

HOUSE OF LORDS

Delegated Powers and Regulatory Reform
Committee

8th Report of Session 2013–14

**Financial Services
(Banking Reform) Bill
(Clauses 1 to 5)**

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The Delegated Powers and Regulatory Reform Committee

The Committee is appointed by the House of Lords each session and has the following terms of reference:

- (i) To report whether the provisions of any bill inappropriately delegate legislative power, or whether they subject the exercise of legislative power to an inappropriate degree of parliamentary scrutiny;
- (ii) To report on documents and draft orders laid before Parliament under or by virtue of:
 - (a) sections 14 and 18 of the Legislative and Regulatory Reform Act 2006,
 - (b) section 7(2) or section 15 of the Localism Act 2011, or
 - (c) section 5E(2) of the Fire and Rescue Services Act 2004;and to perform, in respect of such draft orders, and in respect of subordinate provisions orders made or proposed to be made under the Regulatory Reform Act 2001, the functions performed in respect of other instruments and draft instruments by the Joint Committee on Statutory Instruments; and
- (iii) To report on documents and draft orders laid before Parliament under or by virtue of:
 - (a) section 85 of the Northern Ireland Act 1998,
 - (b) section 17 of the Local Government Act 1999,
 - (c) section 9 of the Local Government Act 2000,
 - (d) section 98 of the Local Government Act 2003, or
 - (e) section 102 of the Local Transport Act 2008.

Membership

The members of the Delegated Powers and Regulatory Reform Committee are:

Baroness Andrews
Baroness Gardner of Parkes
Baroness Farrington of Ribbleton
Baroness Fookes
Lord Haskel
Countess of Mar
Lord Marks of Henley-on-Thames
Rt Hon. Lord Mayhew of Twysden QC DL
Baroness O’Loan
Baroness Thomas of Winchester (Chairman)

Registered Interests

Committee Members’ registered interests may be examined in the online Register of Lords’ Interests at www.publications.parliament.uk/pa/ld/lldreg.htm. The Register may also be inspected in the Parliamentary Archives. Interests related to this Report are in the Appendix.

Publications

The Committee’s reports are published by the Stationery Office by Order of the House in hard copy and on the internet at www.parliament.uk/hldprcpublications.

General Information

General information about the House of Lords and its Committees, including guidance to witnesses, details of current inquiries and forthcoming meetings is on the internet at <http://www.parliament.uk/business/lords/>.

Contacts for the Delegated Powers and Regulatory Reform Committee

Any query about the Committee or its work should be directed to the Clerk of Delegated Legislation, Legislation Office, House of Lords, London, SW1A 0PW. The telephone number is 020 7219 3103 and the fax number is 020 7219 2571. The Committee’s email address is dpr@parliament.uk.

Historical Note

In February 1992, the Select Committee on the Committee work of the House, under the chairmanship of Earl Jellicoe, noted that “in recent years there has been considerable disquiet over the problem of wide and sometimes ill-defined order-making powers which give Ministers unlimited discretion” (Session 1991–92, HL Paper 35-I, paragraph 133). The Committee recommended the establishment of a delegated powers scrutiny committee which would, it suggested, “be well suited to the revising function of the House”. As a result, the Select Committee on the Scrutiny of Delegated Powers was appointed experimentally in the following session. It was established as a sessional committee from the beginning of Session 1994–95. The Committee also has responsibility for scrutinising legislative reform orders under the Legislative and Regulatory Reform Act 2006 and other acts specified in the Committee’s terms of reference.

Eighth Report

FINANCIAL SERVICES (BANKING REFORM) BILL

Introduction

1. This Bill had its Second Reading on 24 July, and is to begin its Committee Stage (on the floor of the House) on 8 October. The majority of the provision (clauses 1 to 8) in the Bill as brought from the Commons is concerned with separating (“ring-fencing”) retail banking activities (“core activities”) from wholesale and investment banking activities, and introducing more stringent regulation for ring-fenced bodies, and other companies in the same group, by the Financial Conduct Authority (“FCA”) and the Prudential Regulation Authority (“PRA”) for the purpose of protecting their ring-fenced activities.
2. Much of the provision now in the Bill previously appeared in a draft Bill which was examined in late 2012 and early 2013 by a joint committee of both Houses (the Parliamentary Commission on Banking Standards – “PCBS”), at whose request we provided a memorandum in November 2012 about delegations of legislative power in the draft Bill. The Bill when it arrived in this House had doubled in length since it was a draft Bill, and now includes some additional delegations of legislative power.
3. A memorandum was prepared for the Committee by the Treasury in July, explaining the delegated powers in the Bill and the associated arrangements for Parliamentary scrutiny.¹ We were pleased to note that the Government have given effect to most of the matters raised in our memorandum to the PCBS. But the Treasury’s memorandum did not deal with recommendations made by the PCBS in its First and Second Reports in Session 2012-13² that there should be an enhanced level of Parliamentary scrutiny over the exercise of certain powers conferred by the Bill. In response to a request made on our behalf, the Treasury submitted a supplementary memorandum in September explaining the Government’s response to these recommendations.³ We shall return to this aspect in paragraphs 11 to 22 below.
4. It had been our intention to consider, at our meeting on 2 October, the entire Bill as brought from the Commons and to make any recommendations to the House in this Report. But late on 1 October, the Government tabled some 98 pages of amendments for Committee Stage of the Bill, including amendments introducing entirely new categories of provision (for instance, an extensive new Schedule about a “Bail-in Stabilisation Option”) and some significant new delegated powers (in relation to which the Treasury has submitted two further supplementary memoranda). Because it would have been utterly impracticable for us to have given these proposed new provisions

¹ <http://www.parliament.uk/business/committees/committees-a-z/lords-select/delegated-powers-and-regulatory-reform-committee/bills-considered/>

² <http://www.publications.parliament.uk/pa/jt201213/jtselect/jtpcbs/98/9802.htm> and <http://www.publications.parliament.uk/pa/jt201213/jtselect/jtpcbs/126/12602.htm>

³ <http://www.parliament.uk/business/committees/committees-a-z/lords-select/delegated-powers-and-regulatory-reform-committee/bills-considered/>

the degree of attention they deserve at our meeting on 2 October, we decided to confine our consideration at that meeting to those provisions of the Bill that are expected to be reached at Committee Stage on 8 October.

5. Accordingly, we deal in this Report with clauses 1 to 5 of the Bill as brought from the Commons and any Government amendments to those provisions that significantly affect delegated powers conferred in them; and we shall deal in a subsequent report with powers conferred in the remainder of the Bill and in Government amendments likely to be reached only after 8 October.

Clause 4 – New Sections 142A to 142E of FSMA: “Ring-fenced Bodies”; “Core Activities”; “Core Services”; “Excluded Activities”; and Treasury Prohibitions

6. New section 142G of the Financial Services and Markets Act 2000 (“FSMA”) prevents a “ring-fenced body” from carrying on an “excluded activity”. Under new section 142A(1) a ring-fenced body is a UK institution which has a Part 4A permission (under FSMA) relating to a “core activity”. “Core activity” is explained in new section 142B.
7. There are three powers relevant to whether or not an institution is caught by the provisions relating to ring-fenced bodies:
 - New section 142A(2)(b) enables the Treasury to exempt classes of institutions by order.
 - New section 142B(2) enables an order by the Treasury to specify circumstances in which accepting deposits is not a core activity.
 - New section 142B(5) enables the Treasury to specify by order activities (in addition to accepting deposits) that are core activities.
8. Accordingly, under the Bill, institutions (other than building societies) that accept deposits will, unless the Treasury makes an order to the contrary, be caught; and institutions (other than building societies) carrying on any other activity that is a regulated activity under FSMA will be caught if the Treasury makes an order to that effect. Before making an order, the Treasury must have regard to certain matters (new section 142A(4)) and must have formed certain opinions stated in the Bill (new sections 142A(3) and 142B(3), (4) and (6)).
9. New sections 142C to 142E confer further powers on the Treasury by order:
 - To enable, and in one case to require, services to be specified as “core services” (being the services that are provided in the course of carrying on a “core activity”) – new section 142C(3) and (4).
 - To enable activities to be specified as not being, or as being, “excluded activities”. The regulated activity of dealing in investments as principal is an excluded activity under the Bill, except in so far as carried on in circumstances specified by the Treasury by order (new section 142D(2)); and other activities may be so specified as excluded activities, either generally or in specific circumstances (new section 142D(4)).
 - To enable certain actions (listed in new section 142E(1)) of ring-fenced bodies to be prohibited, subject to specified exemptions which may themselves be subject to specified conditions (see subsection (4)).

10. Although of considerable significance, we did not find any of the powers in new sections 142A to 142E to be an inappropriate delegation when we considered the draft Bill, and all of these sections remain in substantially the same form as they appeared in the draft Bill. At draft Bill stage, the powers required only the negative procedure, save in the case of the power conferred by new section 142A, which was to be affirmative on its first exercise. While we did not regard that as exceptionable in the case of the powers under new section 142C, we did recommend that an affirmative procedure should apply to the others. In fact, the present Bill now requires an affirmative procedure for all powers conferred by new sections 142A to 142E (see paragraphs 13, 19, 25, 32, 33, 39, 46 and 52 of the Treasury's memorandum).

Enhanced scrutiny for certain provisions?

11. In paragraphs 150-152 of its First Report and again in paragraphs 34 and 35 of its Second Report, the PCBS expressed concern that the wide delegated legislative powers available to the Treasury under the Bill might at some future time be exercised in a way that could have the effect of watering down the ring-fencing arrangements. It therefore recommended that there should be an enhanced level of Parliamentary control over the exercise of certain key powers conferred by the Bill, and it proposed an amendment ("Amendment I" on pages 58 and 59 of the Second Report, annexed to this Report for convenience) that would in effect introduce a form of super-affirmative procedure for those powers, and would involve special scrutiny by an *ad hoc* joint committee to be chaired by the chairman of the Treasury Select Committee of the House of Commons.
12. The PCBS recommended that the enhanced scrutiny procedure should apply to powers conferred by new sections 142B(5) (described in our paragraph 7 above), 142D(2) and (4) and 142E (described in our paragraph 9 above), being the powers that it regarded as being of particular significance and meriting a greater degree of Parliamentary control than that afforded by a simple affirmative procedure. Even though our memorandum to the PCBS in November 2012 did not propose a level of scrutiny beyond the affirmative procedure for those four powers, we believe that this recommendation from the PCBS now deserves very careful consideration by the House. The PCBS spent many months focusing in great detail on the provisions of the draft Bill and reached its conclusions only after receiving extensive expert evidence and following prolonged consideration.
13. While we assessed the relative significance of powers in the draft Bill in the same way as we do when considering any other Bill, we did not, at our meeting that led to our memorandum, then have the advantage of seeing the PCBS's recommendations on the implications and relative importance policy of the Government's policy in the draft Bill. Those recommendations, and the reasoning that supports them, are now available to us, and we accept the PCBS's assessment of the particular significance of the powers conferred by new sections 142B(5), 142D(2) and (4) and 142E and the importance of ensuring a high degree of Parliamentary control over their exercise.
14. We note that an amendment, in substantially the same form as "Amendment I", was tabled at Committee Stage when the Bill was before the House of Commons but was not accepted by that House. We also note that the PCBS's recommendation enjoyed some support when the Bill received its

Second Reading in this House on 24 July, with some importance being attached to the consideration that an enhanced procedure would afford the opportunity for modifications to be made between the laying of a draft order and the eventual making of the statutory instrument arising out of the draft. This is in our view one of the most important features of an enhanced affirmative procedure, in that it requires a period to elapse during which amendments may be proposed by either House (in the present case the PCBS recommendation is for a joint committee of both Houses), and following which the Government are obliged to consider any proposals before deciding whether to proceed with the original draft or to substitute a modified draft.

15. In its supplementary memorandum, the Treasury provides four reasons why the Government are not attracted by the PCBS's proposal. We found two of the four objections particularly unconvincing – the existing arrangements for Parliamentary control of instruments under the FSMA (paragraphs 17-21) and the reluctance to trespass on Parliament's internal workings (paragraph 25).
16. A further objection which the Treasury advances is the novelty of applying an enhanced procedure to the exercise of a delegated power that is not a Henry VIII power (paragraphs 12-16). We acknowledge this – indeed, it was a feature of enhanced procedures that we recognised in our Special Report on strengthened statutory procedures;⁴ but we also suggested in the concluding paragraph of that Report that there might be circumstances in which it would be appropriate to make a strengthened statutory scrutiny procedure available to support Parliamentary control of the exercise of significant powers that are not Henry VIII powers.⁵
17. Finally, the Treasury argues (paragraphs 22 to 24) that an extension of an enhanced procedure to a power that is not a Henry VIII power might in future be regarded as having set a precedent, in effect by establishing a new “baseline” from which such a procedure might be expected to be deployed in relation to powers in subsequent Bills. Whilst we regard that as an important consideration, we take the view that the present Bill provides the context in which the proposal for enhanced Parliamentary scrutiny must now be considered, particularly in view of the importance of the Bill, the nature of the powers concerned and the significant status of the body that has recommended the enhanced procedure.
18. **While drawing these considerations to its attention, however, we believe that it is a matter for the House to decide whether this is the occasion on which it is appropriate to break new ground in the use of enhanced arrangements for Parliamentary scrutiny.** In doing so, it will wish to consider whether the significance of each of the powers is such that an opportunity should be afforded to require proposals for policy modifications to be considered by the Government before a draft order reaches the stage where the House has no choice other than to approve it or not approve it.
19. If the House were to require an enhanced affirmative procedure for the exercise of any of the powers proposed by the PCBS, the question arises

⁴ ref

⁵ Ibid., para 31.

whether the Bill itself should provide for consideration by a joint committee, rather than a committee of each House (as is the case with the super-affirmative procedure under, for instance, section 18 of the Legislative and Regulatory Reform Act 2006); or whether there should be provision (of the kind proposed in subsection (4) of the PCBS's "Amendment I") about the actual constitution of any joint committee. We express no view on this issue except to remind the House that, given the number of variations of strengthened scrutiny procedures already available, we made the following recommendation in our Special Report:

20. "We recommend that in proposing a strengthened scrutiny procedure in any future Bill the Government should normally use an existing model rather than creating a new variation; and they should explain the basis for the decision."⁶
21. Finally, on this matter, we acknowledge that a requirement for an enhanced procedure is bound to give rise to some delay in the making of an instrument under a power to which the procedure applies, beyond the time which might usually be expected in the case of a simple draft affirmative procedure. When we considered the draft Bill in October 2012, one of the reasons then advanced by the Treasury in support of the choice of the negative procedure for powers conferred in new sections 142D(4) and 142E was that it might be necessary to exercise those powers urgently, and that the requirements of an affirmative procedure might give rise to unacceptable delay.
22. In our memorandum to the PCBS, it was pointed out that the FSMA already deals with urgency in existing affirmative cases by means of a 28-day "made affirmative" procedure. The force of that comment is now recognised in paragraphs 46 and 52 of the Treasury's memorandum, and new section 142Z(2)(b) and (3) to (6) now provides for a "made affirmative" procedure for orders under new sections 142D(4) and 142E. The PCBS concluded in paragraph 151 of its First Report that its proposed enhanced affirmative procedure should not apply in urgent cases; and **we accordingly suggest that, if the House decides to require an enhanced affirmative procedure for the exercise of any of the powers proposed by the PCBS, it should not apply in a case to which new section 142Z(4) applies (urgent orders under new section 142D(4) or 142E).**

Clause 4 – New Section 142W of FSMA: Pension Liabilities

23. New section 142W (which was not in the draft Bill) confers powers on the Treasury to make affirmative regulations with a view to protecting a ring-fenced body from having to meet or contribute to liabilities under a pension scheme in respect of scheme members employed by another body in the same group that is not a ring-fenced body. The regulations may require a body to make arrangements to avoid or minimise its exposure to such a liability. The arrangements include arrangements of a kind described in paragraphs (a) to (e) of subsection (3); and that subsection specifies the kind of related provision that the regulations may contain.
24. We do not find this delegation inappropriate, particularly in view of the affirmative procedure that is to apply. When judging whether the balance between Bill and statutory instrument is appropriate in this context, we have

⁶ Ibid, para 25.

been influenced by what is said in paragraph 81 of the memorandum: that there is no question of interfering with the accrued pension benefits of employees of the ring-fenced body. The delegation arrangements seem to us to be consistent with the arrangements that apply in the case of pensions legislation generally, where a great deal of provision (including provision relating to “employer debt”) is contained in subordinate instruments, many of which are subject to negative procedure.

Government amendments

25. We have also considered the Government amendments numbered 17 to 30 tabled on 1 October which affect the powers conferred by new section 142W, and in particular amendments 17, 20, 23 and 24. Although those amendments significantly amplify the scope of the original power, they do not affect the view we have already reached about the appropriateness of the delegation and the affirmative procedure that is to apply.

APPENDIX 1: “AMENDMENT I”

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 142B(5), other than the first, 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,
 - (b) an order under section 142D(2) varies the circumstances in which the regulated activity of dealing in investments as principal is an excluded activity,
 - (c) an order under section 142D(4), other than the first, 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
 - (d) an order under section 142E varies the scope of what ringfenced bodies are prohibited from doing by virtue of that section (including by varying exemptions or conditions), 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 consider appropriate in relation to the proposed draft.
 - (3) If, after the consultation required by subsection (2), the Treasury consider 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.”’.

APPENDIX 2: MEMBERS AND DECLARATIONS OF INTERESTS

Committee Members' registered interests may be examined in the online Register of Lords' Interests at www.publications.parliament.uk/pa/ld/ldreg.htm. The Register may also be inspected in the House of Lords Record Office and is available for purchase from The Stationery Office.

No interests were declared at the meeting on 2 October 2013.

Attendance:

The meeting on the 2 October 2013 was attended by Baroness Farrington of Ribbleton, Baroness Fookes, Baroness Gardner of Parkes, Lord Haskel, Countess of Mar, Lord Marks of Henley-on-Thames, and Baroness Thomas of Winchester.