: My hon. Friend is right, and he gives a good example of why ring-fencing is not the solution to every problem that has been encountered. However, in future, the restriction on using the funds of small depositors for more risky activities will provide safeguards, which will be important. It is also relevant that part of the problem that we encountered was a misalignment of incentives. Sometimes the individuals who were responsible for particular lines of activity were rewarded and encouraged to act in a way that was not in their shareholders' interests, and less in the interests of customers. Again, the changes that are being made can be important in addressing that.

We have talked about some other changes that Vickers recommends. An impact assessment has been conducted, as they always are for such measures. I am always cautious about impact assessments. It is sometimes difficult to specify with precision what the impact will be of something that will require—and is designed to provoke—behavioural changes that have not yet happened, but the best estimate that we have been able to make is that the cost of the measures in the Bill to banks will be something between £2 billion and £5 billion a year. Compared with the assets of the banks of £5 trillion, that is at most a fraction of a percentage point. It is unlikely, in all reasonable circumstances, to have a material impact on the cost of capital.

On other groups and banks within the ring fence, it is worth reminding ourselves that the point of the reform is not to prevent banks from failing, but to ensure that if they do fail, they do so in a way that does not breach the continuity objective that has been set up. The aim of the policy is to allow banks to fail—we hope that they will not, but if they do—in a way that does not compromise the continuity of the system and taxpayers' funds.

I turn to some other points that have been made. My hon. Friend the Member for North East Somerset asked about the sophistication of products that might be available to be sold within the ring fence. That discussion is very much alive. We have debated it initially in the Committee, and we will debate it further. It is one of the relatively few issues on which the opinion between the ICB, the Government and the Parliamentary Commission has not been entirely settled. The risks are very clear, but, as he eloquently advanced, there are advantages in a bank offering its small business customers the ability to protect some of their sales, perhaps in foreign currencies, against some of the prospective losses that might be incurred. That is reasonable, and it is the approach that we have reflected in the Bill, rather than a total abhorrence of any kind of hedging products.

The hon. Member for Cardiff South and Penarth asked for a definition of "independent" with regard to directors. We will probably have a fuller discussion on that when we leave this clause, but I can tell him that "independent" in this context has the same definition as it does in the UK combined code on corporate governance. It is a sound definition. It requires that a director should not be thought of as independent if he or she:

"has been an employee of the company or group within the last five years; has, or has had within the last three years, a material business relationship with the company either directly, or as a…shareholder;…has received or receives additional remuneration from the company apart from a director's fee".

Various conditions are set out, which are reflected and respected in the group.

To my hon. Friend's points about the potential for erosion and the alternative to the electrocution of bankers, rather than the electrification of the ring fence—a different policy—I say that, as we have already discussed, we are putting a clear requirement on the regulator to reinforce the ring fence. There are tough tests before anything that is prohibited can be allowed. The annual reporting required of the Prudential Regulation Authority is in the Bill, and we have taken the opportunity to make it a duty of directors to respect the ring fence. All those things provide a degree of electrification before we even get to the new power for firm and specific separation, which will be introduced on Report. It is worth noting that the Glass-Steagall Act had none of those provisions and reinforcements. We have considered the issue, as have the the Independent Commission on Banking and the Parliamentary Commission.

My hon. Friend asked whether the Government propose to prohibit branches of banks outside the EEA. It will require the permission of the PRA, and one of the draft statutory instruments requires the PRA to be very strict in approving a non-EEA branch. In particular, it needs to be satisfied that such a branch would not put the continuity objective at risk. Under EU law, maintaining branches in EU countries cannot be banned, but there are safeguards; for example, credit institutions require us to operate through the home authorities—the other regulators—in the EU as well, so there is a degree of supervisory consistency across the EU.

Nigel Mills: Is the Minister saying that the Treasury plans to prohibit the setting up of branches in certain territories unless certain key requirements are met?

Greg Clark: Yes. That ability will be provided. The PRA will have to be convinced that it would not be a risk to the UK financial system and its stability.

[Greg Clark]

To conclude, clause 4 is the heart of the Bill. Through its various provisions, it establishes a comprehensive and principled approach to the structural reform that our banking sector needs.

Question put and agreed to.

Clause 4, as amended, accordingly ordered to stand part of the Bill.

Clause 5

Directors of ring-fenced bodies to be approved persons

Chris Leslie: I beg to move amendment 10, in clause 5, page 13, line 36, at end insert—

'(7D) In relation to the directors of a ring-fenced body, the following arrangements shall apply—

(a) Half of the board of directors of the ring-fenced body, both executive and non-executive, will be made up of independent persons.

(b) In this section an "independent person" means a person who—

(i) has not been an employee of the group within the previous five years;

(ii) does not have a material business relationship with the group and has not had one within the previous three years, including an indirect relationship as a partner, director, senior employee or shareholder or an adviser or major customer or supplier;

(iii) does not receive remuneration from the group, other than remuneration in their capacity as an independent person, does not participate in the group's share option or performance-related pay schemes and is not a member of the pension scheme;

(iv) does not have close family ties with any of the company's advisers, directors or senior employees;

(v) does not hold cross-directorships or have significant links with other directors through involvement in other companies or bodies;

(vi) does not represent a significant shareholder; and

(vii) has not served on the board of any body in the group for more than nine years.

(c) The board of directors of the ring-fenced body, both executive and non-executive, will have no formal, business or family relationship with the directors of the rest of the group, other than by virtue of their appointment to the same group.

(d) The primary objective of the board of directors of the ring-fenced body, both executive and non-executive, shall be on the performance and functions of the ring-fenced body and they will have no responsibility for the performance and functions of the remainder of group.

(e) All directors of the ring-fenced body shall have a duty to preserve the integrity of the ring-fence between the group and its subsidiary.'.

Clause 5 relates to other issues associated with the strength of the ring fence. The hon. Member for Amber Valley has taken us into the new territory of the electrocution of bankers, and it all depends on whether you attach the leads to their derivatives.

Here, we are talking about how we can reinforce the ring fence by ensuring that the directors—the people controlling the banks—are independent. The clause sets out another change to the Financial Services and Markets Act 2000 that would ensure that the function of acting as a director of a ring-fenced body is a significant influencing function and must be specified as a controlled function. We will come to those issues if we have a stand part debate.

We are considering an amendment to introduce at the end of the clause a principle, as described in proposed new section 59(7D) of FSMA, that half the board of directors of a ring-fenced body, whether executive or non-executive, must be made up of independent people. That is an important principle because it is a safeguard to protect the integrity of the ring fence. We are slightly surprised that the Government have not yet shown willingness to embrace that notion. On the previous clause, we talked a little about what we mean by "independent", and I welcome the Minister's acceptance that we should be guided by the UK corporate governance code set by the Financial Reporting Council. We suggest that the ratio of 50% should be applied to all directors, whether executive or non-executive.

We have discussed in another context ways of using corporate governance arrangements to ensure that the ring-fenced bank has a degree of independence. We still think it important to look at the relationship between retail and investment, and to have a sibling structure—that is something the Parliamentary Commission felt strongly about—rather than a parent-child relationship. Another way of ensuring that is to make sure that there is a sufficiency of directors who are not dependent on the investment banking arm or a parent company arrangement.

We know that elsewhere in the Bill—perhaps the Minister can remind me where it is—directors are supposed to be given an explicit duty to protect the ring fence. That is an important duty, although I wonder how it can be enforced in practice. Perhaps we can discuss that at another time. We hope that the directors who are given that duty will have sole responsibility to the ring-fenced bank and not to the performance of the group as a whole.

As we know, the lack of scrutiny and challenge of senior executives in some of the banks was at the heart of events that led to the financial crisis—for example, the lack of challenge to the then chief executive of RBS, which included problems not just in the executive team but with non-executive directors. In its 2011 report into the failure of RBS, the FSA said that if a review had been commissioned at the time as first intended, it

"would have sent a strong message to RBS, including its board, and might have provided the FSA with more information on the effectiveness of governance, particularly around the potential dominance of the chief executive".

In another context, one of the whistleblowers at HBOS, Paul Moore, the head of group regulatory risk between 2002 and 2004, said that his experience of non-executive directors

"on risk committees is that they were generally inadequate. As a rule, they did not have technical expertise in risk management, audit, assurance, oversight."

Lord McFall, the former head of the Treasury Committee, said:

"We were shocked when we discovered many non-executive directors were holding not only senior full-time jobs but also multiple non-executive directorships, as well as other roles. This simply cannot have given them the time to conduct proper oversight. Too often seemingly eminent and highly-regarded individuals failed to act as an effective check on, and challenge to, executive managers, instead operating as members of a 'cosy club.'"

Our amendment would help to strengthen the ring fence, given the day-to-day pressures of the larger financial group in which directors might find themselves, and it would ensure that the independent directors were able to live up to that role.

4 pm

The Minister indicated that there is a definition of "independence" set out in the UK corporate governance code, and we have sought to pick up many of those aspects in the amendment by suggesting that an "independent person" means a person who

"has not been an employee of the group within the previous five years; does not have a material business relationship with the group and has not had one within the previous three years, including an indirect relationship as a partner, director, senior employee or shareholder or an adviser or major customer or supplier…does not receive remuneration from the group, other than remuneration in their capacity as an independent person, does not participate in the group's share option or performance-related pay schemes and is not a member of the pension scheme",

and also, because these things sometimes need to be said, a person who—

"does not have close family ties with any of the company's advisers, directors or senior employees…does not hold cross-directorships or have significant links with other directors through involvement in other companies or bodies…does not represent a significant shareholder; and…has not served on the board of any body in the group for more than nine years."

Those are sturdy safeguards in how the UK corporate governance code ought to define this matter. It would be useful if, rather than just talking about concepts of independence, the Minister could find an opportunity to enshrine those concepts in the Bill. I would be grateful if he would consider the concept of having a proportion of directors who satisfy that definition.

We tabled the amendment to probe Government thinking on the matter; I am sure that that is fairly self-explanatory. I would be grateful if the Minister would respond.

Greg Clark: I am grateful for the opportunity to talk about the composition of boards, because it is important, and the hon. Gentleman is right in his desire to probe the Government's intentions on that. It is extremely important that the board of the ring-fenced body should maintain its independence from the group; in fact, the Government's intention is to go further than is proposed in his amendment.

The hon. Gentleman will recall that in the White Paper produced in June 2012, the Government's view, which remains our view, was that it would be appropriate that at least half of the ring-fenced bank's board should be independent. That remains our intention, so one problem with the amendment is that it specifies that the proportion should be 50% when, in fact, it seems to us that it is desirable that it should be greater than that. We have no problem at all with the definition of independence in the corporate governance code, as that is also our view of what constitutes being independent. We have no difficulty with that.

Let me explain the approach that the Government have been minded to take; then I will happily consider the views of Members about whether it is the best approach. We have established the principle that there should be separation. We discussed the Haldane principles in the debates on clause 4, which places an obligation on the PRA to maintain those principles as part of its practice and regulatory duties. Governance is one of those principles. The essence of that approach is to empower the regulator and require it to do that, rather than to specify the matter in primary legislation. That is for a number of reasons, one of which has been illustrated through the question of whether 50% is the right number. It seems to us and to the regulator that the right number may be variable.

Suppose that a ring-fenced body constituted the vast majority of a group's assets. It might be better for the regulator to be able to calibrate what the cross-governance requirements were. If a tiny part of the group was outside the ring fence, it might be appropriate not only to permit but to require higher participation on the group board by the ring-fenced bank. The specification of exactly half might not be quite right.

There is also some difficulty in the transposition of the code's requirement that the directors should not have any business relationship with or responsibility to the rest of the group. That could weaken the ability of the ring-fenced bank to be heard on the main board of the group. Although the principles of the code are clear, we need to give the regulator the ability to go beyond those requirements in some cases. Of course, the PRA would have to have good prudential reasons to insist that a senior member of the ring-fenced bank be on the main board of the group. Strict separation could undermine the ICB's objective that one of the benefits of ring-fencing is to enable a group to operate as a group. The proposals for the composition of boards are designed to capture that balance.

The Financial Reporting Council, in considering the recommendations, has expressed concern in evidence to the PCBS that the regulator should be able to make the right judgment as to what constitutes true independence according to the Haldane principles. The Government's approach is to agree with the recommendations that have been made and the spirit of the hon. Member for Nottingham East's amendment.

So far we have been persuaded, not least by the views of experts such as those on the Financial Reporting Council and the regulator, that we need regulatory flexibility to be used in the right way. I therefore do not think that the amendment, which the hon. Gentleman said was a probing amendment, would help. I think it would take us backwards.

This is a matter of great interest and importance. Throughout the parliamentary scrutiny it, if there are any ways in which a strengthening or a clarification would be advantageous, the Government will consider it.

Chris Leslie: I am feeling quite cheery now. It makes me optimistic to think that had I tweaked the amendment slightly and considered some of the smaller issues about the relationship between the group and the ring-fenced body, we might have had another concession on our hands. I almost want to tell the Minister not to table a Government amendment—let us make those changes, and we will table them on Report so that we can show the whole House how magnanimous he can be.

It is helpful that the Minister has said that he agrees with our corporate governance code as the basis for many of the definitions. It is also quite useful that the Government have talked about using the corporate governance method as a way of bolstering the independence

[Chris Leslie]

of the ring-fenced body from the parent company or the investment bank. We are not far apart on that issue. That is helpful, and we will take the Minister's points away to think further about them. I look forward to consensus breaking out on Report, if only on this narrow issue. I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Question proposed, That the clause stand part of the Bill.

Chris Leslie: Clause 5 amends section 59 of the Financial Services and Markets Act 2000 to ensure that directors of ring-fenced bodies, or people with an equivalent management role in ring-fenced firms with no board of directors, should be approved persons and exercise a control function. It is sensible that all retail bank directors have to be approved persons, but will the Minister explain why the requirement is not being extended to directors of non-ring-fenced banks? I would have thought that it was important that all bank directors, whether of investment or retail banks, should fall under the disciplinary capabilities of the regulators. I had assumed that that was already the case, but it is clearly not. What possible reasons can there be for not ensuring that all directors of all banks are deemed approved persons?

The clause also extends the current system of supervision of bank directors to the people running ring-fenced operations under the new twin peaks regulatory system created by FSMA. Obviously, the PRA will be the body responsible for authorising senior staff. Will the Minister explain which ring-fenced bodies will not have a board of directors? If hon. Members look at line 30 on page 13 of the Bill, they will see that there is an interesting little section in parentheses:

"the function of acting as a director (or, where the ring-fenced body does not have a board of directors, as a member of its equivalent management body)".

Will the Minister explain exactly what that means and how he expects the equivalent management body to operate under these particular reforms? I was wondering which banks do not have boards of directors in that way.

Will the Minister update the Committee on the transfer of records and all relevant data relating to authorised persons from the FSA to the PRA? The PRA is being created over the next 10 days or so, so we are seeing a lot of data and information migrating from the existing FSA to the lovely shiny new offices right next to the Bank of England on Moorgate under the auspices of the PRA. We would not want any pieces of paper to go astray in that move, and we want to see data and records transferred properly, so I hope that the Minister can assure us that everything is going smoothly.

Generally speaking, clause 5 contains a reasonable change, but it could do with the amendment about the independence of directors just to flesh it out some more. I would be grateful if the Minister can help us by responding to my queries.

Greg Clark: Let me first make a few remarks about the purpose of the important clause 5. As I think I made clear in the debate on the amendment, if we hear helpful suggestions throughout the life of the Committee and the House's scrutiny, we are happy to go further.

The regulator and the Government have a crucial role to play in upholding and enforcing the ring fence, but we agree with the Parliamentary Commission on Banking Standards and the ICB that the ring fence needs to be upheld from within the ring-fenced bodies themselves. The ICB's final report said:

"It is difficult for regulations to work effectively if they are operating against the grain of corporate culture."

The requirements on directors in this part of the Bill are therefore important. The clause ensures that the directors of ring-fenced banks will always be under a personal duty to uphold the ring fence. If a director is knowingly complicit in a breach by the ring-fenced bank of any of the ring-fencing requirements, the regulator will be able to take enforcement action against that director. That is part of giving ring-fenced banks truly independent governance, which is an essential part of ensuring that the culture of ring-fenced banks works alongside the regulator's other powers.

4.15 pm

Directors of ring-fenced banks will always have to be approved persons under either the PRA or the FCA regime, which means that the regulator may use a suite of powers, including unlimited fines, suspension of approvals, limitations on how a director may act in relation to a ring-fenced bank and published statements of a director's misconduct. That is an effective way in which the regulator can make its powers felt.

Our approach is consistent with the strengthening of the powers of the conduct and prevention regulators. The provisions establish requirements for ring-fenced banks in particular, but the hon. Member for Nottingham East makes a reasonable point on possibly requiring directors of non-ring-fenced banks to be approved persons. On Report, we will consider whether there is advantage in extending some of the provisions.

For a ring-fenced bank or ring-fenced body not to have a board would be a slightly curious circumstance, and I cannot think that it is either likely or possible, but it is a piece of future-proofing.

Jacob Rees-Mogg: It occurs to me that someone could set up a limited liability partnership, which would not have a board.

Greg Clark: My hon. Friend is absolutely right. We still think it is unlikely that a bank would operate under such a structure, but it is theoretically possible, subject to the necessary approvals. We do not envisage that, or expect it to happen, but we feel it is important to make a contingency in this clause.

Nick Smith: I am pleased that the Minister accepted the spirit of our proposed amendment and that more than half the directors will be independent. In his introduction he used the phrase "approved persons," but does he have a definition in mind?

Greg Clark: I fear that there is an extensive definition of "approved persons" in FSMA. The phrase has a certain meaning in everyday life, but in the context of financial services it has a definition so extensive that I will send it to the hon. Gentleman so that he may consider it before we next meet. Needless to say, although

the definition respects the spirit of everyday use, it is defined technically to give the regulator powers over the individual so that only approved persons can participate at various levels of responsibility in a bank. That ensures that the regulator can bite, as it were, on individuals as well as on companies. I will furnish him with the pages of definition from FSMA, which has probably been amended by subsequent Acts of Parliament.

The Chair: The question is—

Chris Leslie: I beg your pardon, Mr Hood, but I was in the mindset of debating an amendment and I entirely forgot that the Minister's speech was the final word on the matter. I ought to have sought to intervene on him—

The Chair: Order. The hon. Gentleman is absolutely right. He should have intervened before the Minister sat down, but, on this occasion, I will ask the Minister whether he is prepared to accept a belated intervention.

Greg Clark: It is clearly the case that I sat down while I was continuing to speak, for some unaccountable reason. I am happy to give way to the hon. Gentleman.

Chris Leslie: I am grateful to the Minister for giving way, and I apologise for missing that moment. The fact that he could not think of reasons why all bank directors should not be approved persons was helpful, because I could not think of any either. I hope that we can tackle that issue on Report, as he seemed to indicate. We would like to give notice that we intend to do something about the matter at that point.

Greg Clark: I will finish my remarks. The hon. Gentleman is right to say that it seems logical and sensible for bank directors to be approved persons. We will consult the regulator, and if there are reasons why an absolute requirement is inappropriate, I will make sure that we are aware of that before Report.

Question put and agreed to.

Clause 5 accordingly ordered to stand part of the Bill.

Clause 6

PRA ANNUAL REPORT

Chris Leslie: I beg to move amendment 25, in clause 6, page 14, line 7, at end insert—

'() the nature and extent of the dealings by ring-fenced bodies in derivative products (including options, futures, contracts for differences and similar products);'.

The Chair: With this it will be convenient to discuss amendment 27, in clause 6, page 14, line 7, at end insert 'and

() developments affecting the appropriateness of the amount for the time being specified for the purposes of any exemption under section 142A(2)(b) for UK institutions holding deposits below that specified amount.'.

Chris Leslie: Clause 6 deals with the requirement on the PRA, which comes into existence in only a few days' time, to produce an annual report on how ring-fenced banks comply with the ring-fencing provisions. Although the Opposition agree that the clause is important and necessary, we do not think it is sufficient for keeping track of whether ring-fencing is working. We made suggestions about independent reviews in a parliamentary context when debating amendments to clause 4.

Clause 6 sets out what the PRA's annual reports should contain, including

"the extent to which, in its opinion, ring-fenced bodies have complied with the ring-fencing provisions,"

whether ring-fenced bodies have taken steps to comply, whether there has been any enforcement activity, and the extent to which it has been necessary to give guidance to ring-fenced banks. Those are all self-evident.

The amendments are inspired by the PCBS. Amendment 25 would ensure that the PRA reports describe the "nature and extent" of the activities undertaken by retail banks in the field of derivatives. That is an important safeguard, following the careful thought that the PCBS has given to the extent to which derivatives activities should be allowed within the ring fence. The hon. Member for North East Somerset made a helpful contribution to the Committee about anecdotal circumstances on the margins, where what might appear to be the normal banking activities of ordinary retail customers might impinge on insurance or hedging requirements that may, in a limited way, be justifiable within a ring fence. We think, and the PCBS did as well, that the PRA must keep an eye on what is happening here. This recommendation is an adjunct to the PCBS's wider set of recommendations on derivatives.

Amendment 27 would ensure that the PRA reports on issues that might arise periodically and that might affect the view of whether exemptions from ring-fencing are still appropriate. We discussed earlier in our proceedings whether the de minimis exemptions, as they are known, were adequate. The Government have somewhat skirted around the issues that we have raised in the amendments, but it is important for Parliament's views to be taken into account and for regulators to be able to delve into the details and consistently probe the issues involved. Derivatives and future trading have evolved quite rapidly, as have volumes, worldwide, so it would be useful for the PRA to keep check on the banks' activities in those fields in its annual report. Some of the statistics in this area are quite scary, when we think of the scale involved: there are $300 trillion-worth of contracts for which LIBOR acts as a benchmark in terms of derivative activities, ranging from products related to mortgages and student loans to interest rate swaps. Indeed, the amount of money set aside by some of the universal banks for compensation for the mis-selling of interest rate swap products to small and medium-sized enterprises is already over £1 billion, and some derivatives experts believe that that figure may itself underestimate the eventual costs. Those factors are significant and can impact on the activities of retail banking.

A consistent requirement to monitor and comment on the latest developments would therefore be necessary and welcome. Given that there is still so much uncertainty about whether ring-fencing will provide adequate

[Chris Leslie]

protections, a commentary from the regulators about the validity of the exemptions process would also be very useful.

The Government seemed to say in their early reports that they accepted the principle that reviewing the de minimis exemption arrangements should be part and parcel of the PRA reporting process, and I would be grateful if the Minister could confirm whether my understanding is correct. However, there seems to be a little uncertainty about what exactly the Government expect to be in the PRA's reports. I hope that the Minister agrees that it would be better to be specific at this stage about the dimensions of what the PRA should be reporting on.

Greg Clark: Again, there is no great distance between the Government and the Opposition on this issue. We want the PRA to report annually, and we want that report to be broad in its scope. Two particular questions arise; they are questions about handling those issues, on which we can come to a view. Our approach is that the responsibility of the PRA in making its annual report should be broadly defined. It should be done not through a detailed checklist of required components, but through the broad categories that pertain to its work. That is what is in the Bill—the extent to which ring-fenced bodies have complied with provisions, the steps taken in order to comply with the provisions, questions of enforcement and so on.

Although there is nothing inherently objectionable in the inclusion of derivatives, for example, it raises the question whether other specific things should be included. That would take us in the direction of a different approach, which would be to specify in greater detail the exhaustive list of matters, or at least a minimum list of matters, that the PRA should review. That is not something that we favour. We have taken a broad approach, which gives the PRA the ability to report on a wide range of matters, but to prioritise in its report those matters that it considers to be the most important.

I do not think of this issue as a strict article of faith, and I am happy to consider the views of the House and of the other place, as the Bill progresses, as to whether ours is the right approach. We think it is right to empower the PRA in this way and to avoid missing things out.

There is a particular issue with regard to the de minimis exemption. We need to keep the de minimis threshold under review. That threshold must be appropriate, so that it fulfils its purpose. The regulator, of course, can have a role in reporting on circumstances that may be relevant to revision of that. But it is important that it is for the Government and for Parliament to decide how that de minimis threshold should be set.

4.30 pm

It is the PRA's job to ensure that the banks comply with the rules of the ring fence. The PRA's job, in this case, is to ensure that the de minimis threshold is applied properly. But decisions about which banks or activities are inside or outside the ring fence, including the de minimis threshold, are for the Government and Parliament to decide, not the regulator.

Amendment 27 would require the PRA to be drawn into judgments on the appropriate location of the ring fence and on which smaller banks would be exempt. That is not consistent with the approach that we have taken—that such matters should, now and in future, be a matter for Parliament rather than the regulator, so it is not consistent with the clear division of responsibilities that we are aiming for throughout this Bill.

I note the hon. Gentleman's approach, particularly in amendment 27, on including derivative products. It might be worth considering, between now and later stages of the Bill, whether a more exhaustive list could be considered, but at the moment we are not persuaded that this would add anything to the general powers that the PRA has to consider matters in its review, as expressed in the Bill.

Chris Leslie: On amendment 27, I can see the point that the Minister makes about whether the PRA reporting requirement on de minimis exemptions might stray into policy questions about where the ring fence should be located. I am not sure that that is a particularly strong reason not to have it as a specified requirement in the PRA report, but I accept that there are some issues to be worked through in that regard. It is worth thinking about those some more.

The Minister's arguments against amendment 25 were not particularly substantial. He knows well that the parliamentary commission feels strongly about further safeguards on derivatives. I do not regard it as an onerous safeguard simply to require specific extra reporting on the nature of extensive dealings in derivative products. It is a reasonable amendment that comes from the parliamentary commission.

Far be it from me to act as an agent for the parliamentary commission—perhaps one day I could aspire to be a co-optee to it—but I feel a sort of duty to stand up a little bit for the hard work that it has done over many months, advancing specific recommendations. It is a delight and a privilege that the only amendment accepted so far was one of our own home-grown versions, but the hon. Member for Chichester and other members of the PCBS might be slightly nonplussed if we went through the whole process without the Government's accepting, even on fairly small, reasonable issues, some amendments that it had taken time and trouble to draft.

I do not think it is enough of an excuse to say, "Oh well, we haven't taken a prescriptive list approach." Having been a Minister, I know that that is from the bran tub of reasons to reject amendments, with the big, black word "Resist" emboldened at the top of the Minister's pages—"I think that we can discard that one. It could have been done better." I am happy to give way to the Minister if, on reflection, he wants to accept the amendment.

The reason given is not good enough to stop amendment 25. Therefore I feel duty bound to test the Committee's view on the amendment, unless the Minister has changed his mind in response to my thoughts. He can see the point I am making about the PCBS wanting to try and make a little bit of progress, during the Committee stage. It is important to show willing, even on small issues such as this.

Greg Clark: Perhaps I may intervene. The provision concerns derivatives, and I said on Tuesday that we would expect the PRA to report factually on the experience of derivatives within the ring fence, so there is nothing substantial between us on that. We will expect that to be part of the annual report. However, it will be the only activity specified in the report.

Derivatives have clearly caused a problem in the past, and I dare say that other financial instruments and products may cause problems in future, so I would not want the PRA which, like the FCA, has been set up to look forward rather than backwards, to be anchored into looking at the causes of problems in the past. They need to be looked at, but that should not have primacy over its responsibility to scan the world of banking for problems with breaches of the ring fence or conduct. Having said that, derivatives are a live matter, and the Parliamentary Commission is making further recommendations. This will not be the last word on the matter. We will study what the Commission has to say, and if it makes a case for a particular exemption from the more general approach for derivatives, we will consider it very seriously.

Chris Leslie: That is useful, and I do not want to labour the amendment or to serve a contrary purpose so that the Minister sticks his heels further into the mud and resists it, but I do not think that he has given a good enough reason to resist it. I think the matter is important enough to specify it, and I feel honour-bound on behalf of the Parliamentary Commission to nudge him to consider a little more seriously in Committee some of the amendments that it has suggested. I am not persuaded to withdraw the amendment.

Question put, That the amendment be made.

The Committee divided: Ayes 6, Noes 8.

Division No. 5]

AYES

Ashworth, Jonathan	Jamieson, Cathy
Doughty, Stephen	Leslie, Chris
Durkan, Mark	Smith, Nick

NOES

Clark, rh Greg	Rees-Mogg, Jacob
Hands, Greg	Sharma, Alok
Mills, Nigel	Thornton, Mike
Mowat, David	Williams, Stephen

Question accordingly negatived.

Ordered, That further consideration be now adjourned.—*(Greg Hands.)*

4.38 pm

Adjourned till Tuesday 26 March at ten minutes past Nine o'clock.