

HOUSE OF LORDS

Delegated Powers and Regulatory Reform Committee

5th Report of Session 2009-10

Financial Services Bill

Government Response: **Equality Bill: Parts 6-15**

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The Delegated Powers and Regulatory Reform Committee

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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.

Fifth Report

FINANCIAL SERVICES BILL

Introduction

1. This Bill deals with a number of matters, in particular making various changes to the role of the Financial Services Authority (FSA). A memorandum from H.M. Treasury explaining the delegated powers in the Bill is printed at Appendix 1.
2. In addition to conferring powers on the Treasury and the Secretary of State, the Bill confers on the FSA a number of powers to make rules. These are at clauses 7(4), 11 (new section 139A), 12(1) (new sections 139B and 139C), 13 (new sections 131B to 131D), 26 (new section 404(3)) and 29 (new section 224F) and Schedule 1 (paragraph 12 of new Schedule 1A). The Financial Services and Markets Act 2000 already confers on the FSA wide executive and legislative powers subject to no Parliamentary control. It appears to the Committee that it can therefore be accepted that the FSA is an appropriate delegate, and that it is appropriate for there to be no element of Parliamentary control, unless the powers conferred by this Bill are significantly different in nature or extent to the powers already conferred by the 2000 Act (as most recently amended by the Banking Act 2009).

Clause 7(4) – FSA general rules

3. Section 138 of the 2000 Act enables the FSA to make general rules, which are subject to the consultation and other requirements described in paragraph 29 of the memorandum. The powers may currently be exercised for the purpose of protecting the interests of consumers. This is one of the regulatory objectives set out in section 2 of the 2000 Act. The other objectives are market confidence, public awareness (removed by clause 6 of the Bill) and the reduction in financial crime. Clause 5 of this Bill adds the objective of financial stability. Clause 7(4) widens the purposes for which general rules may be made so as to include all of these other objectives. **The Committee draws clause 7(4) to the attention of the House as it represents a significant extension of the existing power.**

Clause 11 – rules about remuneration

4. Clause 11 is about requiring authorised persons to have a remuneration policy (new section 139A(1) of the 2000 Act) and prohibiting persons from being remunerated in particular ways (new section 139A(9) of the 2000 Act). The FSA must make rules about the former, and may make rules about the latter. The unusual feature of rules about the latter is that they may render void a provision of an agreement which contravenes a prohibition in the rules. This seems a departure from the general rule set out in section 151(2) of the 2000 Act that no contravention of the FSA's rules makes any transaction void or unenforceable. Again, **the Committee draws this important rule-making power to the attention of the House.**

Clause 22 – collective proceedings: regulations

5. Paragraph 60 of the memorandum describes the collective proceedings for which the Bill provides. Clause 22 enables the Treasury to make regulations (subject to negative procedure) about collective proceedings. The relationship between the regulations and court rules is not entirely clear from paragraph 64 of the memorandum, and the powers conferred on the Treasury seem in some respects to be ones which could have been exercisable instead by rules of court.
6. The most notable aspects of the power are that the regulations may modify the effect of a limitation provision (subsections (2)(e) and (3)) or make provision about damages (subsection (2)(f) and clause 23). These are much more about significant substantive rights than about procedure and **the Committee concludes that regulations under clause 22(2)(e) or (f) should be subject to affirmative procedure.**

Clause 26 – consumer redress schemes

7. Section 404 of the 2000 Act enables the Treasury to make an order authorising the FSA to make and operate a scheme for determining the nature and extent of an authorised person's failure to comply with rules and establishing liability to pay compensation. The order may specify requirements with which the scheme must comply and is subject to approval by both Houses of Parliament. No such scheme has been put forward by the FSA, according to the Government memorandum "partly because of the time-consuming procedural hurdles involved and the potential for it to incur a large amount of costs setting up a scheme without any guarantee that the authorising order will be made" (paragraph 76).
8. Clause 26 replaces section 404 with a section enabling the FSA to make rules requiring authorised persons or payment services providers to make and operate their own consumer redress scheme. Six further sections, 404A to 404F, go into further detail about the shape of such rules. This is explained at paragraphs 77 to 81 of the memorandum.
9. New section 404A lists some of the things for which the FSA's rules may provide, including specifying the kinds of redress which are to be made which may include remedies which would not be awarded in legal proceedings (new section 404E(1)). Under section 404A(1)(k) and (7), the rules can provide for the FSA themselves to determine whether a failure has caused loss to the consumer and to determine what the redress should be. There is nothing in the Bill expressly to limit the compensation, except that in exercising the rule-making power as respects kinds of redress and how it is determined the FSA must secure that the redress is just having regard to the nature and extent of the loss (new section 404A(4) and (5)). **This is clearly a significant power which the Committee draws to the attention of the House.**
10. Because there is no requirement in the new section 404 for an order by the Treasury to authorise the FSA to establish a scheme, a stage of potential Parliamentary intervention is being lost. The Bill itself authorises the FSA to make the requisite rules and this may account for the inclusion in the Bill of provisions of a type which under the existing section 404 might have been included in the order to be made by the Treasury. **We draw this to the attention of the House.**

Clause 30 – financial stability information

11. In clause 30 there is an order-making power conferred on the Treasury which is subject to affirmative procedure and is described in paragraphs 114 to 117 of the memorandum. **The Committee draws to the attention of the House that the hybrid instrument procedure is disapplied for these orders (by new section 165C(8)), so that the House can satisfy itself that the disapplication is appropriate.**

Clause 36 – consequential provision

12. Clause 36(3) enables the Treasury or the Secretary of State by order subject only to negative procedure to make “such other provision amending, repealing or revoking any enactment as they consider necessary or expedient in consequence of any provision made by this Act”.
13. The Committee set out its views on Henry VIII powers such as this one in a special report in Session 2002-03. The Committee concluded that:

“in some instances the negative procedure provides a sufficient level of Parliamentary scrutiny. We take the view, however, that there should be a presumption in favour of the affirmative procedure and that reasons for any departure from the affirmative procedure should be set out in full in the Explanatory Notes accompanying a bill and in the memorandum submitted to this Committee”.¹
14. We accept that the negative procedure can sometimes be justified for Henry VIII powers, depending on the circumstances. For example, there is a very limited Henry VIII power in clause 25 of this Bill which is subject only, in the Committee’s view appropriately, to the negative procedure. And in last session’s Postal Services Bill, the Committee did not object to a Henry VIII power similar to the one in clause 36 of this Bill.²
15. Such circumstances will be the exception rather than the rule and will always require careful consideration. In this particular case, the Committee noted that the power is more limited than many similar powers found in other Bills. It does not extend to “incidental or supplemental provision” and it does not extend to consequences of subordinate legislation under the Bill. It is also relevant that many consequential provisions have already been identified and included on the face of the Bill in Schedule 2. On the other hand, it is an important principle that each piece of legislation must be considered in its own context. In particular, the Committee is mindful that the FSA is given a very wide degree of autonomy within its statutory framework, and that the integrity of this statutory framework (and any proposed change to it) is therefore of exceptional importance, increasing the importance of effective Parliamentary oversight. Given these considerations, **the Committee invites the House to consider whether any exercise of the power in clause 36(3) which amends primary legislation should attract the affirmative procedure.**

¹ 3rd Report, Session 2002-03, HL Paper 21

² Paragraph 6, 5th Report, Session 2008-09, HL Paper 60

EQUALITY BILL: PARTS 6 -15 — GOVERNMENT RESPONSE

16. We considered this Bill in our 2nd (Parts 1 to 5) and 3rd (Parts 6 to 15) reports. We then considered Government amendments to Parts 1 – 5 of the Bill in our 4th Report. The Government have now responded by way of a letter, printed at Appendix 2, from the Leader of the House, the Right Hon Baroness Royall of Blaisdon.

APPENDIX 1: FINANCIAL SERVICES BILL

Memorandum by HM Treasury

Introduction

1. Following consultation³, the Financial Services Bill (“the Bill”) was introduced in the House of Commons on 19 November 2009 and passed to the House of Lords for consideration on 26 January 2010.

2. This memorandum identifies the provisions for delegated legislation in the Bill. It explains the purpose of the delegated powers taken; describes why the matter is to be left to delegated legislation; and explains the procedure selected for each power and why it has been chosen.

Policy context

3. Since July 2007, the global financial system has experienced unprecedented levels of financial instability. The causes of this instability are varied and global. They include both macroeconomic factors, such as global financial imbalances, and microeconomic factors, such as the failure of banks to manage adequately financial risk. The key trigger for the instability was the downturn in the US housing market, leading to a sharp devaluation of financial products backed by assets (particularly mortgages) heavily exposed to this market, particularly the “subprime” segment.

4. In mid-September 2008, in the aftermath of the failure of Lehman Brothers in the US, there was an intensification of the stress in global credit markets, leading to the worst financial crisis for generations. As it became clear that the stability of not just individual institutions but the entire banking system was at risk, with potentially devastating consequences for UK households and businesses, the Government intervened in October 2008 and again in January 2009 to safeguard the stability of the financial sector and limit the negative effects on the economy.

5. The Government’s interventions have been targeted at tackling problems in individual institutions, addressing system-wide instability, and getting credit flowing through the economy once more. These interventions share the common purpose of protecting the customers of financial institutions – people and businesses – from the consequences of financial instability and restricted access to credit. In particular:

- by dealing with specific institutions such as Northern Rock and Bradford & Bingley, the Government ensured that problems at one institution did not spread through the banking system, that no retail depositor in UK banks or building societies lost money, and that borrowers were not unduly disrupted;
- by acting decisively as the global financial crisis raised system-wide risks in October 2008, to prevent the collapse of the banking system and the enormous costs that would have entailed for businesses and individuals, and by comprehensively addressing the needs for liquidity, capital, and

³ Reforming financial markets. HM Treasury, 8 July 2009. http://www.hm-treasury.gov.uk/d/reforming_financial_markets080709.pdf

funding, the Government ensured that the banking system was in a position to support the economy through the provision of credit to creditworthy borrowers; and

- by acting to limit the risks attached to banks' existing assets, through the Asset Protection Scheme, and by agreeing quantified and legally-binding lending commitments with banks accessing Government support.

6. Chapter 3 of *Reforming financial markets*, provides a comprehensive account of the development of the financial crisis and the Government's response to it.

Legislative context

7. In 1997, the Government proposed a new system of financial regulation in the UK. A tripartite structure for overseeing the UK financial system was created, with distinct roles for HM Treasury (the "Treasury"), the Bank of England (the "Bank") and the Financial Services Authority (the "FSA") (together, the "Authorities") and distinct responsibilities for overall financial stability issues, which are set out in a memorandum of understanding between the Authorities⁴.

8. The Bank of England Act 1998 established the arrangements for the Bank's current monetary policy responsibilities. Under the 1998 Act, the banking supervision function that had previously been undertaken by the Bank was transferred to the FSA.

9. The Financial Services and Markets Act 2000 ("FSMA") set out the framework within which the FSA operates, as the single regulator for the financial services industry. It also established the framework for the Financial Services Compensation Scheme (the "FSCS") to provide compensation for consumers in the event that a financial services firm is unable to meet its obligations to them.

10. The Banking (Special Provisions) Act 2008 was enacted after it became clear that no buyer could be found to stabilise Northern Rock plc in a way that protected the interest of taxpayers. The Act contained a "sunset provision" whereby certain powers could not be used after the period of one year beginning with the day on which the Act was passed.

11. The Banking Act 2009 (the "Banking Act") built on the tripartite framework to enhance the ability of the Authorities to deal with crises in the banking system, to protect depositors and to maintain financial stability. The Act established a new permanent Special Resolution Regime (SRR), providing the Authorities with a range of tools to deal with banks and building societies that are failing.

The Financial Services Bill

12. This Bill builds on the reforms achieved in the Banking Act and contains provision to further strengthen and reform financial regulation and to support, educate and empower consumers. The following provisions of the Bill are relevant for the purposes of this memorandum:

Objectives of the FSA etc

13. Clauses 5, 7 and 8 amend FSMA and make various provisions in relation to the FSA and its functions. Clause 5 gives the FSA a new regulatory objective: that of contributing to the protection and enhancement of the stability of the UK

⁴Available at http://www.fsa.gov.uk/pubs/mou/fsa_hmt_boe.pdf

financial system. Clause 7 makes various changes to the powers of the FSA in the light of its new regulatory objective. A duty to take steps to promote international financial regulation and supervision is added by clause 8.

14. Clause 6 (and Schedule 1) implement, in part, the Thoresen review⁵ and provide for the establishment of a new consumer financial education body (“CFEB”). The Thoresen review was commissioned in 2007 to investigate the options for delivering access to generic financial advice on a national scale, so that people have a better understanding of finance and ability to manage their financial affairs.

Remuneration of executives of authorised persons

15. Clauses 9 and 10 enable the Treasury to make by provision by regulations about the preparation, approval and disclosure of executives’ remuneration reports.

16. Clause 11 imposes a duty on the FSA to make rules requiring persons authorised under FSMA (or authorised persons of a specified description) to maintain and act in accordance with remuneration policies, and makes other provision about remuneration. One amendment was made to clause 11 in Commons’ Committee which is relevant to the matters covered in this memorandum (see paragraph 45).

Recovery and resolution plans

17. Clause 12 imposes a duty on the FSA to make rules requiring authorised persons under FSMA (or authorised persons of a specified description) to prepare and maintain plans known as recovery and resolution plans, and makes other provision about those plans.

Short selling

18. Clause 13 gives the FSA power to make rules regulating short-selling by requiring disclosure of information in relation to short-selling which is taking place, and to prohibit short-selling in specified cases.

FSA’s disciplinary powers

19. Clause 14 to 17 extend the disciplinary powers of the FSA, requiring it to issue statements of policy in relation to the various sanctions.

Collective proceedings

20. Clauses 18 to 25 make provision for a new form of collective proceedings in relation to certain types of “financial services claim”. Clauses 22 and 23 provide for the Treasury to make regulations about collective proceedings. Clause 24 makes provision for court rules to be made about collective proceedings. One amendment was made to clause 25 in Commons’ Committee which is relevant to the matters covered in this memorandum (see paragraph 73).

⁵ Thoresen Review of Generic Financial Advice: Final Report, HM Treasury, 3 March 2009. http://www.hm-treasury.gov.uk/d/thoresenreview_final.pdf

Other measures to protect consumers

21. Clause 26 substitutes a new section 404 in FSMA, which makes provision for the FSA to make rules in relation to consumer redress schemes. Clause 27 imposes restrictions on the provision of credit card cheques.

Financial Services Compensation Scheme

22. Clause 28 makes provision in relation to the expenses that the FSCS may be required to meet in connection with the exercise of a stabilisation power under Part 1 of the Banking Act. Clause 29 makes provision for the FSCS to act as paying agent under certain other compensation schemes.

Powers to require information

23. Clause 30 enables the Treasury to prescribe by order persons from whom the FSA may require certain information. Clause 31 provides for the Treasury to specify by order schemes whose purposes correspond to or are connected with the Asset Protection Scheme (“APS”), for the purposes of the Treasury’s power to require the production of information.

Banking Act 2009

24. Clause 32 provides for the Treasury by order to apply any provision of Part 5 of the Banking Act to a “service provider”. Clause 33 makes a number of minor changes to the Banking Act, including provisions relating to the making of secondary legislation by the Treasury and property transfer instruments by the Bank of England.

Director of Savings

25. Clause 34 makes provision for the Director of Savings to administer court funds on behalf of the Accountant General of the Senior Courts.

General

26. Clause 36(3) contains a power to make consequential changes.

27. This memorandum is structured in line with the Bill, addressing the powers in each relevant clause in turn. Defined terms are set out in the Annex to this memorandum.

RELEVANT PROVISIONS OF THE BILLClause 5 – Financial stability objective; clause 7 – Meeting FSA’s regulatory objectives

<i>Power:</i>	<i>To make general rules</i>
<i>Body:</i>	<i>FSA</i>
<i>Parliamentary scrutiny:</i>	<i>None</i>

28. Clause 5 provides for FSMA to be amended to provide the FSA with a financial stability objective. Section 138(1) and 1(A) (general rule-making power) of FSMA are being amended by clause 7(4) so that the FSA may make general rules in pursuit of its new objective.

29. Section 155(1) of FSMA provides that if the FSA proposes to make any rules, it must publish a draft in a way best calculated to bring the proposed rules to the attention of the public. The draft must be accompanied by the items referred to in section 155(2), which generally include a cost benefit analysis, an explanation of the purpose of the rules and a notice that representations about the proposals may be made to the FSA within a specified time. The FSA must have regard to the representations and, if the rules are ultimately made, it must publish the representations and its response. It must also, if it considers that there is a significant difference between the draft rules and the final rules, publish details of the difference. These requirements do not apply where the FSA considers that the delay in complying with them would be prejudicial to the interest of consumers (section 155(7)). The FSA is also under a general duty to maintain arrangements for consulting practitioners and consumers under sections 8 to 11 of FSMA on the extent to which its general policies and practices are consistent with its general duties under section 2 of FSMA.

30. The Treasury considers that the requirements described in paragraph 28 remain appropriate in the light of the amendments proposed in clauses 5 and 7(4).

Clause 6 – Enhancing public understanding of financial matters etc; Schedule 1 – Further provision about the consumer financial education body

Power: *To levy sums to meet costs relating to the new consumer finance education body by rules (in the case of the FSA) and by notice (in the case of the OFT)*

Body: *FSA (paragraph 12 of Schedule 1A); Office of fair Trading (paragraph 13 of Schedule 1A)*

Parliamentary scrutiny: *None*

31. These provisions are intended, in part, to implement certain of the Thoresen review recommendations by setting up a new CFEB. In addition, the new body will take over the ‘public awareness’ work carried out by the FSA under the regulatory objective set out at section 4 of FSMA.

32. The Bill adds a new Schedule to FSMA – Schedule 1A – which makes detailed provision in relation to the CFEB. It provides for the CFEB to be funded from three sources, namely from funds raised by a levy by the FSA of FSMA regulated persons, by sums raised from a levy by the Office of Fair Trading (“OFT”) of persons applying for or to renew a consumer credit licence under the Consumer Credit Act 1974 (“CCA”), and from funds provided by Government.

33. Paragraph 12 of Schedule 1A enables the FSA to make rules for the levying of sums to meet part of the costs of establishing the CFEB and the CFEB’s costs in discharging its statutory function. The power enables the FSA to specify which persons, who are authorised for the purposes of FSMA, can be required to contribute and the amounts to be collected from such persons. The FSA can decide which persons to levy and can apply different levels for different cases, taking into account the size of a business and the particular activities of the business.

34. The FSA has a number of existing powers in FSMA to raise money by issuing rules. These include under section 234 (which gives the FSA a power to make rules requiring such authorised persons as it determines to pay such sums as it

determines to meet part of the costs of the Financial Ombudsman Service (“FOS”)) and paragraph 17 of schedule 1 (which gives the FSA the power to make rules for the payment to it of such fees as it believes will enable it to carry out its functions under FSMA). The obligation in paragraph 12(1) is modelled on the power in section 234(1).

35. The FSA’s powers to make rules are subject to the requirements in section 155 (see paragraph 28 above). But section 155(9), which disappplies the obligation to publish a cost benefit analysis, will be extended to this new power by paragraph 13 of Schedule 2 of the Bill.

36. Paragraph 13 of Schedule 1A enables the OFT to collect sums to meet part of the costs of establishing the CFEB and the CFEB’s costs in discharging its statutory function. The OFT may discharge this obligation by collecting specified amounts, or amounts calculated in a way it specifies, from such consumer credit licence holders or applicants for licences as it determines. These costs are imposed by way of a general notice, which is required to be approved by the Secretary of State for Business Innovation and Skills and the Treasury.

37. The CCA allows the OFT to issue notices in a number of circumstances, including to specify fees to be paid in connection with an application for a licence. The OFT also has power under section 234A of FSMA to issue notices imposing requirements on consumer credit licensees and applicants for such licences for the purpose of collecting sums set by the FOS in respect of the FOS’s costs in relation to the consumer credit part of the FOS jurisdiction. The power in this Bill is modelled in broad terms on the provision in section 234A of FSMA, save that whereas under FSMA the OFT collects fees to meet an amount set by the FOS, under the Bill the OFT sets the level of fees as part of a proportion of the CFEB’s costs, which the OFT will set after consultation with the FSA and the CFEB.

38. The provision enables the OFT to determine the appropriate level of charges from time to time, and to specify different levels of charges for different classes. The OFT can therefore decide on appropriate levels of charges, taking into account licensees’ or applicants’ resources. The OFT is however held accountable by having to obtain the approval of the Secretary of State and the Treasury before imposing charges.

The Treasury consider that a requirement to make rules or (as the case may be) issue notices is the appropriate approach to the collection of costs from FSMA authorised persons and CCA licensees and applicants, given the precedents for this power, and the fact of oversight from the Treasury and the Secretary of State.

Clause 9 - Executives’ remuneration reports; Clause 10 - Executives’ remuneration reports: supplementary

<i>Power:</i>	<i>To make regulations</i>
<i>Body:</i>	<i>the Treasury</i>
<i>Parliamentary scrutiny:</i>	<i>Draft affirmative resolution procedure on first exercise, and thereafter when burdens are increased. Otherwise, negative resolution procedure</i>

- a) may require authorised persons, or any class of authorised person, under FSMA to prepare a remuneration report in relation to their officers and employees;

- b) make provision for the information which must be included in the remuneration report, how information is to be set out in the report, and what (if anything) is to be the auditable part of the report.

39. The regulations may apply (with any modifications considered necessary) any provision made by or under the Companies Act 2006 in relation to directors' remuneration reports to executive remuneration reports, and may in particular apply provisions creating offences. Clause 10(5) ensures that the Treasury may not impose a liability for an offence which is more onerous than the liability for the offence under the applied provision.

40. These powers are similar to those given to the Secretary of State in section 421 of the Companies Act 2006 in relation to the directors' remuneration report required from quoted companies, but are more extensive so that the Treasury is able to ensure that all the rules which relate to directors' remuneration reports are applied equally to the new executive remuneration reports (so that quoted companies, which are already subject to the obligation to produce directors' remuneration reports have one set of rules applied in the same way, and with the same sanctions), and that entities which are not companies are subject to the same regime.

41. The requirements which must be satisfied by directors' remuneration reports are set out in Schedule 8 to the Large and Medium-Sized Companies (Accounts and Reports) Regulations 2008.⁶ There is concern that the remuneration structures in firms in the financial sector have been inconsistent with sound risk management by giving employees incentives to pursue risky policies which undermine the firm's own risk management systems, and that the requirements for the disclosure of directors' remuneration should be extended to the remuneration of the highest earning employees of systemically important firms, such as banks. These powers are intended to enable the Treasury to make regulations achieving this.

42. They will also ensure that the Treasury has the powers necessary to implement any recommendations made by Sir David Walker in relation to the transparency of remuneration on the completion of his Review of Corporate Governance in UK banks and other financial institutions. The powers being given to the Treasury include a power to determine which classes of authorised person should be subject to the requirement to produce a remuneration report, to ensure that, where, in future, the remuneration practices of firms in different parts of the financial sector cause concern, the obligation to prepare a remuneration report may be extended to them.

43. The power will be subject to the affirmative resolution procedure when it is first exercised, and thereafter on any occasion when regulations made under this power increase the burden on firms by imposing greater disclosure requirements, to ensure that such regulations are subject to greater parliamentary scrutiny. Regulations made under the power which have the effect of reducing burdens on firms will be subject to the negative resolution procedure. This follows the precedent set in section 473 of the Companies Act 2006 for the parliamentary procedure used for regulations under section 421 in relation to the contents of directors' remuneration reports.

⁶ S.I. 2008/410.

Clause 11 - Rules made by FSA about remuneration[A]: FSA powers

Power: *To make rules*

Body: *FSA*

Parliamentary scrutiny: *None*

[B]: Treasury powers

Power: *To give directions*

Body: *the Treasury*

Parliamentary scrutiny: *None*

44. This clause inserts a new section 139A into FSMA. The new provision imposes a duty on the FSA to make general rules to require each authorised person under FSMA (or each authorised person of a specified description) to have, and act in accordance with, a remuneration policy. Rules must secure that any remuneration policy which an authorised person is required to have is consistent with the effective management of risk and the Implementation Standards issued by the Financial Stability Board on 25 September 2009⁷.

45. This clause also gives the FSA power to impose a new sanction for contractual provisions which contravene rules prohibiting persons from being remunerated in a specified way. The FSA may provide in such rules that any provision contravening such a prohibition is void, and provide for the recovery of any payment made, or other property transferred under it. This provision will be made in rules made by the FSA under their general rule making power in section 138(1) and 1(A) of FSMA. It is intended to ensure that the FSA are able to attach appropriate sanctions to contraventions of remuneration rules, and to avoid legal uncertainty by identifying the rules to which the sanction attaches. Rules made by the FSA which provide that a contractual provision which contravenes a prohibition is void will not affect any provision contained in an agreement which was made before the date on which the rules containing the prohibition were made. Only subsequent amendments to pre-existing contracts, and contracts made after that date will be affected. This point was clarified by a Government amendment (amendment 56) in Commons' Committee following a recommendation made by the Joint Committee on Human Rights in their third report of the 2009-2010 session⁸.

46. Any such rules made by the FSA will be subject to the requirements, set out in section 155 of FSMA (see paragraph 28 above), for the FSA to consult on proposed rules, and to subject them to rigorous cost benefit analysis. Because these rules will not be made by a Minister, they will not be made by statutory

⁷ FSB Principles for Sound Compensation Practices, Implementation Standards, 25 September 2009. http://www.financialstabilityboard.org/publications/r_090925c.pdf

⁸ Legislative Scrutiny: Financial Services Bill and the Pre-Budget Report, House of Lords/ House of Commons, Joint Committee on Human Rights, Monday 21 December 2009. <http://www.publications.parliament.uk/pa/jt200910/jtselect/jtrights/21/21.pdf>

instrument or subject to Parliamentary control. In that respect they are identical to other rules made by the FSA under FSMA.

47. New section 139A(5) gives the Treasury a power to direct the FSA to consider whether the remuneration policies of those authorised persons who are listed in the direction, or who fall within a class of authorised persons described in the direction, comply with the requirements for remuneration policies set out in FSA rules. Under section 139A(6), the Treasury must consult with the FSA before giving any such direction. It is not possible to set out on the face of the Bill which institutions should be subject to full scrutiny of their remuneration policies, as this is likely to change over time. This power will enable the Treasury to ensure that the remuneration policies of systemically important institutions are approved by the FSA.

Clause 12 – Rules made by FSA about recovery and resolution plans

[A]: FSA powers

Power: *To make rules*

Body: *FSA*

Parliamentary scrutiny: *None*

[B]: Treasury powers

Power: *To make an order*

Body: the *Treasury*

Parliamentary scrutiny: *Negative resolution procedure*

48. This clause inserts new sections 139B to F in FSMA. New sections 139B(1) and 139C(1) respectively impose a duty on the FSA to make rules requiring authorised persons under FSMA (or authorised persons of a specified description) to prepare and keep up-to-date a recovery plan and a resolution plan. A “recovery plan” is a plan that aims to reduce the likelihood of failure of an authorised person (or a member of its group) by setting out action to be taken in order to secure that its business or a specified part of it is capable of being carried on in stressed circumstances. A “resolution plan” is a plan relating to action to be taken in the event that circumstances arise in which the business of an authorised person has failed or is likely to fail. Such a plan is aimed principally (but not exclusively) at facilitating action that may be required to be taken by the relevant authorities to resolve the authorised person (for example, in the case of a banking institution, by using the stabilisation powers in the Banking Act). Imposing a requirement on authorised persons to prepare such a plans will contribute to the Authorities’ aim of ensuring that financial institutions (particularly large systemic institutions) do not fail or can be resolved more easily without systemic disruption and putting the public finances at risk if they do.

49. Any such rules made by the FSA will be subject to the requirements, set out in section 155 of FSMA (see paragraph 28 above), for the FSA to consult on proposed rules, and to subject them to rigorous cost benefit analysis. Because these rules will not be made by a Minister, they will not be made by statutory instrument or subject to Parliamentary control. In that respect they are identical to other rules made by the FSA under FSMA.

50. Clause 12(2) enables the Treasury, by order, to require the FSA to make rules by a date specified in the order requiring authorised persons of a description specified in the order to prepare a recovery plan or resolution plan. Before making an order, the Treasury must consult the FSA. The Treasury does not consider that it would be possible to specify a timetable on the face of the Bill. The FSA has recently started a pilot project with a small number of large firms in relation to recovery and resolution plans, and that project will inform the development of its policy in relation to those plans. Also, the FSA is required under new section 139E(8) to take account of international standards that are currently being developed in this area. The Treasury considers that the negative resolution procedure is appropriate in this case. An order will affect the date by which rules must have been made but will not alter the substance of the FSA's duty. The requirement for consultation before an order is made ensures that the FSA's views must be taken into account.

Clause 13 - Power to prohibit, or require disclosure of, short selling

<i>Power:</i>	<i>To make rules</i>
<i>Body:</i>	<i>FSA</i>
<i>Parliamentary scrutiny:</i>	<i>None</i>

51. Clause 13 inserts Part 8A into FSMA, consisting of new sections 131B to 131J. These new sections give the FSA power to regulate short-selling by requiring disclosure of information in relation to short-selling which is taking place, and to prohibit short-selling in specified cases. The FSA has some powers under FSMA to regulate short-selling which amounts to market abuse under section 118 of FSMA in this way by issuing a Code under section 119 of that Act identifying behaviour amounting to market abuse⁹. The definitions of market abuse which are most relevant to short-selling are subject to a sunset provision currently expiring on 31 December 2009 (this is to be extended to 31 December 2011). These new provisions are intended to give the FSA express powers to regulate short-selling, whether or not it can be considered to constitute market abuse.

52. New section 131B(1) gives the FSA power to make rules prohibiting short-selling in relation to relevant financial instruments (that is, instruments which satisfy the definition in new section 131C(4)): they must be admitted to trading on a regulated market in an EEA state, or have such other connection with a market in an EEA state as is specified in FSA rules. The rules must specify the cases in which the prohibition applies. This may relate to financial instruments issued by a specified company, or of companies in a specified sector. Whether any such prohibition is imposed, and which financial instruments it is to apply to, will depend on conditions in the financial market. Usually there is no need to impose any limitations on short-selling. However, in periods of financial crisis short-selling may increase the volatility of the share price of a company whose shares are being sold short, decreasing market confidence in that company, and leading to contagion affecting related stocks. During 2008, it was found necessary to impose a temporary ban on short-selling in relation to shares of UK banks and insurers and their parent companies.

⁹ See <http://fsahandbook.info/FSA/html/handbook/MAR/1> (part of the MAR sourcebook in the FSA Handbook).

53. New section 131B(2) gives the FSA power to make rules requiring any person who engages in short-selling in relevant financial instruments, to disclose information in relation to the short-selling. FSA rules may also require disclosure of such information by specified categories of authorised person (such as financial intermediaries) who are acting on behalf of someone else. The rules must specify the information which must be disclosed about the short-selling. Increasing the transparency of short-selling both provides valuable additional information to the market, and helps to detect short-selling which is being used to commit market abuse. The level at which it is necessary to require disclosure of short-selling will depend on market conditions. Giving the FSA discretionary powers to set this level and to determine which financial instruments should be affected in rules will enable it to reflect changing conditions in the financial markets, maximising the effectiveness of the disclosure requirements.

54. New section 131D allows the FSA to impose temporary restrictions on short-selling, or temporary disclosure requirements without prior consultation, where it is satisfied that it is necessary either to maintain confidence in the UK financial system or to protect the stability of the UK financial system. This will enable the FSA to impose requirements for disclosure immediately in an emergency, but such requirements may initially last no longer than three months. They may be extended for a further three months if the FSA is still satisfied that the test set out in section 131D(1) is still satisfied (because, for example, the same conditions prevail in the market). Thereafter they will lapse.

55. Except where section 131D applies, the FSA's powers to make short selling rules are subject to the requirements, set out in section 155 of FSMA (see paragraph 28 above), for the FSA to consult on proposed rules, and to subject them to rigorous cost benefit analysis. Because these rules will not be made by a Minister, they will not be made by statutory instrument or subject to Parliamentary control. In that respect they are identical to other rules made by the FSA under FSMA.

Clauses 14 to 17 – FSA's disciplinary powers

Power: *To issue statements of policy*

Body: *FSA*

Parliamentary Scrutiny: *None*

56. Clauses 14, 16 and 17 provide for the FSA to impose the following sanctions:

- a) suspend, or impose restrictions on, a permission which an authorised person has to carry on a regulated activity where an authorised person has contravened requirements (clause 14);
- b) impose a financial penalty on a person who has performed a controlled function without approval (clause 16);
- c) suspend, or impose restrictions, on the performance of a controlled function by an approved person where that person has been guilty of misconduct (clause 17).

57. Under sections 69 and 210 of FSMA the FSA must prepare and issue a statement of its policy on the imposition of penalties on approved persons under section 66 of FSMA and authorised persons under section 206 of FSMA, and the amounts of such penalties. The procedure required to be followed by the FSA

before issuing a statement of policy is set out in sections 70 and 211 of FSMA and involves the publication of a draft policy and a statutory obligation to take into account representations.

58. Schedule 2 to the Bill adds the new sanctions in clauses 14 and 17 to the matters in respect of which the FSA must prepare and issue statements of its policy under sections 210 and 69 respectively (see paragraph 20 and paragraph 10 of Schedule 2).

59. Clause 16 imposes a requirement on the FSA to prepare and issue a statement of its policy with respect to the imposition of penalties under this clause and the amount of such penalties. This procedure in relation to issuing the policy is consistent with the requirements for the FSA to issue policy statements in respect of disciplinary proceedings against approved or authorised persons (see paragraph 58 above).

Clauses 18 to 25 – Collective proceedings

[A] Power: To make an order

Body: *the Treasury*

Parliamentary scrutiny: *Draft affirmative resolution procedure*

[B] Power: To make an order

Body: *the Treasury*

Parliamentary scrutiny: *Negative resolution procedure*

[C] Power: To make regulations

Body: *the Treasury*

Parliamentary scrutiny: *Negative resolution procedure*

[D] Power: To make court rules

Body: *the Civil Procedure Rules Committee of England and Wales; the Northern Ireland Court of Judicature Rules Committee; and (in Scotland) court rules made by the Court of Session*

Parliamentary scrutiny: *Negative resolution procedure; or (in Scotland) none*

[E] Power: To make an order

Body: *the Treasury*

Parliamentary scrutiny: *negative resolution procedure*

60. Collective proceedings are proceedings that can be brought by a representative person on behalf of a group of persons whose financial services claims raise the same, similar or related issues. They will begin by the court making a “collective proceedings order”. Financial services claims are, broadly, the majority of claims that may arise from the use of financial services and consumer credit services.

61. The representative need not have a direct interest in the proceedings and might, for example, be a consumer body. Collective proceedings will be capable of being brought either on an opt-in basis or an opt-out basis. This has the effect that a person will be directed to notify the representative (in a manner to be decided by the court) either that they do, or that they do not, wish their claim to be included in the collective proceedings. That is to say that group members will be required to opt-in or to opt-out. The court will be able to make directions in relation to collective proceedings, including that opt-out proceedings should change to opt-in proceedings, or that collective proceedings should continue as individual proceedings to be pursued by the represented persons.

62. Clause 21(5) contains a power for the Treasury to amend clause 21 so as to include within the meaning of “financial services claim” a cause of action relating to the provision of any financial service or ancillary activity. Being a power to amend primary legislation, in order to expand the scope of collective proceedings, it is to be subject to the affirmative resolution procedure.

63. Clause 21(2) contains a power enabling the Treasury to provide by order that a “financial services claim” does not include any cause of action of a description specified in the order. This would enable the Treasury to exclude certain categories of financial services claim where it would not be appropriate for them to be included in collective proceedings. The power is to be subject to the negative resolution procedure. It is a power directed to removing certain kinds of cause of action from the definition of “financial services claim”, so as to restore the ordinary position with regard to those causes of action. It is thought that the negative procedure is therefore suitable.

64. Clause 22 contains a power for the Treasury to make regulations about collective proceedings. This power is required to enable provision to be made for new court procedures and to change some important rules that normally apply in relation to court proceedings. It is necessary to do this by way of a secondary legislation partly so that its use can be coordinated with proposed new court rules which are expected to have general application for all collective proceedings and will come into force at a time after the Bill has received Royal Assent. These rules will be made by the Rules Committee and, in Scotland, the Court of Session under existing powers and under the rule making power contained in the Bill. It is also necessary to have a Treasury power because provision will need to be made in the light of experience and after further consideration and, if appropriate, consultation. This is necessary because this type of collective proceedings is new.

65. The power to make regulations includes a power to set out certain requirements to be met or taken into account before a collective proceedings order can be made. Appropriate threshold conditions and considerations are essential to ensure that collective proceedings are employed fairly and efficiently. The Rules Committees and Court of Session are expected to make most of the necessary provision in general rules. This Treasury power is likely to be used to make additional provision for matters that are more closely related to the particular features of financial services claims and any required provision that is not made in court rules.

66. The power includes a power to exclude claims brought by or against certain persons or to include them only in prescribed circumstances. The power also includes a power to make regulations in relation to notices which, for example, will ensure that third parties including group members receive appropriate notices in an adequate manner.

67. The power includes a power to provide for no account to be taken of periods of time for the purposes of limitation. The power will ensure that the “limitation clock” can be stopped for claims that are, or are about to be, represented in collective proceedings. The Treasury may also provide that the court can disregard periods of time, where appropriate, and this might conceivably include, for example, a case where a direction is made that claims that were represented collectively can proceed as separate individual claims. The power will also enable relief to be given from the consequences of a mistake with regard to the collective proceedings, if appropriate, where a person has been prejudiced with regard to limitation.

68. The power includes a power to make provision about damages. This includes, as mentioned in clause 23, a power to provide in relation to how damages are to be held and dealt with. The purpose of this power is to ensure that the court can award damages as a lump sum aggregate of individual claims without the need to assess claims individually. The court will also be able to determine that any such lump sum is to be apportioned between group members by reference to a formula or by some other method. The power will enable provision to be made for damages to be paid to a representative body as trustee, who would then be able to distribute the damages to the group members and pay any surplus to a third party, such as a charity connected with the objects of the group. The power will therefore ensure, for example, that damages can be awarded and dealt with in circumstances where it is not, say, necessary, efficient or practicable for the court to hear from group members individually.

69. The power is to be subject to the negative resolution procedure. The negative procedure is thought to be appropriate because the power is to effect changes which have a procedural character. Where these changes will be more substantive, for example in respect of changes to the law on damages and limitation, they will nonetheless be a necessary consequence of these new collective court procedures.

70. Clause 24 contains a power for rules of court to be made about collective proceedings. This power will ensure, for example, that court rules that are made in the United Kingdom are capable of making provision for special features of collective proceedings. These include the potential to: modify or restrict any rights of appeal that may accrue to represented persons (who will still however be represented where the representative appeals); to appoint or replace representatives of a group; and to set out the criteria to be applied by the court when deciding whether to make a collective proceedings order.

71. The power also includes a power for rules to provide in connection with the costs incurred by a representative in holding and dealing with damages and allowing those costs to be paid out of the damages where appropriate. Provision can also be made enabling the court to authorise a person to represent defendants in collective proceedings, provision in respect of counterclaims and to allow issues to be determined on an individual basis (for example after the stay or dismissal of collective proceedings). The power in relation to counter claims will enable, for example, generic counter claims to be brought collectively on behalf of defendants against the representative.

72. The power to make court rules is to be subject to the negative procedure in England and Wales and in Northern Ireland, which is the usual procedure for rules that are made by the Rules Committees. It is not to be subject to any procedure in Scotland which is the usual procedure for Acts of Sederunt, made by the Court of Session, providing for court rules.

73. Clause 25 contains a power for the Treasury to amend the definition of “the court” in subsection (2) so as to extend it to include the sheriff court in Scotland. The exercise of the power would therefore allow collective proceedings to take place in the lower court in Scotland. The Treasury wishes to take account of the views of the appropriate bodies in Scotland before deciding whether to exercise this power. But the matter will first need to be further considered in Scotland. The power was introduced by way of a Government amendment (amendment 85) to clause 25 at Committee stage in the House of Commons.

74. The power is to be subject to the negative resolution procedure. Whether the power is exercised will to a large extent follow from developments in relation to court procedure and practice in Scotland. Further, to allow collective proceedings to take place in the sheriff court would be consistent with the effect of the bill in relation to England and Wales and Northern Ireland, where collective proceedings will be able to take place in the lower courts.

Clause 26 - Consumer redress schemes

[A]: FSA powers

Power: *To make rules*

Body: *FSA*

Parliamentary procedure: *none*

[B]: Treasury powers

Power: *To make an order*

Body: *the Treasury*

Parliamentary procedure: *Draft affirmative resolution procedure*

75. Existing section 404 of FSMA enables the FSA to require firms to conduct a past business review and pay compensation to consumers where the FSA is authorised to do so by an affirmative resolution order made by HM Treasury.

76. Section 404 was a late amendment to the Financial Services and Markets Bill and has never been used by the FSA, partly because of the time-consuming procedural hurdles involved and the potential for it to incur a large amount of costs setting up a scheme without any guarantee that the authorising order will be made.

77. Clause 26 replaces section 404 of FSMA to give the FSA power to make rules requiring firms to operate consumer redress schemes. A consumer redress scheme is a scheme under which a firm is required (i) to investigate whether it has failed to comply with a requirement on it and if so the nature and extent of such failure; and (ii) whether the failure has caused any loss to consumers; and if so make appropriate redress to consumers.

78. New section 404(1) sets out the test for making rules requiring firms to establish consumer redress schemes, namely if (a) it appears to it that there may have been a widespread or regular failure by firms; (b) it appears to it that, as a result, consumers have suffered or will suffer loss for which a remedy would be available in legal proceedings; and (c) it considers it desirable in order to secure that redress is made to those consumers.

79. New section 404A(1) describes the matters for which provision may be made in rules made under section 404. The FSA's power to give examples of things done, or omitted to be done, that are to be regarded as constituting a failure to comply with a requirement (para (b)) is limited by subsection (2), which provides that the only examples to be given are those which, in the FSA's opinion have been or would be held by a court to constitute a failure. The power to set out matters to be taken into account or steps to be taken by firms and the kinds of redress that is to be made (paragraphs (c) and (d)) are similarly limited by subsections (3) to (5).

80. Subsections (1)(h) to(k) enable the FSA to make provision in the scheme rules: (i) requiring firms to provide information to it on the investigation or the matters being investigated; (ii) for the FSA to authorise competent persons (for example, independent accountants) to become involved the operation of a scheme; or (iii) for the FSA or a competent person appointed by it to carry out the various steps of a scheme, including determining liability. The FSA already has similar powers under sections 165, 166, 168 and 384 of FSMA. However, as the scheme goes wider than authorised persons (covering formerly authorised persons and payment service providers) it was necessary to include additional powers. Subsection (8) provides that where the rules include provision for the FSA or a competent person to operate a scheme instead of the firm, the rules must also provide for a right of referral to the Financial Services and Markets Tribunal in respect of determinations on liability and redress.

81. In making s404 rules, the FSA will be bound by the same safeguards as when making general rules under section 138 of FSMA, namely a public consultation under section 155 (see paragraph 28 above). This requires the FSA to publish a draft set of proposed rules accompanied by, amongst other things, a cost benefit analysis. The FSA must have regard to any representations made to it as part of the consultation process. A further cost-benefit analysis must be provided if the issued rules differ significantly from the consultation draft along with an explanation of the differences.

82. The Treasury take the view that their involvement in setting up a scheme is unnecessary and inappropriate given the FSA's independence from government and given the safeguards listed above. They also consider that the requirement for Parliamentary approval creates a disproportionate hurdle to the FSA taking swift regulatory action to deal with a situation of widespread consumer detriment and risks politicising decisions which are properly in the domain of the regulator.

83. The definition of consumer in new section 404D restricts the scope of the FSA's power to establish a scheme to activities which are regulated by the FSA. New section 404F gives the Treasury power to make an order amending the definition of "consumer" to extend the scheme to activities which are not currently covered by the provision. It is anticipated that this could be used where a particular failure spans activities which are regulated by the FSA as well as those which are not, for example consumer credit activity, and that it would be appropriate for a single scheme to cover both activities.

84. Given that an order amending the definition of consumers will have the effect of extending the scope of schemes, it will be subject to the affirmative resolution procedure (see paragraph 32(2)(b) of Schedule 2 to the Bill).

Clause 27 – Restrictions on provision of credit card cheques

Power: *To make an order to make provision about the form of a declaration by a debtor*

Body: *the Secretary of State*

Parliamentary scrutiny: *Negative resolution procedure*

85. Clause 27 inserts a new section 51A of the CCA. Under this new section, credit card cheques may only be provided to a person who has asked for them. A person who provides credit card cheques otherwise than in accordance with the section commits an offence.

86. Clause 27 also inserts a new section 51B of the CCA. Under section 51B, section 51A does not apply to credit card cheques provided in connection with an agreement that is entered into by the debtor wholly or predominantly for the purpose of a business carried on, or intended to be carried on, by the debtor.

87. Section 51B (2) provides that if an agreement includes a declaration by the debtor to the effect that the agreement is entered into for business purposes, the agreement is treated as having been so entered. This does not apply if the creditor knows, or has reasonable cause to suspect, that the agreement is not so entered.

88. Section 51B (4) enables the Secretary of State by order to make provision about the form, content and signing of declarations referred to in paragraph 86 above. This enables the detail of the form of declaration to be omitted from the CCA and to be amended from time to time without primary legislation if necessary.

89. By virtue of section 182 of the CCA, the power to make an order under section 51B is subject to the negative resolution procedure. This is the normal procedure for powers of the Secretary of State to make regulations or orders under the CCA. The form of the declaration to be provided by the debtor is essentially procedural in nature and we consider that the same approach is appropriate here.

90. The existing section 16B of the CCA provides an exemption from the Act for certain agreements entered into by debtors and hirers wholly or predominantly for business purposes. There is provision for a declaration by the debtor or hirer to the effect that the agreement is entered into for business purposes; and section 16B(4) provides a precedent for a similar ability for the Secretary of State by order to make provision about the form, content and signing of such declarations.

Clause 28 – Contributions to costs of special resolution regime

Power: *To make regulations*

Body: *the Treasury*

Parliamentary scrutiny: *Draft affirmative resolution procedure*

91. The FSCS is the scheme established by the FSA in rules made under Part XV of FSMA to compensate customers of authorised financial services firms when those firms are unable, or likely to be unable, to pay claims.¹⁰ The FSCS is

¹⁰ The rules are contained in the Compensation Sourcebook (COMP) and Chapter 6 of the Fees Manual (FEES 6) in the FSA Handbook available on the FSA website (www.fsa.gov.uk).

designed so that funding for the compensation payments can be met¹¹ by imposing a compensation costs levy on participant firms i.e. institutions who are authorised by the FSA to carry out the same regulated activity as the failed institution.

92. Section 214B of FSMA (inserted into Part XV of FSMA by section 171 of the Banking Act) provides for the Treasury to make regulations specifying when the Treasury may require the FSCS to fund certain expenses arising in connection with the exercise of a stabilisation power under Part 1 of the Banking Act. In order to ensure that the amount required from the FSCS reflects what the FSCS would have had to pay out if the institution had gone into normal insolvency, section 214B(4) requires that the regulations must ensure that the amount required from the FSCS does not exceed the amount of compensation that would have been payable if the stabilisation power had not been exercised and the failed institution had been unable to satisfy claims against it; and, for that purpose, the amount of compensation that would have been payable does not include amounts that would have been likely to have been recovered by the FSCS from the failed institution. We refer to this as the FSCS's "cap". Section 214B(5) provides that an independent valuer ("IV") be appointed to calculate the amounts likely to have been recovered from the failed institution.

93. As drafted, section 214B does not take account of the fact that a resolution of a failed institution and recovery of monies in respect of claims arising in connection with the resolution can take a great deal of time. Most significantly, the FSCS's cap cannot be upwardly adjusted to take into account the financing costs the FSCS would have borne if it the institution had gone into default and it had been required to meet claims in respect of protected deposits at the outset. This could have significant financial implications for the Exchequer where it finances the making of payments in the resolution.

94. The new sections 214B, 214C and 214D therefore replace section 214B to clarify that the total amount of payments required from the FSCS in connection with the exercise of a stabilisation power may not exceed the FSCS notional net expenditure (minus any actual compensation paid out by the FSCS¹²). This notional net expenditure now can include the cost of financing likely to have been borne by the FSCS if it had been required to make payment at the outset. This means that the amount that can be required from the FSCS - and therefore the FSCS's levy payers - is increased.

95. The new provisions also clarify that the expenses to be charged to the FSCS may also include interest (including compound interest) borne by the Treasury or another person on payments made in connection with the exercise of the stabilisation power. The regulation-making provides that the Treasury set the rates of interest to be used in calculating the contribution the Treasury can require the FSCS to make and the FSCS's cap, and make necessary ancillary provision.

96. Further details as to the regulation-making power are now included in new clause 214C.

97. In order for the Treasury to accurately work out the hypothetical amount of interest incurred by the FSCS, the new provisions require the IV to produce an estimated time profile of these recoveries and enable the Treasury to be able to

¹¹ The FSCS also recovers its compensation payout by taking over the claim of the customer and proving for that claim in the insolvency of the failed institution.

¹² The FSCS might have to pay actual compensation in a resolution where a stabilisation power has been exercised to transfer, for example, the deposit book to another entity, and a person has a claim against the FSCS in respect of that institution under a different part of the FSCS..

specify certain principles that he or she must apply e.g. to specify a long-stop date for the IV to based his or her calculations on. The FSCS is to use this time profile to calculate when payments of compensation would be made in the hypothetical scenario.

98. The new provisions clarify that the regulations may provide for the verification of other matters as well as the expenses incurred in connection with the exercise of the stabilisation power.

99. Where the regulations prescribe how the FSCS is required to make a payment before the FSCS's cap has been established, new provisions provide for hypothetical interest incurred and recoveries to be taken into account when requiring such a payment.

100. We consider that is appropriate to leave the detail of the above to secondary legislation as the mechanisms involved will be intricate and lengthy. Industry will need to be consulted on the details.

101. These regulations are to be exercised by the Treasury under the affirmative resolution procedure. We consider the affirmative resolution procedure to be suitable here to give sufficient opportunity to Parliament to scrutinise the draft regulations, given that the new provisions have a significant financial consequence for the FSCS and its levy payers.

102. The Treasury also intends to apply the new provisions retrospectively i.e. from a date before new regulations come into force, in order to allow the Treasury to pass an increased part of the burden imposed by the resolution of the Dunfermline Building Society¹³ on the UK taxpayer (and thus the UK's financial deficit) to the FSCS's levy payers. Clause 28(2) allows interest to be included in the calculations of the FSCS's contribution to the costs of a stabilisation power from 19th November, which is the date upon which the Treasury is making an announcement to that effect. In reality, only the basis for making calculations in respect of payments to be made by the FSCS for the Dunfermline resolution will be changed by the new provisions. No contribution from the FSCS will be required until the end of the resolution, long after the making of regulations under the new provisions.

Clause 29 - Power to require FSCS manager to act in relation to other schemes

<i>Power:</i>	<i>New clauses 224B to 224F (to be inserted into FSMA) provides a power to notify the FSCS to act on behalf of the manager of another compensation scheme for the payment of compensation to customers of persons who provide financial services</i>
<i>Body:</i>	<i>the Treasury</i>
<i>Parliamentary scrutiny:</i>	<i>Not applicable</i>

103. The FSCS can already act as a paying agent for the deposit guarantee schemes of other EEA member states in the default of a bank who has used its

¹³ The resolution of Dunfermline Building Society on 30 March 2009 involved the first use of the stabilisation powers in Part 1 of the Banking Act 2009. The substantial part of Dunfermline's business (including its retail deposit liabilities) was transferred to Nationwide Building Society. The shortfall of assets over liabilities transferred to Nationwide was made up by a payment by the Treasury of approximately £1.6 billion.

‘passport rights’ under EC law/EEA law to provide services in the UK and has elected to join the FSCS to ‘top up’ compensation due under its home state’s deposit guarantee scheme. The FSCS can also act similarly in the event of a default by an investment firm which also operated in the UK under EC passport rights.

104. This clause inserts new sections 224B to 224F into FSMA. The new provisions allow the Treasury to notify the FSCS to act on behalf of other bodies (foreign governments, overseas deposit guarantee schemes etc) regardless of whether the defaulting financial services firm in question is able to join the FSCS and has elected to do so. A notification may be made only if compensation is payable under another scheme or arrangement and the administrator of that scheme has consented to the FSCS acting as its paying agent.

105. The FSCS may refuse to cooperate with the notification if (among other things):

- a) 106. it considers that it will not be able to obtain the necessary information or assistance to allow it to act as paying agent;
- b) it is not satisfied that the necessary funds for both the payment of compensation and the FSCS’s costs in assessing and making the payment are in place or guaranteed;
- c) acting as paying agent will be detrimental to its role as the UK’s financial services compensation scheme; or
- d) the body for whom the FSCS is acting as paying agent has failed to confirm that it will not take action against the FSCS or that it has failed to indemnify the FSCS against third party claimants.

107. Furthermore the FSCS will have the right to charge a fee for any preliminary work it has to do. Also, it may stop acting as agent if the situation changes and the grounds above cease to be met.

108. The provisions accordingly provide that the FSCS’s management costs in carrying out the work, and the funding for the payment of compensation, have to be met before the FSCS commences acting as paying agent so that no burden should fall on levy payers. There is, however, the possibility that there may be a slight increase in the FSCS’s costs caused by it acting as paying agent, that either cannot be attributed to work done for a particular principal or cannot be recovered from the Principal.

109. As the FSCS is already able to act as paying agent for EEA compensation schemes in certain circumstances, a notification under this provision acts only to widen the scope of the FSCS’s existing powers. It would of course be impractical to list all the schemes and arrangements for which the FSCS may, under this new power, be required to act as agent. Further more the provision is designed to give the Treasury flexibility to enable a foreign scheme to be able to use the FSCS as and when appropriate.

110. There are considerable advantages in providing for a single organisation to act as paying agent for UK customers (or for non-UK customers of a UK based financial service provider) essentially in terms of speed of payout and in maintaining public confidence in the financial services industry. This was demonstrated in October 2008 when the Icelandic bank Landsbanki went into default and the FSCS acted as paying agent for its Icelandic counterpart.

111. Given the need for flexibility, together with the FSCS's ability to refuse to act if certain key conditions are not met, the Treasury considers that this delegated power is a practical measure, uncontroversial in nature and of little general effect. It is therefore appropriate that such a power be exercised by the Treasury through a notification.

112. The functions of the FSCS in acting as paying agent are outside the scope of Part 15 of FSMA. However, the FSA would be able to make rules in connection with exercise by the FSCS of its functions in acting as paying agent. This will enable the FSA to make rules to provide for the assignment of rights of claimants under the other scheme to allow the Principal to be able to make a claim from the estate of the insolvent institution in respect of the compensation the FSCS has paid out on its behalf. This would put it beyond doubt that under English law the rights of the claimants have been assigned.

113. The clause also makes provision for rules made by the FSA to be able to allow the FSCS to impose a levy to meet its costs in acting as a paying agent. This power is subject however to a caveat which requires that such a levy can only be imposed if the FSCS has tried and failed to obtain reimbursement of its costs from another source.¹⁴

114. FSA Rules, made under powers conferred under Part 15 to FSMA, form the COMP Part of the FSA Handbook and deal with the intricacies as to how the compensation scheme works in practice - such as the qualifying conditions for paying compensation - see COMP 3.2. We consider that it is appropriate that this power is given to the FSA along with their existing power. In making such rules the FSA will be required to comply with section 155 of FSMA (see paragraph 28 above), which will enable levy payers to make representations.

Clause 30 - Information relating to financial stability

<i>Power:</i>	<i>To make an order</i>
<i>Body:</i>	<i>the Treasury</i>
<i>Parliamentary scrutiny:</i>	<i>Draft affirmative resolution procedure (In cases of urgency orders must be laid before Parliament after being made, and cease to have effect at the end of 28 days unless approved by affirmative resolution. Otherwise normal affirmative resolution procedure applies)</i>

115. This clause inserts four new sections into FSMA (sections 165A to C and section 169A). These new provisions permit the FSA to call for information from specified classes of person, where the information concerned is relevant to the stability of one or more aspects of the UK financial system, and provide for safeguards in connection with the use of that power. The classes of person from whom information may be sought include:

- a) the owners and managers of relevant investment funds;
- b) persons providing services to any authorised person; and

¹⁴ Given the FSCS's right to refuse to act if funding is not in place before it starts to pay compensation, it is likely that any levy made under this power will be de minimis.

- c) persons prescribed, or of a description prescribed by an order, made by the Treasury (section 165A(2)(d)).

116. The conditions under which the Treasury may make an order under this provision are set out in new section 165C. The Treasury must be satisfied that the activities carried on by the persons prescribed or described in the order, or any failure to carry out those activities, pose or would be likely to pose a serious threat to the stability of the UK financial system.

117. These provisions are intended to ensure that the FSA has the necessary powers to call for information from persons who are not authorised under FSMA and therefore not subject to its ordinary jurisdiction to enable it to monitor potential threats to the stability of the financial system, and where necessary, to take action to prevent any such threat developing. They are intended to complement the existing powers the FSA has to call for information from authorised persons, and those connected to them under section 165 of FSMA. The information available to regulators now suggests that, in addition to authorised persons, it is necessary for the FSA to monitor the activities of investment funds and service providers such as information technology providers to banks (the failure of a computer system in a bank may present serious difficulties to the continued operation of that bank unless adequate safeguards are in place) if it is to monitor potential threats to financial stability. However, it is not possible to foresee all possible ways in which new entities and new financial activities may develop to such an extent that their failure may threaten financial stability in the UK. For this reason, the Treasury is taking a new power enabling it to extend the FSA's powers to call for information to persons who are not within the scope of the powers currently being proposed. The power may be exercised in relation to identified institutions, or a class of institutions, provided that the conditions set out in new section 165C(1) are satisfied.

118. It is subject to the draft affirmative resolution procedure. Where the Treasury is satisfied that it is necessary for the power to be exercised without laying a draft for approval, the order may be made without the draft being laid before and approved by each House of Parliament to ensure that the Treasury is able to act in an emergency to give the FSA power to seek information from a new class of person. However, any order made must still be laid before Parliament, and will cease to have effect at the end of a period of 28 days unless it is approved by a resolution in each House. Where the Treasury is not satisfied of the need to make the order immediately, it will be subject to the normal affirmative resolution procedure.

Clause 31 – Asset protection scheme etc

Power: *To specify by order schemes whose purpose corresponds to or is connected with the asset protection scheme in order that the information gathering powers may be applied to them*

Body: *the Treasury*

Parliamentary scrutiny: *Negative resolution procedure*

119. Clause 31 gives the Treasury the power to require the production of information and documents from any person who participates in, or is proposing

to participate in, the APS or any qualifying scheme for the purposes of, or in connection with, the scheme (sub-clause (1)).

120. The APS is defined in sub-clause (2). A qualifying scheme is any scheme specified in an order by the Treasury (sub-section 3). Sub-clause (8) provides that the Treasury may only specify a scheme in an order if it appears to them that the purpose of the scheme corresponds to, or is connected with, the purpose of the APS.

121. As there are currently no schemes (actual or in prospect) that correspond to, or are connected with, the APS, it is necessary to make provision for the Treasury to be able to specify such schemes, should they come into existence in the future, in order that the Treasury's information gathering powers may be applied to them. As a scheme to be specified as a qualifying scheme must be so closely linked with the APS, the scope for the exercise of discretion in the assessment of whether a scheme falls under the criteria and therefore can be specified in an order, is limited. The negative resolution procedure therefore provides an appropriate degree of Parliamentary oversight in relation to a subject-matter which is unlikely to be contentious.

Clause 32 - Services forming part of recognised inter-bank payment systems

Power: *To make an order to apply any provision of Part 5 of the Banking Act to "service providers"*

Body: *the Treasury*

Parliamentary scrutiny: *Draft affirmative resolution procedure*

122. Part 5 of the Banking Act creates a new statutory regime for the oversight of "recognised" inter-bank payment systems.¹⁵ In particular, Part 5 confers a power on the Treasury to specify, by way of a recognition order, an inter-bank payment system as a "recognised" system for the purposes of Part 5 of the Act (section 184).

123. The Treasury may make a recognition order in respect of an inter-bank payment system if they are satisfied that any deficiencies in the design of the system or any disruption of its operation would be likely (a) to threaten the stability of, or confidence in, the UK financial system, or (b) to have serious consequences for business or other interests throughout the UK (section 185(1)). In considering whether to recognise a payment system the Treasury must have regard to a number of criteria set out in section 185(2). New powers are conferred on the Bank of England in relation to recognised systems (for example, the Bank has the power to issue directions to the operator of a recognised system (section 191)).

¹⁵ Inter-bank payment systems are integral to the proper functioning of the UK economy, facilitating payment services such as direct debits, cheque clearing, cash withdrawals e.g. from ATMs, and settlement services for sterling and foreign exchange transactions, securities, derivatives and commodity trades. Approximately £200 trillion passed through the main UK payment systems in 2008 (source: *The Payment Systems Oversight Report 2008*, Bank of England, April 2009 (Issue No. 5)).

124. Sections 181 to 187, 204 (in part) and 205 came into force on 4 August 2009.¹⁶ It is expected that the remaining sections of Part 5 will be commenced before 2010.

125. During the course of the implementation of Part 5 of the Banking Act, the Treasury have become aware of the reliance of some inter-bank payment systems on key infrastructure which is outsourced to service companies, for example IT systems designed to facilitate the transfer of money. In view of the degree of reliance on these systems, the Treasury consider it may be appropriate for the Bank to have direct powers over such service providers (defined in subsection (2)) in order to enable the Bank to take direct action in relation to those service providers to enhance the robustness of the recognised inter-bank payment systems.

126. The Treasury recognise that various stakeholders and interested parties will have views on any proposal to extend the scope of the regime provided for in Part 5 of the Act and therefore have taken a power to make an order applying (subject to any necessary modifications) any provisions of Part 5 to service providers, rather than by making textual amendments to Part 5 of the Act at this stage. This power provides flexibility for the Treasury to apply or modify all or any provision of Part 5 if the Treasury consider this to be appropriate following further work in this area.

127. As the Treasury recognise the significance of any extension of the Bank's powers to service providers, subsection (6) requires the Treasury to consult before laying in Parliament a draft order in exercise of the power conferred by this clause.

128. In addition, any order made in exercise of this power would be subject to the draft affirmative resolution procedure, which would provide Parliament with adequate opportunity to scrutinise the draft order.

129. It is also noteworthy that should Part 5 be extended to service providers, the Treasury would be required to specify in a recognition order the person(s) who are subject to any extension of Part 5. Prior to specifying a person as a service provider, the Treasury is required to consult with the Bank, the FSA, the operator of the recognised inter-bank payment system and the person who may be specified as a "service provider" and consider any representations made (subsection (4)).

¹⁶ S.I. 2009/2038. These sections confer powers on the Treasury to issue recognition orders and to de-recognise systems if the criteria for recognition are no longer met, and confer powers on the Bank of England to obtain, and share with the Treasury, information relevant to the recognition process.

Clause 33 – Minor amendments of provision made by Banking Act 2009: Subsection (2) – Provision creating liabilities in a property transfer instrument or order made in exercise of powers conferred by Part 1 of the Banking Act 2009

<i>Power:</i>	<i>Clarification of provision which may be made in an instrument or order made under existing delegated powers</i>
<i>Body:</i>	<i>Bank of England or the Treasury</i>
<i>Parliamentary scrutiny:</i>	<i>Negative resolution procedure (if exercised by Treasury); to be laid before Parliament (if exercised by Bank of England)</i>

130. The Committee will be familiar with the delegated powers conferred on the authorities (the Bank, the Treasury and the FSA) under the special resolution regime of the Banking Act from the consideration of the Banking Bill last year.¹⁷

131. The amendment to the Act specified in subsection (2) of clause 33 is minor and technical and clarifies the scope of the provision that may be made in property transfer instruments or orders made in exercise of existing delegated powers. The Treasury does not consider that the amendment requires any change to the procedures for exercising those delegated powers. However, the amendment is discussed for completeness and some background to the amendment is provided below.

Background

132. Part 1 of the Banking Act provides for a special resolution regime (“SRR”) which confers powers on the Bank and the Treasury to intervene in a bank that is failing, or is about to fail, to meet its threshold conditions¹⁸ for authorisation to perform regulated activities (such as deposit-taking).

133. Under the SRR, there are three stabilisation options: (i) the power for the Bank to transfer the property, rights and liabilities (“business”) of a bank to a bridge bank (wholly owned and controlled by the Bank) or (ii) the shares or business of a bank to a private sector purchaser and (iii) the power for the Treasury to transfer a bank into temporary public ownership (sections 11 to 13). These options are effected by way of the stabilisation powers: the share transfer powers (sections 14-32) and the property transfer powers (sections 33-48). The Bank exercises its powers by way of transfer instruments (which must be laid before Parliament), the Treasury exercise their powers by way of transfer orders (subject to the negative procedure).

134. Before the Authorities may exercise the stabilisation powers, a number of general and specific conditions (tailored to the stabilisation option to be effected) must be met (sections 7 to 9) and the Authorities must have regard to the special resolution objectives (provided for in section 4 of the Act) and the code of practice issued by the Treasury under section 5 of the Act.

¹⁷ <http://www.publications.parliament.uk/pa/ld200809/ldselect/lddelreg/12/12.pdf>

¹⁸ Under section 41 of, and Schedule 6 to, the Financial Services and Markets Act 2000.

135. Following the exercise of a stabilisation power, the authorities may make supplemental, onward and reverse transfer instruments or orders (see, for example, sections 26, 27, 28, 29, 42, 43, and 44).

Partial property transfers

136. The Bank need not transfer all of the property, rights and liabilities of a bank to a bridge bank or to a private sector purchaser (equally, the Treasury need not transfer all of the business of a bank that has been transferred into temporary public ownership to an onward transferee). Instead, the Bank of England and the Treasury can effect a transfer of some of the business of a bank, for example its deposit book. This is referred to as a “partial property transfer” and the part of a bank remaining following a partial transfer of business is called a “residual company”.

137. In the case of partial property transfers (whether effected under the Act or, in the past, under the Banking (Special Provisions) Act 2008 (“the 2008 Act”)), the Treasury note that it will often be the case that more liabilities than assets will be transferred from a failing bank. For example, in order to protect the interests of depositors by maintaining continuity of banking services the authorities may seek to transfer a deposit book (a book of unsecured debts owed by a bank to its customers) to another bank. However, in order to make the transaction commercially viable in the event that no (or insufficient) assets are transferred from the failing bank, the authorities may need to meet any shortfall in assets to be transferred in order to match the value of the liabilities. An example of this scenario arose in the resolution of Dunfermline Building Society on 30 March this year, where the Bank of England effected a transfer of some of Dunfermline’s business to Nationwide Building Society.¹⁹ As Nationwide wished to acquire more of Dunfermline’s liabilities than assets, the Treasury entered into a payment agreement to pay Nationwide a sum equal to the shortfall.

Creation of liabilities in the residual company

138. The effect of this, unless further provision is made, is that where more liabilities are transferred than assets and public funds are used to make up the difference, the residual company would effectively receive a windfall at the expense of the taxpayer as a greater proportion of assets will be left behind in the residual bank relative to the remaining liabilities. So if, as is likely, the residual company were to be wound up, creditors would receive a higher dividend in consequence (effectively subsidised by the use of public funds in the resolution). The Treasury do not consider that it is acceptable in policy terms for public funds to be used to create such a windfall, and in consequence it is necessary to make provision in connection with the transfer to ensure that public funds can be recovered from the insolvency estate of the residual company sharing *pari passu* with other creditors. In the case of the resolution of Dunfermline where Nationwide acquired more of Dunfermline’s liabilities than assets, the payment agreement made provision for:

- a) 139. the Treasury to pay Nationwide a sum in addition to the assets and liabilities transferred to Nationwide under the property transfer instrument;

¹⁹ The Bank of England’s news release and property transfer instrument are available using the following link: <http://www.bankofengland.co.uk/publications/news/2009/030.htm>.

- b) 140. the creation of a claim in the Dunfermline resolution between the residual building society and the Treasury, which was capped at the total amount the Treasury were required to pay under the terms of the payment agreement.

141. This claim was created in the Dunfermline resolution in exercise of the general property transfer powers of the Banking Act. Sections 33(1)(b) (which was the relevant provision in the Dunfermline resolution), 42(3)(b), 43(3)(b), 44(4)(c), 45(3)(b) and 46(3)(b) specify that property transfer instruments or orders may, in addition to providing for the transfer of property, rights or liabilities, “make other provision for the purposes of, or in connection with, the transfer of property, rights or liabilities of a specified bank”.

142. However, in view of the large sums of public money that may be involved (for example, in the case of the transfer to Nationwide, the Treasury’s payment was initially estimated to be £1.6 billion), the Treasury consider it would be beneficial to make a minor and technical amendment to the Act to make express provision for liabilities can be created against the residual company in a property transfer instrument or order. Typically the liability would be owed to the Treasury, however, it may be owed to any other person providing funds to make a resolution possible.

143. In addition, the precise amount of the liabilities transferred (such as the deposit book) and therefore the amount of any cash transfer required may not be known at the time for the resolution so, following further reconciliations, balancing payments may need to be made. Therefore the liability may need to be varied accordingly; hence subsection (2) of the new section 48A of the Act inserted by subsection (2) of clause 33 makes clear that the provision may be framed by reference to an agreement (e.g. a payment agreement entered into by the Treasury and the acquirer of the deposit book, which will include provision for such adjustments).

144. In the event a liability is created against a residual company, the Treasury (or other person) would assume positions in the insolvency of the failing bank in accordance with the insolvency priorities of the creditors who have been transferred from the failing bank. Accordingly the Treasury would benefit from distributions from the insolvency estate in accordance with these priorities. Therefore the position of other creditors remaining in the residual company would not be prejudiced by the creation of this liability as it would be consistent with the priorities of the creditors had the transfers not been made and had the institution not gone into insolvency.

145. Clearly, an exercise of the partial property transfer powers would result in an interference in the property rights of the failing bank. However, extensive provision is made in the Banking Act for the compensation measures that must be put in place following an exercise of the transfer powers, which include the “no creditor worse off arrangements” in the case of partial property transfers, which ensure that pre-transfer creditors of a failing bank are left in no worse position following an exercise of the transfer powers than they would have been in had the institution entered into insolvency immediately before the transfers were effected.

Clause 33: Subsections (3) and (4) – Modifications to sections 55 and 56 of the Banking Act 2009

Power:

To make detailed provision for independent valuers in compensation scheme, resolution fund, and third

party compensation orders (subsection (3) and (4)(b)) and power to pay remuneration and allowances to persons appointed to remove independent valuers from office (subsection (4)(a))

Body: the Treasury

Parliamentary scrutiny: Draft affirmative resolution procedure

146. The resolution of Dunfermline Building Society represents that first (and, so far, only) exercise of the stabilisation powers conferred by Part 1 of the Banking Act. In accordance with the requirements of the Banking Act the Treasury have since made the Dunfermline Building Society Compensation Scheme, Resolution Fund and Third Party Compensation Order 2009 (S.I. 2009/1800) (“the Compensation Order”) and the Dunfermline Building Society Independent Valuer Order 2009 (S.I. 2009/1810) (“the Independent Valuer Order”).

147. Provision is made in the Compensation Order (which was subject to the draft affirmative procedure (section 62(2)) for the appointment of an independent valuer (article 5) to perform the functions referred to in article 4 of that Order. However, detailed provision in connection with the independent valuer, for example:

- a) the remuneration and payment of allowances to the valuer and the panel appointed to appoint the valuer;
- b) the valuer’s procedure, staff, records and accounts and information gathering powers; and
- c) the procedure for appealing determinations of the valuer,

is made in the Independent Valuer Order, as such provision may only be made by virtue of an order subject to the negative procedure (sections 55(9) and 56(5)).

148. As it is not possible to have a single instrument combining provisions subject to different Parliamentary procedures, in the case of the Dunfermline resolution it was necessary to make two separate instruments. However, for future resolutions, in the interests of administrative efficiency, the Treasury considers it would be helpful to have the power to make detailed provision for an independent valuer (specified in sections 55 and 56) in a:

- a) compensation scheme order;
- b) resolution fund order; or
- c) third party compensation order,

which provides for the appointment of an independent valuer (see sections 54(1), 58(3)(a) and 59(3)(a)).

149. As such, the amendments specified in clause subsections (3) and (4)(b) of clause 33 enable the Treasury to make detailed provision for the valuer in orders subject to the draft affirmative procedure, which would provide additional flexibility for the Treasury as well as enhancing the Parliamentary scrutiny of those provisions. The existing powers to make separate orders under sections 55 and 56 using the negative procedure are to be retained in order to provide maximum flexibility to the Treasury, for example, to make supplemental provision regarding the staff of independent valuers.

150. In addition, subsection (4)(a) of clause 33 extends the power conferred on the Treasury by section 56(1) to provide, by order, for the payment of remuneration and allowances to certain persons appointed in accordance with section 54(4)(b) to remove independent valuers from office (on the ground of incapacity or serious misconduct). The Treasury considers this minor and technical amendment is appropriate to ensure that such persons could be reimbursed for any expenses incurred in performing this function.

Clause 33: Subsection (5) – Third party compensation scheme orders in the case of transfers of building societies into temporary public ownership

Power: *To make provision for a third party compensation order in the case of a transfer of a building society into temporary public ownership*

Body: *Treasury*

Parliamentary scrutiny: *Draft affirmative resolution procedure*

151. Section 84 of the Banking Act 2009 applies, subject to some modifications, Part 1 of that Act (the special resolution regime) to building societies. Section 85 sets out the provisions the Treasury may make in an order to transfer a building society into temporary public ownership. In particular, the Treasury may transfer the deferred shares²⁰ in a building society into temporary public ownership or may cancel those shares and issue new deferred shares to the Treasury (or other public body).

152. The transfer of the deferred shares into temporary public ownership will result in an expropriation of property from the owners of those shares. Section 51 of the Act requires the Treasury to make a compensation scheme order to enable compensation to be assessed or paid to those persons who have had their property expropriated (“transferors”) (as modified by note (b) in the penultimate row of table set out in section 84 of the Act).

153. In addition, the property rights of third parties may also be interfered with by provisions of the transfer order (for example by virtue of the application of section 22 of the Act, which specifies that the transfer order is to be disregarded in determining whether a default provision applies²¹). Section 51(4) of the Act enables the Treasury to make a third party compensation order in a compensation scheme order (or as a free-standing order- see section 59(2)), which may make provision for any compensation payable to persons other than transferors, for such compensatable interferences in their property rights.

154. Where a building society is brought into temporary public ownership by cancelling existing deferred shares and issuing new deferred shares to the Treasury

²⁰ Building societies can have two forms of membership: shareholding members (holding ordinary or deferred shares) and borrowing members. Borrowing members comprise depositors and residential mortgage customers. The deposit element is held as a share and the members enjoy certain voting and other proprietary rights. Generally, these shares are not transferable. Deferred shareholders are usually bodies corporate who have invested in the building society. These members cannot be repaid except in the event of winding up where all the other creditors (including members with non-deferred shares) have been repaid in full. Deferred shares are defined in the Building Societies Act 1986 section 8(1)(c) and are defined in the Building Societies (Deferred Shares) Order 1991.

²¹ This means that a third party could not exercise their rights, for example, to terminate a contract with the building society by virtue only of the reason of the change of control of the building society arising as a result of the transfer into temporary public ownership.

there will be no expropriation of property, but there may still be interferences in the property rights of third parties. However, note (c) in the penultimate row of the table set out in section 84 specifies that in circumstances where the Treasury have issued new deferred shares, section 51(2) shall not apply, i.e. the Treasury may not make either a compensation scheme or resolution fund order. This is because no shares are being transferred.

155. An unintended consequence of this modification is that the Treasury has no power to make a third party compensation order, which would mean that either the Treasury would have to make *ex gratia* payments of compensation to third parties, where appropriate, or those persons would be left to make a claim under the Human Rights Act 1998. Both of these options are considered to be unattractive from a policy perspective.

156. Instead, the technical amendment to the Act provided for in subsection (5) of clause 33 enables the Treasury to make a third party compensation order where new deferred shares are issued. Third party compensation orders are subject to the draft affirmative procedure (section 62(2) of the Act), which the Treasury considers provides an appropriate degree of parliamentary scrutiny.

Clause 34 - Administration of court funds by Director of Savings

157. Subsection (2) of this clause enables the Director of Savings to discharge certain functions of the Accountant General of the Senior Courts if appointed by the Accountant General under the court funds rules to do so. The court funds rules are the rules as to the administration and management of funds in court made under section 38(7) of the Administration of Justice Act 1982.

158. Under section 38(8)(a) of the Administration of Justice Act 1982, the court funds rules may provide for the discharge of the functions of the Accountant General under the rules by a person or persons appointed by the Accountant General; and rule 4 of the court funds rules currently in force (the Court Funds Rules 1987) provides that the functions of the Accountant General under the rules may be discharged, to such extent as the Accountant General may direct, by any officer appointed to do so.

159. Subsection (2) of this clause does not, therefore, confer any new delegated power, rather it makes use of an existing power: it enables the Director of Savings to carry out functions where appointed under existing delegated powers (section 38(7) and (8) of the Administration of Justice Act 1982) to do so.

160. Subsection (3) of this clause provides that the functions of the Director that are within section 69(1)(a) of the Deregulation and Contracting Out Act 1994 (contracting out of statutory functions) include any power of the Director of Savings, conferred under court funds rules, to discharge functions on behalf of the Accountant General.

161. Section 69(1) of the Deregulation and Contracting Out Act 1994 sets out the functions of a Minister or office-holder which may be exercised by, or by employees of, such person as may be authorised by the office-holder or Minister whose function it is where a Minister by order so provides (section 69(2)). An order under section 69 is subject to the draft affirmative resolution procedure (section 77(2)).

162. Therefore, the effect of subsection (3) of this clause is to put beyond doubt that the Director of Savings' court funds functions (i.e. the functions to be discharged on behalf of the Accountant General) may be included in an order made under section 69(2) of the Deregulation and Contracting Out Act 1994. It is

arguable that the Director's court funds functions would be covered by section 69(2) absent subsection (3), as the criteria in subsection (1)(a) to (c) appear to be met, but the matter is not beyond doubt given that it is a power of exercising a function on behalf of another person.

163. Subsection (3) does not, therefore, confer a new delegated power: however, it does potentially increase the scope of the existing order making power in section 69(2) of the Deregulation and Contracting Out Act 1994. It is considered appropriate to extend the power in this way. The Director of Savings' court funds functions will be very similar in nature to those functions which the Director currently carries out and which are already included in an order made under section 69(2) (the Contracting Out (Functions Relating to National Savings) Order 1998) (and currently contracted out by the Director of Savings to Siemens).

Clause 36 – Minor and consequential amendments

<i>Power:</i>	<i>To make an order</i>
<i>Body:</i>	<i>the Treasury or the Secretary of State</i>
<i>Parliamentary scrutiny:</i>	<i>Negative resolution procedure</i>

164. Clause 36(3) provides a power for the Treasury or Secretary of State to make provision by order amending, repealing or revoking any enactment as they consider necessary or expedient in consequence of any provision made by the Bill.

165. The Treasury and Department for Business, Innovation and Skills consider that the negative resolution procedure is appropriate in this case. The power is a narrow one: the provision provides power only to make consequential changes to the law. Also, the two Departments have attempted to deal with all consequential changes in the Bill. Accordingly, the power is very much a reserve power in case any necessary consequential changes have not been identified. Most recently, the Committee did not object to this approach in relation to the Postal Services Bill.

ANNEX: LIST OF DEFINITIONS

APS – Asset Protection Scheme

Authorities – the Bank of England, the Financial Services Authority and the Treasury

Bank – Bank of England

Banking Act – Banking Act 2009

CCA – Consumer Credit Act 1974

CFEB – Consumer Financial Education Body

FOS – Financial Ombudsman Scheme

FSA – Financial Services Authority

FSCS – Financial Services Compensation Scheme

FSMA – Financial Services and Markets Act 2000

IV – Independent valuer

OFT – Office of Fair Trading

Treasury – HM Treasury

APPENDIX 2: EQUALITY BILL: PARTS 6 -15 — GOVERNMENT RESPONSE

Letter to the Chairman from the Right Hon Baroness Royall of Blaisdon,
Leader of the House of Lords

1. The Government tabled a number of amendments on 4 February, each of which is in response to recommendations or points raised by the Delegated Powers and Regulatory Reform Committee in its report on Parts 6 to 15 of the Bill, contained in its Third Report of Session 2009-10.

2. The Solicitor General's letter of 22 January covered a note responding to that further report, where in a number of places the Government said it would carefully consider the Committee's recommendations. The amendments tabled on 4 February pick up on these points and I attach a note which sets out the details. I also attach the list of amendments as tabled and the attached annex refers to the amendment numbers in that list.

- To complete the picture, I should add that, in response to the Committee's initial report on Parts 1-5 of the Bill, the Government has previously tabled the following amendments:
- 60ZA: the Committee recommended that the power in Schedule 3 to add, vary or omit exceptions to clause 29 (prohibiting discrimination in the provision of services and exercise of public functions, etc) should be limited so as not to allow the exceptions relating to the functions of Parliament and the judiciary to be omitted or reduced. This amendment was agreed during Lords Committee on 19 January.
- 135: the Committee noted that there seems to be an omission in respect of the power to make an Order in Council under clause 82. This amendment, which is for future debate, corrects that omission.
- 135A, 136ZA, 136ZB: the Committee recommended that the affirmative procedure should apply to the power in clause 2 in relation to adding or removing public authorities covered by the socio-economic duty or adding or removing restrictions. These amendments, which are for future debate, achieve this, in respect of regulations made by a Minister of the Crown or by Scottish or Welsh Ministers.
- 136: the Committee noted that it was unclear whether orders referred to in clauses 200(3) were subject to any parliamentary procedure. This amendment, which is for future debate, clarifies that any statutory instruments that are not subject to the affirmative procedure because they are listed in clause 200(3) are subject to the negative procedure.

3. I am placing a copy of this letter and attachment in the House Library.

The Right Hon Baroness Royall of Blaisdon

Leader of the House of Lords

Schedule 18, amendment 1: power in relation to exceptions to the public sector equality duty

4. Schedule 18 sets out the exceptions to the public sector equality duty. It also contains a power for a Minister of the Crown to add, limit or omit those

exceptions. The Delegated Powers and Regulatory Reform Committee, in its report on Parts 6 to 15 of the Equality Bill (Third Report of Session 2009-10), recommended that this power should be limited so that it could not be used to remove or limit the exceptions provided for judicial functions or those relating to Parliament, the Scottish Parliament, the National Assembly for Wales and the General Synod. The Government said in its response to the Committee (letter from Baroness Royall of 22 January covering one from the Solicitor General to Lord Goodhart) that it would carefully consider this recommendation, and amendment 1 meets the recommendation.

Clause 150, amendment 2; clause 200, amendment 10; clause 201, amendments 14-17 and 19; and clause 202, amendments 20-23 and 25: power in relation to the list of public authorities subject to the public sector equality duty

5. Clause 150(1) enables a Minister to amend Schedule 19 (the list of bodies subject to the public sector equality duty) by order. The Delegated Powers and Regulatory Reform Committee, in its above report on the Bill, recommended that this power should not be capable of being used to add, to Schedule 19, the judicial and parliamentary bodies currently excluded from the duty by virtue of Schedule 18. It also recommended that the limited power should be subject to the affirmative procedure, not the negative procedure as currently provided. The Government said in its response to the Committee that it would carefully consider the recommendation to limit the power, and amendment 2 meets the recommendation. (In effect, it is a counterpart of amendment 1.) The Government also said in its response that it would carefully consider the recommendation to make the limited power subject to the affirmative procedure, but that there were certain cases where the negative procedure would be more appropriate. Amendment 10 in respect of clause 200 (which sets out which powers are subject to affirmative and which to negative procedure) has the effect of applying the affirmative procedure to the use of this power, for example when adding an entry, but retaining the existing negative procedure for use of the power in relation to cases where an entry is removed because an authority has ceased to exist or is changed because an authority has changed its name. Amendments 14 to 17 and 19, and 20 to 23 and 25 make equivalent changes regarding use of the power by Welsh Ministers and Scottish Ministers respectively to add, vary or omit entries in their Parts of Schedule 19.

Clause 195, amendment 3; clause 200, amendment 9: guidance-making powers regarding age discrimination exceptions

6. Clause 195(1) provides a power for a Minister by order to make exceptions from the ban on age discrimination, including in the provision of services and exercise of public functions. Clause 195(3)(a) allows such an order, amongst other things, to “confer on a Minister of the Crown or the Treasury a power to issue guidance” – such guidance would cover, typically, advice on how a business that wished to rely on an exception could ensure that in practice it remained within the exception. Clause 195(3)(b) allows an order also to require the Minister or the Treasury to consult before issuing guidance; and clause 195(3)(c) allows an order to “make provision (including provision to impose a requirement) that refers to guidance...”. In practice, this means that an order could require guidance to be complied with, in order to be able to rely on the exception allowed. Under clause 195(6) such a requirement could, for example, refer to compliance with a document specified in the guidance, for example a code. The Delegated Powers

and Regulatory Reform Committee, in its above report on the Bill, noted that the provisions for sub-delegation in clause 195(3) and (6) did not involve any parliamentary scrutiny of the guidance and recommended that they be removed from the Bill. The Government has explained that these powers are necessary so that guidance can give service providers certainty about what they have to do to use an exception; and that the guidance would contain matters too detailed for legislation. To provide parliamentary scrutiny, amendment 3 has the effect that guidance issued under a power contained in an order under clause 195 can come into force only on a date specified in a separate order, which will be subject to negative procedure. It therefore gives Parliament an opportunity to scrutinise the guidance. Linked amendment 9 is consequential. It ensures that the provisions in clause 200 for making orders and regulations under the Bill apply to those made by the Treasury as well as those made by a Minister of the Crown.

Clause 196, amendments 4-7; and new clause after clause 196, amendment 8: safeguards relating to the harmonisation power

7. Clause 196 provides a harmonisation power which enables a Minister by order to align elements of domestic equality law in the Equality Acts that are not covered by future EU provisions with elements of domestic equality law that need to be changed as a result of those future EU provisions. The rationale is that the Equality Bill is putting right various inconsistencies that have accumulated in domestic equality law over the last 40 years as a result of implementing EU Directives, when the implementing vehicle (secondary legislation under the European Communities Act) has not been able to cover areas of domestic equality legislation that are linked with but not covered by the Directives; and that having put right these inconsistencies, a forward-looking power is needed which will enable future potential inconsistencies to be avoided. The Delegated Powers and Regulatory Reform Committee, in its above report on the Bill, was not persuaded that a harmonisation power was needed and considered it to be inappropriate. In its response, the Government noted the Committee's view and said it was considering what further safeguards would be appropriate (currently, the use of the power is subject to a consultation requirement; a 12-week minimum period after the consultation starts, before making the order; and a requirement on the Minister to report to Parliament every 5 years on the power's use). The overall effect of the amendments is to provide further safeguards: amendments 4 and 5 add a further condition to the required consultation, by requiring the Minister to carry out a further consultation if he thinks it appropriate to change all or part of the proposal; amendment 5 removes the exception which would allow the Minister to forego or shorten consultation if the matter is urgent; amendments 6 and 7 reduce the frequency of ministerial reporting to Parliament from 5 to 2 years. The new clause after clause 196 adds further conditions in relation to the draft order, in particular (subsections (1) and (2) that it must be accompanied by an explanatory document setting out particular information and reasoning. Subsections (3) and (4) provide for limited restrictions on disclosure of representations in the explanatory document which are preceded in the Legislative and Regulatory Reform Act.

Clause 200: amendments 11 and 12 in respect of clause 199: orders containing consequential provisions

8. Clause 199 enables, in subsection (7), a provision that is consequential upon the commencement of the Bill to be contained in a separate order which would not be subject to parliamentary procedure. The Delegated Powers and Regulatory

Reform Committee, in its above report on the Bill, recommended that such additional orders should be subject to the negative procedure. In its response, the Government said it would carefully consider this recommendation. Amendments 11 and 12 change clause 200(7) in a way that provides negative procedure for such additional orders.

Clause 200: amendment 13: exemption from hybridity procedure

9. The Delegated Powers and Regulatory Reform Committee, in its above report on the Bill, noted that clause 200(10) disappplies the hybrid instruments procedure for affirmative instruments under the Bill and drew this to the attention of the House. In its response the Government noted the Committee's comments and indicated some powers to whose use it considered the hybrid instruments procedure should not apply, for example clause 2 and clause 150 which simply enable the adding (under affirmative procedure) of various bodies that are subject to the relevant duties. The amendment achieves the effect of narrowing the exemption from the hybrid instruments procedure to use of an order under clause 2 (power to add bodies to be covered by the socio-economic duty) or regulations under clause 150 (power to specify public authorities), 152 (power to impose specific duties), 153(2) (power to impose specific duties on cross-border authorities) or clause 154(5) (power to modify or remove duties that have already been imposed).

Clauses 201 and 202: amendments 18 and 24

10. The Delegated Powers and Regulatory Reform Committee noted that it was unclear whether statutory instruments made by Ministers of the Crown and referred to in clauses 200(3) were subject to any parliamentary procedure. Amendment 136 has previously been tabled to clarify that instruments which are not subject to the affirmative procedure because they are listed in 200(3) are subject to the negative procedure. The same point arises in relation to instruments made by the Welsh and Scottish Ministers. Clauses 201 and 202 set out the procedures to be followed in their respective legislatures when the Welsh and Scottish Ministers make statutory instruments. Amendments 18 and 24 mirror amendment 136 and clarify that instruments which are not subject to the affirmative procedure because of clauses 201(2) and 202(2) are subject to the negative procedure.

APPENDIX 3: 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.

For the meeting on 10 February, Lord Butler of Brockwell declared an interest on the Financial Services Bill as an Adviser to TT International.