A Government response to the Joint Committee

Introduction

A.1 The Joint Committee on the draft Financial Services Bill (the Joint Committee) was formed in July 2011, charged with the role of considering the draft Bill published by the Government in its White Paper of June 2011. The Joint Committee consisted of 12 members, six MPs and six peers, and was chaired by the Rt. Hon Peter Lilley, MP.[1] The Joint Committee completed its deliberations and published its report on 19 December.

A.2 The Government welcomes the report of the Joint Committee, and thanks the members of the Committee for their work. The analysis, advice and recommendations of the Committee have been invaluable in developing and taking forward the Government's reform programme for financial regulation, and the Government has made a significant number of amendments to the Financial Services Bill based on the Joint Committee's recommendations.

A.3 This Annex sets out each of the Joint Committee's recommendations in full, alongside the Government's response.

Recommendations and responses

A.4 This section presents the Joint Committee's recommendations in turn, grouped by subject matter, followed by the Government's response. The text of each recommendation is presented in indented italic text, for ease of identification. The paragraph numbers in brackets refer to those in the Joint Committee's Report.

General recommendations

Successful regulation depends more on the regulatory culture, focus and philosophy than on structure. (Paragraph 16).

To be successful the reforms will have to change the regulatory culture and philosophy. It is through a change in culture and philosophy that the relevant authorities can best ensure both financial stability and good conduct of business. A key aspect of the cultural change needed will be a shift towards forward looking supervision. This will require staff with appropriate experience, approach and attitudes. A change in culture is not something that legislation can guarantee but legislation can influence the culture of a regulator by:

1. *setting objectives,*
2. *allocating and aligning powers and responsibilities,*
3. *establishing appropriate systems of accountability.*

1 The other members of the Committee were: Baroness Drake, Lord McFall, Lord Maples, Lord Newby, Lord Skidelsky , Baroness Wheatcroft, Nicholas Brown MP (Newcastle upon Tyne East), David Laws MP (Yeovil), David Mowat MP (Warrington South), George Mudie MP (Leeds East) and David Ruffley MP (Bury St Edmunds)

Without significant changes to clarify objectives, allocate appropriate powers and create proper accountability the Bill as currently drafted will not guarantee a change in regulatory culture. This report makes recommendations to address these weaknesses. (Paragraph 24)

A.5 As highlighted throughout the body of this document, the Government agrees with Joint Committee's emphasis on the importance of regulatory culture at the PRA and FCA. As the Government has made clear in the previous consultation documents, the box-ticking approach to financial regulation in the run-up to the financial crisis failed. The new regulators must be empowered to use their judgement to examine firm's business models and determine their viability, not just in the present, but with a view to future risks.

A.6 The Joint Committee has made many constructive observations relating to the approach of the regulators, and the need to entrench a judgement-led approach. The Government particularly welcomes the Joint Committee's recommendations to introduce a duty for the PRA's to supervise, and to review the threshold conditions that firms must satisfy in order to remain authorised. As described in more detail below, the Government has made amendments to implement these proposals.

Recommendations on statutory objectives

The FPC's objective

We recommend the Government reconsider the drafting of clause 3 (new Bank of England Act 1998 clause 9C(6)) to make clear the importance of monitoring the global exposure of UK banks. (Paragraph 32)

The reference in the FPC's objective to monitoring "systemic risks attributable to structural features of financial markets or to the distribution of risk within the financial sector" is presumably intended to place a duty on the FPC to consider the interconnected nature of the market—this duty should be made more explicit. (Paragraph 33).

A.7 The Government believes that the language in the draft Bill already covered the particular types of risk identified by the Joint Committee. However, the Government recognises the importance of being as clear as possible in defining key issues when legislating to provide for the statutory objective of a new body with significant macroeconomic responsibilities. Therefore, in line with the Joint Committee's recommendations, the Bill has been amended to make this absolutely clear.

Defining financial stability

Preventing excessive or inadequate growth of credit will be an important part of the way that the FPC meets its objective. However, it will also need flexibility to consider other factors which bear on the stability of the financial system. Moreover, it would in our view be premature to attempt to set quantitative targets for credit growth before the FPC has experience of developing and applying macro-prudential tools. So we do not recommend setting a credit based objective for the FPC. (Paragraph 40)

A.8 The Government notes that the Joint Committee has endorsed its view that an objective focused more closely on the sustainable supply of credit would not be workable or appropriate.

Financial stability and economic growth

The Government is right to require the FPC to consider the impact of its decisions on growth. But the Bill's current drafting is too strong and restrictive. The FPC is not authorised to take any actions to promote stability if it is likely to have a significant adverse effect on the financial sector's contribution to growth in the medium or long

term. The Bill should be redrafted so that like the MPC, the FPC must have regard to the Government's growth and other economic objectives subject to meeting its primary responsibility of attaining financial stability. (Paragraph 44)

A.9 The FPC's objective will require it to contribute to the Bank's financial stability objective to "protect and enhance the financial system of the United Kingdom". Action to increase the resilience and stability of the financial system must, however, be proportionate. While the recent financial crisis has demonstrated the significant negative impact that macro-prudential risks crystallising in the financial system can impose on the economy, disproportionate regulation could be just as damaging.

A.10 When the Chancellor gave evidence to the Joint Committee he argued that the Government should not seek the "stability of the graveyard"[2] in strengthening the system for protecting financial stability. In other words, the FPC should not be able to pursue stability to the point where the financial sector can no longer support the real economy. The FPC must, therefore, strike a balance between making the financial sector safer overall without compromising economic growth in the long term. This is why the FPC's objective features a stronger growth element than that of the MPC.

A.11 The current formulation of the FPC objective achieves the right balance between financial stability and economic growth. While the objective requires the FPC to consider the impact of its action on growth, it clearly allows – and indeed requires – the FPC to take action to mitigate systemic risk (for example, an asset price bubble). By taking effective and timely action (in the example above, to "lean against" unsustainable credit growth), the FPC will be protecting long-term economic growth. Allowing such a bubble to build and then burst would likely have serious negative implications for growth in the medium or long term.

The role of the Treasury in interpreting the financial stability objective

The draft Bill should be amended so that the Treasury, not the FPC, have the final say about the remit of the FPC. We would normally expect the Treasury and the FPC to come to an agreement about the remit and therefore we would not expect the Treasury to have to override the FPC on a regular basis. If the FPC has any objections to the annual remit issued by the Treasury it should make these public and alert the House of Commons Treasury Committee. Notwithstanding that the Treasury may suggest matters that the FPC should regard as relevant to the Committee's understanding of the Bank's financial stability objective the Bank of England will remain responsible for the entirety of that objective. (Paragraph 49)

A.12 The Government notes this recommendation and has made appropriate amendments to the Bill, as discussed in detail in chapter 2. The Government acknowledges the need for the FPC to be properly accountable to democratic institutions, but believes that this cannot be achieved if its institutional responsibilities are diluted. Macro-prudential judgements are such that the FPC may need to make unpopular decisions – for example, to limit the availability of credit to address an unsustainable asset bubble. It is vital that such decisions can be taken independently of political influence. However, the Government agrees with the Joint Committee's assertion that where the FPC does not agree with the Treasury's recommendations, it should make its concerns public. The Bill has been amended accordingly to require the FPC to respond publicly to the Treasury's remit, setting out how it intends to comply with the recommendations and, where appropriate, setting out its reasons why it does not intent to act in accordance with the remit.[3]

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[2] The Chancellor's statement can be found in the record of the oral evidence to the Joint Committee on the draft Financial Services Bill, which is available from www.parliament.uk

[3] New section 9D of Bank of England Act, as inserted by clause 3 of the Bill

Indicators of financial stability

> *The FPC should begin work towards developing indicators of financial stability in dialogue with the Treasury. They should be published and the FPC should report against them. The set of indicators should be flexible and subject to regular review. (Paragraph 54)*

A.13 The Government believes that openness and transparency are important to secure public understanding of macro-prudential policy. The Bank has made clear in its response to the TSC's report into Bank accountability[4] that the FPC will regularly publish, and report against, indicators of financial stability.

Financial stability and recourse to public funds

> *We agree with the Chancellor that avoiding where possible the need for taxpayers' money to support or rescue parts of the financial services industry is a key element of financial stability. There will of course always be a possibility that public funds are called on to preserve stability but part of the objective of the FPC should be to minimise the likelihood of this happening. The FPC's objective should be amended to require it to "reduce the likelihood of recourse to public funds". (Paragraph 58)*

A.14 The Government agrees with the Joint Committee that the protection of public funds should be a core priority for the new regulatory system. In fulfilling its objective to protect and enhance financial stability, the FPC will be responsible for reducing the likelihood of serious threats to stability that might have the potential to put public funds at risk. However, the FPC will not have a role in crisis management and will therefore not be involved in decisions made when there is a material risk to public funds, much less in specific decisions about the use of public funds to resolve a particular risk. The Government believes that the proposed specific "public funds" objective for the FPC would therefore not be appropriate.

Possible conflict between the MPC and the FPC

> *We do not expect any serious conflicts between the MPC and FPC but they may arise. Careful co-ordination and communication should minimise the risks as should the evolution of the FPC's interpretation of its objectives. In the rare occasions when the two committees come into conflict the Governor should inform the Court – or the equivalent body if it is reformed – and the Chancellor, to explain how the conflict will be handled. Even if there is a difference of opinion the two committees must remain independently responsible for their own levers. (Paragraph 70)*

A.15 The instruments through which monetary policy and macro-prudential regulation are pursued will likely interact with each other in influencing macroeconomic outcomes. So while the decisions of one Committee will inevitably have an effect on the deliberations and decisions of the other, they will each be responsible for their own levers. The Government notes that this is an approach endorsed by the Joint Committee. The Government agrees with the Joint Committee that coordination and communication between the MPC and FPC will be very important.

A.16 There will be significant executive cross-membership between the MPC and the FPC – the Governor, two deputy governors and the executive director responsible for markets will sit on both committees. This will ensure that the interactions between each separate remit are fully considered and taken into account. Shared membership should ensure consistent policy and there is no need to legislate for specific mechanisms.

4 Bank of England, *Response from the Court of the Bank to the recommendations made by the Treasury Committee and Joint Committee on the Draft Financial Services Bill on the Accountability of the Bank oF England*, January 2012, paragraph 5.Available from www.bankofengland.co.uk

A.17 Fundamentally, given the Bank's broad overview of the financial sector and the close link between monetary stability and systemic regulation, the Government believes that combining responsibility for the two areas within the Bank, but in separate Committees, will strengthen the Bank's pursuit of both objectives.

Organisational status of the FPC

The governance arrangements in the draft Bill—where the FPC is a committee of the Court and the MPC is a committee of the Bank—risk giving the impression that one body is more important than the other. The FPC should be made a committee of the Bank. (Paragraph 74)

A.18 The Government notes the Joints Committee's recommendation. It has been argued, including by the Bank's senior management when giving evidence to the TSC, that the FPC should remain under the oversight of Court in order to allow better coordination of the Banks' various financial stability activities. The Government notes the recent response of the Court of the Bank on this matter and will consider the status of the FPC further.

The PRA's objective

In order to align its objectives with its own activities and with international best practice, the Bill should explicitly give the PRA a microprudential objective alongside its concern with avoiding risks to the whole system. When supervising PRA regulated persons, the primary objective should remain to reduce risks to the stability of the UK financial system. The secondary objective should be to reduce potential costs of failure to the Financial Services Compensation Scheme, taxpayer funds and customers. Neither objective requires the PRA to be a zero failure regulator. The second objective will mean ensuring firms comply with rules on for example, capital adequacy, solvency and liquidity that will reduce but not eliminate the likelihood of failure. (Paragraph 78)

A.19 The Government acknowledges that are some attractions to reframing the PRA's objective in terms of prudential outcomes, as the Committee has suggested. However, specifying particular desired outcomes creates difficulties. For example, the extent to which the failure of a firm results in a call on public funds will depend to an extent on the actions of the government of the day, for example in taking a decision to nationalise or recapitalise a failing institution. It is also potentially problematic to highlight some outcomes over others. In some circumstances, the failure of a significant firm followed by a large FSCS payout may the best way of protecting depositors and taxpayers while maintaining market discipline. The secondary objective suggested by the Joint Committee could, in such circumstance, lead to a lack of clarity over the regulator's remit.

A.20 On balance, therefore, the Government believes that it is more appropriate to frame the PRA's objective more broadly, requiring the PRA to focus on the regulation of the safety and soundness of individual firms, so as to improve financial stability.

Competition in the PRA objective

Competition within the financial sector is an important part of developing a stronger, more diverse system. The actions of the PRA have the potential to affect the costs of individual firms or of particular types of institution, and affect the barriers to entry and expansion in the market. While the need to protect and promote competition in the sector should not dictate the actions of the PRA, nor detract from the clear role of the OFT in this area, we believe it is a factor that ought to be considered in the course of PRA decision making. We invite the Treasury to consider how best this duty could be included in the Bill. (Paragraph 83)

A.21 Financial stability, supported by a rigorous and effective regulatory framework, provides a strong platform for the financial services industry's sustainable growth and success. Central to the Government's model is that regulatory remits need to be more focused and less diffuse if the failings of the current model are not to be replicated.

A.22 The Government recognises, of course, that competition is an important feature of a healthy financial sector that is able to meet the needs of those who consume the services it provides. The FCA will be the regulatory authority responsible for promoting this outcome, and as discussed elsewhere, the Government accepts the Joint Committee's recommendations to strengthen the FCA's remit in this regard. The Government's view, therefore, is that the combined effect of competition scrutiny powers (as applied to the PRA and FCA) and the FCA's objective will be appropriate mechanisms for recognising and safeguarding the importance of competition in the new arrangements.

The PRA's insurance objective

> *There is legal uncertainty regarding the definition of the "reasonable expectations" of policyholders. Using a phrase of this kind makes it difficult for the PRA to be clear on the meaning of its duties, and near to impossible for consumers and Parliament to hold the PRA to account for its actions. The phrase has been shown to be problematic in the past: it is unwise for the Treasury to revive it in new legislation and thereby risk the same difficulties recurring. The PRA should be responsible for ensuring that with-profits consumers are treated fairly, but the Treasury must find a way to redraft the Bill to achieve this end without using the problematic phrase "reasonable expectations". The PRA should be given an explicit duty to consult the FCA, as the consumer expert, on matters affecting with-profits consumers. (Paragraph 90)*

A.23 The Government notes this recommendation and has made appropriate amendments to the Bill.

The FCA's objective

> *The FCA's strategic objective should be amended to focus on promoting fair, efficient and transparent financial services markets that work well for users. This would better reflect the Treasury's intended purpose for the FCA, which is to ensure that business across financial services and markets is conducted in a way that advances the interests of all users and participants. (Paragraph 99)*

> *We recommend that the FCA should have a clearer role in promoting competition. To this end the FCA's operational objective of "promoting efficiency and choice" should be replaced by "promoting competition, efficiency and choice for the benefit of consumers". This will give the FCA a clear mandate in the area of competition and a clear responsibility for taking forward some of the ICB's recommendations aimed at making it easier for customers to move between retail banks and compare products. (Paragraph 103)*

A.24 The Government notes these recommendations and has made appropriate amendments to the Bill to clarify the FCA's strategic objective, and replace its "efficiency and choice" operational objective with one that focuses on promoting effective competition in the interests of consumers, as described in detail in chapter 4.

The definition of consumers

> *Given that the draft Bill requires the FCA to tailor its approach to different types of consumer we believe the definition of "consumer" should remain broad and not be restricted to a narrower category. (Paragraph 111)*

A.25 The Government notes that the Committee endorses its view that the definition of consumer should remain broad. The definition used in the draft bill reflects the various participants in the financial system which the FCA may seek to protect by virtue of an exercise of its general functions – this definition must be broad enough to ensure that these powers are not inappropriately constrained. The Government feels that the operational objectives make clear that there should not be a one size fits all approach, and that the regulator must differentiate between different types of consumers in determining what constitutes an appropriate degree of protection.

Balancing the responsibilities of consumers and firms

We recommend that the consumer responsibility principle be complemented by an amendment to the draft Bill to place a clear responsibility on firms to act honestly, fairly and professionally in the best interests of their customers. The FCA should be empowered to hold firms to account for this and ensure companies address conflicts of interest and the needs that consumers may have for advice and information that is timely, accurate, intelligible to them and appropriately presented. (Paragraph 126)

Clearly, the actions firms should be expected to take will depend on context and circumstances. For example, the way information is presented to retail consumers is likely to be different from that appropriate for a professional investor. (Paragraph 128)

A.26 The Government notes this recommendation and has made appropriate amendments to the Bill, as detailed in chapter 4. In sum, the Government is making two changes to the consumer protection objective. First, the Government is adding a new "have regard" so that in deciding what degree of protection is appropriate the FCA will be required to have regard to the general principle that those providing regulated financial services should be expected to provide a level of care appropriate to the consumer involved or transaction being undertaken. Second, the Government is replacing the current have regard covering in general terms the need for accurate information with one setting out explicitly consumers' need for advice and information that is accurate, timely and fit for purpose. In addition, the Government has also amended the senior management responsibility principle to which the new regulators will have 'have regard' to when discharging their general functions. The new wording requires the regulators to have regard to "the responsibilities of the senior management of persons subject to requirements imposed by or under this Act, including those affecting consumers, in relation to compliance with those requirements". This reflects the fact that the senior management of regulated firms are responsible for securing compliance with the regulatory framework, including requirements that affect consumers.

Recommendations on responsibilities and powers

Crisis management

It is vital that legislation makes proper provision for handling crises (including the ongoing need for the lender of last resort function) and resolving bank failures—including possible restructuring of banks to make them more resoluble. (Paragraph 10)

The powers and responsibilities of the Bank of England and the Treasury during a crisis are key. They should be carefully reviewed in light of the concerns we have raised. A duty for these bodies to co-ordinate in a crisis should be on the face of the Bill. The definition of the term "material risk" should be subject to parliamentary approval and not left to a Memorandum of Understanding. The Bill should also make it clear that there are no circumstances where it is permissible for the Bank not to notify the Treasury as soon as material risk to public funds becomes clear. (Paragraph 140)

A.27 The Government agrees with the Joint Committee that crisis management is a very important issue, and that it should be covered by appropriate statutory provision. More specifically, the Government agrees that a statutory duty on the Bank (including the PRA) and Treasury to coordinate activity in a crisis would be a helpful clarification, and as such has amended the Bill accordingly.

A.28 The Government can confirm that the drafting in the Bill does not provide any discretion for the Bank over whether or not to notify the Treasury once a material risk to public funds has clearly arisen. The draft crisis management MOU at Annex E sets out in detail the factors the Bank will consider when deciding whether it is necessary to make a notification of a risk to public funds. However, the MOU does not give a strict definition of what "material risk" means, as it would be difficult, if not counterintuitive, to attempt to provide a formulaic test for something that is ultimately a matter of judgement. Attempting to codify such a decision in a strict statutory test would be counter to the general thrust of changing the culture of the regulatory system to place a greater emphasis on expertise and judgement – an approach which the Joint Committee has elsewhere stated it supports.

A.29 Given this, the Government has chosen not to attempt a formal definition of "material risk" and has instead taken the approach of detailing the process by which the judgement of materiality will be made. Given this focus on process, the Government considers that the crisis management MOU, rather than the primary legislation itself, is the most suitable place for this material to be included.

> *The Bill should be amended so as automatically to give the Chancellor power to direct the Bank after a formal warning of a material risk to public funds. At this stage ultimate responsibility rests with the Chancellor. (Paragraph 143)*

A.30 The Government notes this recommendation and has made appropriate amendments to the Bill to provide the Chancellor with a new power of direction, as detailed in chapter 2.

Powers and responsibilities of the FPC

Powers to identify and monitor systemic risks

> *We are sympathetic to the need for the FPC to have powers to collect information from those outside the regulatory perimeter. In fact the FPC will normally be able to obtain the information it needs through the PRA but sometimes this might cause delay. The FPC should be given a reserve power if it thinks that requesting the information directly through the PRA could cause delay or have adverse consequences. (Paragraph 148)*

A.31 The Government notes this recommendation and has made appropriate amendments to the Bill to reduce the potential for delay when the FPC recommends that it is necessary for information be gathered by the PRA from firms or classes of firms to which the PRA does not yet have access.

Operation of the FPC's power of direction

> *Where the FPC is to be given the power to direct the PRA and FCA to implement a macro-prudential tool it should also be given the power to direct the regulators as to the timing and means of implementing that tool. The FPC should use this power where the timing and means of implementation are likely to have a significant impact on the effectiveness of the tool. If these circumstances do not exist the decisions about timing and means are better left to the regulators—the PRA and FCA—who hold the expert knowledge. (Paragraph 161)*

A.32 The Government does not believe this change is necessary. In addition to the power to direct the PRA and FCA to implement macro-prudential decisions, the Bill provides powers for

the FPC to make specific recommendations on timing and means of implementation of the macro-prudential tools. The PRA and FCA must comply with such recommendations unless they have very strong reasons not to, which they must explain publicly in the event that they decide not to comply. The Government believes that the PRA and FCA will hold the expert knowledge required to make the micro-prudential judgements to ensure that the timing and method of implementation proposed by the FPC does not cause any unintended consequences, including to the stability of individual firms.

Power for the FPC to set UK macro-prudential rules

We welcome the language in the proposed Capital Requirements Directive IV that appears to allow member state authorities to take into account "structural variables and the exposure of the banking sector to any other risk factors related to risks to financial stability". Nevertheless, the Government must continue to push for the removal of all restrictions on the ability of member states to raise their capital requirements above internationally agreed minima. Such freedom to impose higher capital requirements is essential given the large size of Britain's banking sector relative to its economy. (Paragraph 172)

The FPC and the PRA should consider carefully what actions they will take with regard to capitalisation and liquidity requirements in the event of another crisis and must consider to what extent they are currently constrained by European regulation and how far this represents a threat to the UK's ability to respond to any financial crisis. Where they assess that they are constrained by European regulation they should report this to the Treasury and to the committee that we recommend as being responsible for co-ordinating international representation on these type of issues. (Paragraph 175)

A.33 The Government agrees that it is vital that European legislation gives national regulators the discretion to go beyond the internationally agreed Basel III proposal when national circumstances require it in order to safeguard financial stability and reduce the risk of a potential call on taxpayer funds. The European Systemic Risk Board has also emphasised the need to ensure that national authorities are equipped with sufficient discretion to take macro-prudential action at a national level. The Government will continue to work to ensure that there is adequate flexibility in European legislation. The Government also agrees that the international coordination committee and the MOU which establishes it will provide the principal forum in which to discuss these matters.

European rulebook negatively impacting on use of judgement

A.34 More broadly, but linked to their recommendation on capital requirements, the Joint Committee recommended a role for the proposed international regulatory committee in "ensuring that the European rulebook does not limit the necessary discretion of the UK supervisory authorities to achieve forward looking regulation". The Government agrees with the sentiment of this recommendation; the informed use of judgement by the new regulatory bodies is a key overriding tenet of these reforms to the regulatory system. This may well develop to be a key role for the Committee that will be established in the international organisations MOU, but does not require specifying in legislation.

Powers and responsibilities of the PRA

Powers in respect of firms headquartered outside the UK

For all major banks with significant branches in the UK the PRA should be on the college of supervisors for that bank. (Paragraph 178)

A.35 The FSA is a member of regulatory colleges for all major banks with significant branches or subsidiaries in the UK, and the PRA will take on such memberships. Regulatory colleges, in

addition to providing highly valued means of knowledge sharing and cross-border supervision for large multi-national financial institutions, provide opportunities for constructive international cooperation in financial services regulation. Separate from regulatory colleges are core colleges, which tend to be included in Crisis Management Groups: these core colleges bring together the supervisors of the most significant subsidiaries globally. The FSA is a member of these where the UK subsidiary is significant enough within the group, and the PRA will take on these memberships.

> *Even though the PRA may, under CRD IV, gain limited powers to oversee the UK operations of EEA firms these will remain ultimately the responsibility of their home state regulator. The PRA and the FCA should seek to ensure that the public understand when a banking group is not subject to UK prudential regulation. Where deposits are not covered by the Financial Services Compensation Scheme the regulators should require banks to make this clear with prominent warnings in branches and on websites. The regulators should work with consumer groups to plan how best to get this message heard and understood. (Paragraph 180)*

A.36 The Government agrees with this recommendation, and welcomes the work already carried out by the FSA in this area. The Government would expect both the FCA and PRA to continue this work in the normal pursuance of their objectives.

Reporting on international coordination

> *The PRA will be under a duty to co-ordinate with international regulators. This is an immensely important duty given the international dimension of many of the firms whose failure could impact on the stability of the UK financial system. In order that the PRA can be effectively held to account for its duty to co-ordinate with international regulators we recommend a further duty to report on its work in this area. (Paragraph 182)*

A.37 The Government notes this recommendation and has made appropriate amendments to the Bill.

Empowering the PRA to conduct judgement-led supervision

> *Forward looking supervision is a desirable aim. Mechanical enforcement of rules should not be the objective of the regulators. We agree with the Bank of England that more needs to be done to ensure the PRA has the legal power to supervise using forward looking judgement. As a first step the Bill should be amended to place a duty on the PRA to supervise firms. The Treasury should then consider how to enshrine in the legislation the concept of forward looking supervision. In particular, the threshold conditions which set out what firms must do to become and remain authorised should be carefully reviewed to ensure that they embody all the things that the PRA may wish to consider in a forward looking regime. (Paragraph 196)*

> *There has been concern and uncertainty about what forward looking supervision might mean for firms. Once established, the new regulators should provide clarity on this issue. A less predictable approach means that regulators will have greater discretion and it is therefore important that attention is paid to the proportionality principle. (Paragraph 197)*

A.38 The Government agrees with Joint Committee that forward-looking, judgement-led supervision will be a key improvement resulting from its new framework. The Government notes, in particular, the recommendation that the PRA be given a formal duty to supervise firms, and has made appropriate amendments to the Bill. With respect to threshold conditions, the Government has noted carefully the Committee's suggestions in this area, including its concerns that fundamental change should be subject to detailed consultation. The Government will

conduct a comprehensive review of the threshold conditions and bring forward changes in due course, as detailed in chapter 3 of this document.

A.39 With respect to communication by the new regulators with firms, the Government is encouraged by the work that has already been carried out in this area with the joint publication of approach documents for the PRA and FCA by the Bank of England and FSA. The approach documents have already started to provide firms with a clear idea of what will be expected of them and this will be articulated further in the coming months.

Designation of PRA scope

> *The PRA's regulatory perimeter should be broader. We should expect firms of the significance of MF Global, and firms engaging in rehypothecation of client money and assets, to be supervised by the PRA. (Paragraph 209)*

A.40 The Government, the Bank, and the FSA will continue to consider the question of PRA scope, including issues around rehypothecation of client assets. There is also a role for the interim Financial Policy Committee, which has a mandate to advise the Government on issues relating to financial stability and the regulatory perimeter. No change has been made to the provisions of the Bill, as the legal framework already provides sufficient flexibility for changes to be made through secondary legislation – including the Regulated Activities Order, and the Order to be made under new section 22A (designation of activities requiring prudential regulation by the PRA).

> *We are persuaded that there is cause for concern in the area of regulation of holding companies, and recommend that the Treasury examine how it can provide the PRA with more comprehensive powers to ensure a consistent regulatory approach. (Paragraph 211)*

A.41 The Government notes this recommendation and has made appropriate amendments to the Bill. As detailed in chapter 3, the Government has broadened the powers over holding companies provided to the PRA in the draft Bill. The Government also notes the need for change to the regime for regulation of holding companies – many of which exist to provide corporate structures governing the operation of global financial conglomerates – to be agreed internationally, across jurisdictions. The Government is engaging proactively with the emerging European legislation in this area, including the Financial Conglomerates Directive, and the new crisis management framework.

> *It is right that the designation of PRA regulated activities is left to secondary legislation. The financial landscape develops quickly and any definition fixed in primary legislation could soon become redundant or inadequate. The secondary legislation approach will allow a quicker response if the regulatory perimeter needs to be changed in order to accommodate a new area of risk. Nevertheless, given that the initial designation of PRA regulated activities is a key factor in understanding the intentions and scope of the Bill, a draft of the Order must be available when the Bill is introduced into parliament. (Paragraph 213)*

A.42 The Government notes that the Joint Committee endorses its approach in this area. A draft of the Order to be made under section 22A (designation of activities requiring prudential regulation by the PRA) of the Bill is published on the Treasury website, as recommended by the Joint Committee.

> *The procedures for orders designating PRA activities should be amended to provide for an enhanced affirmative procedure in non-urgent cases, retaining the made affirmative procedure for urgent cases only. We appreciate that there will be instances where fast action is required, but it is not appropriate for the 28-day procedure to be applied as a*

matter of routine. The enhanced affirmative procedure should be modelled on that contained in Section 11 of the Public Bodies Act. (Paragraph 217)

A.43 The Government notes this recommendation and has made appropriate amendments to the Bill. The Government recognises that additional Parliamentary scrutiny of the designation order would be desirable, and has therefore amended the procedure to the affirmative.

The role of the PRA in markets regulation

For consistency of regulation, there is a strong rationale for keeping regulation of market infrastructure together. Given the PRA's role in regulating prudentially significant firms, we recommend that the regulation of market infrastructure should sit within the PRA. As is the case for other PRA-regulated firms, the FCA will have an important role in regulating market infrastructure with the respect to conduct issues, and it is important that the legislation makes this clear. Appropriate coordination mechanisms between the two regulators will be required. (Paragraph 231)

A.44 The Government's proposals have always been clear that the Bank of England (not the PRA) should be responsible for regulating clearing and settlement infrastructure (e.g. settlement systems and recognised clearing houses) while the FCA would regulate trading infrastructure (e.g. recognised investment exchanges and multilateral trading facilities). This is consistent with the Bank of England's existing responsibility for regulating systemically important recognised payment systems.

A.45 It would not be appropriate for the PRA to regulate all market infrastructure. Only recognised clearing houses that are central counterparties have the kind of financial exposures (for both capital and liquidity) that PRA-authorised firms have. Settlement systems do not have that kind of exposure, and their technological similarities with payment systems support the co-location of regulatory responsibilities in the Bank of England. The close links between the Bank of England and the PRA will ensure that the Bank has access to appropriate expertise for regulating the financial requirements of central counterparties.

A.46 It is more appropriate for trading infrastructure to be regulated by the FCA which will be responsible for regulating the conduct of authorised persons who use recognised investment exchanges or multilateral trading facilities to deal for their own account or the account of their customers.

We are concerned by the gap in resolution arrangements for market infrastructure firms that may be of systemic importance. The Treasury should take action to ensure that this gap is closed. (Paragraph 233)

A.47 The Government agrees that resolution arrangements of market infrastructure firms need to be investigated. However, this is a global issue and must be addressed as such. Work on this is under way internationally; the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) are currently hosting a working group (which includes the UK and is FSA-chaired) looking at central counterparty resolution powers.

Information from auditors

The PRA will be better able to identify risks building up in individual firms if it established an effective working relationship with bank auditors. The draft Bill should be amended to place a statutory duty on the PRA to meet regularly with bank auditors. The Treasury should consider whether any complementary duties can and should be placed on auditors for example to draw certain risks to the attention of regulators. (Paragraph 236)

A.48 The PRA should be free to determine its own approach to assessing the prudential integrity of the firms that it regulates – the Government does not wish to prescribe operational matters in legislation. The Bank and FSA have stated that the PRA will engage closely with auditors, and the PRA and FCA will have powers to make rules imposing duties on auditors.

Quality of information held by firms

> *The Bill should be amended to place a duty on the Bank of England (or its subsidiary the PRA) to develop information standards for the UK financial services industry and to report regularly on progress in improving these information standards in order to support financial stability. (Paragraph 243)*

A.49 The PRA (and the FCA) will have the ability to make rules requiring firms to hold information in a particular way, as the FSA does now. The FSA has already made some such rules - for example the single customer view rules, which require banks to hold information in a form that enables rapid FSCS payout. Similarly, recovery and resolution plan rules require firms to hold information that would assist in resolving their business.

A.50 The Joint Committee report notes that the Office for Financial Research has "responsibility for monitoring of systemic financial risks and, in order to undertake this task, has been given powers for the setting of data standards for the industry." But the UK's regulatory system will be structured differently to the US system. The FPC will monitor systemic risk – and the PRA and FCA will both be under a duty to provide the FPC with the information it needs to do so. Given this, and the fact that both regulators will be able to make rules of the sort recommended by the Joint Committee, the Government does not believe it would be necessary to legislate for such a duty.

Powers and responsibilities of the FCA

Consumer credit

> *We welcome the Government's decision to look at whether consumer credit should be moved to the FCA. Consumer credit products may pose different problems to other financial products, and it is important that the way in which they are regulated is proportionate, taking into account costs to firms and potential benefits to consumers. However, given the potential for consumer detriment in the case of some types of credit products, there are significant benefits in transferring consumer credit to the FCA, to ensure clarity of responsibilities, and to ensure that the FCA is better able to identify and deal with consumer issues across the financial services market. (Paragraph 250)*

A.51 The Government notes this recommendation, and can confirm that powers will be included in the Financial Services Bill to enable the transfer of responsibility for consumer credit regulation from the OFT to the FCA. However, the Government recognises that such a transfer would involve a significant change for many firms not currently authorised by the FSA, and the importance of ensuring that FCA regulation takes account of the distinct and diverse nature of the consumer credit market. The Government will, therefore, only exercise the powers in the Bill when it has identified a FSMA-based model that delivers proportionate regulation for the different segments of the consumer credit market. The exercise of these powers would also be subject to full consultation and impact assessment, and approval by both Houses of Parliament.

Early publication of disciplinary action

> *We recommend that the requirement to consult before disclosing the fact that a warning notice has been issued should be removed from the draft Bill. However, we do think it important that the FCA has the discretion to weigh the relevant factors and decide which set of interests listed in the Bill (fairness, potential to be prejudicial and potential for detriment to financial stability) are best served by disclosing or not disclosing that a*

warning notice has been issued. We also think that the FCA should be required to publish guidance as to how it will exercise its discretion in respect of disclosing that a warning notice has been issued. This will provide some degree of certainty to firms over how the FCA will treat different cases. (Paragraph 258)

A.52 The Government notes that opinion on this power has been divided; while industry has broadly opposed the power or called for further safeguards, the FSA and some consumer groups have strongly supported the power, and have called for the need to consult to be removed. The Joint Committee has endorsed this latter position. The Government believes that its current proposal strikes the right balance between making the power usable and providing appropriate safeguards for those affected. The Government also notes that the power as drafted ensures procedural fairness. The Government has therefore not made any changes to this power.

Trusted consumer products

A system of identifying and certifying simple, low cost financial products is an attractive idea. This is not a role that the regulator should take on but it is something the voluntary sector itself may be well placed to do. The FCA should be prepared to help the voluntary sector in these endeavours by providing information on products and their costs. (Paragraph 263)

A.53 The Government agrees that the identification and certification of simple financial products is not necessarily a role for the regulator. A Steering Group chaired by Carol Sergeant, former head of risk management at Lloyds TSB and MD of the FSA, has been tasked by the Government to deliver a report to Ministers by July 2012 on how a suite of simple financial products could be introduced by the industry. The Group is comprised of industry and consumer representatives, the Treasury and the FSA will have observer status on the Group.

Competition powers

The Government should review its decision on the FCA's competition powers. The FCA should be given concurrent powers alongside the OFT to make market investigation references to the CC. The FCA will need greater competition powers to achieve its recommended objective than is currently set out in the draft Bill. (Paragraph 279)

We also recommend that designated consumer bodies should be able to make super-complaints to the FCA, as well as the OFT. (Paragraph 280)

A.54 The Government has concluded that no change is required to the mechanism provided for in the draft Bill, which allows the FCA to make a referral to the Office of Fair Trading rather than the Competition Commission. Instead it will accept the recommendation of the TSC that the issue be revisited once the FCA has bedded in, as detailed in chapter 4.

PRA and FCA duty to co-ordinate

The PRA and FCA must co-ordinate as far as possible to minimise the burden on dual-regulated firms. We welcome the assurances that information given to one regulator will be shared with the other so that the same information will not have to be given twice. While a joint rule book and a single point of contact may not be possible, the two bodies should consider other methods of reducing the burden. A draft of the Memorandum of Understanding on co-ordination between the PRA and FCA must be available when the Bill is introduced into parliament. (Paragraph 291)

A.55 Effective coordination between the PRA and FCA will be essential to ensure that they can deliver their statutory objectives in an effective and timely manner. A draft of the coordination MOU has been published by the Bank and FSA, and sets out clear, detailed mechanisms for coordination between the two regulators.

The draft Bill should be amended so that the FCA will have to give its consent before the PRA approves any persons holding significant influence in a dual-regulated firm. (Paragraph 294)

A.56 The Government notes this recommendation and has made appropriate amendments to the Bill.

Influencing EU and international decisions

We strongly support proposals for an international regulatory committee. To be really useful it would need to go wider than just representatives of the FCA and PRA. We suggest that the international co-ordination Memorandum of Understanding establishes a committee responsible for ensuring the UK authorities agree consistent objectives and exercise their functions in a way that is effective. This committee should report to the Chancellor and include representatives of the PRA, the FCA, the Bank and the Treasury. The Treasury should chair this committee. (Paragraph 305)

A.57 The Government notes this recommendation and has made appropriate amendments to the Bill and the draft international organisations MOU (included at Annex F).

The new committee which we proposed be established to agree objectives and maximise the UK's influence in EU and international negotiations should have as an objective ensuring that the European rulebook does not limit the necessary discretion of the UK supervisory authorities to achieve forward looking regulation. (Paragraph 198)

A.58 The Government agrees with the sentiment of this recommendation; the informed use of judgement by the new regulatory bodies is a key overriding tenet of these reforms to the regulatory system. This may well develop into a key role for this new Committee, but it does not require specifying in legislation.

Responsibility for considering the ethics and remuneration structures of firms

The Government should consider the FSA's recommendations on changing the remuneration arrangements for executives and non-executive directions, or introducing a concept of 'strict liability' of executives and Board members for the adverse consequences of poor decisions, in order to ensure that bank executives and Boards strike a different balance between risk and return. Amendments could be brought forward to this Bill. (Paragraph 225)

A.59 The Government will consider the FSA's recommendations in this area carefully. As detailed in chapter 5, the Government and the FSA will publish a joint consultation document in the spring, discussing options for further action in this area.

Attracting the right staff

The PRA and the FCA will need to attract staff with the appropriate approach and experience if the required cultural change is to be realised. There is considerable debate, which we cannot resolve, about how this can be achieved within the financial constraints of public sector bodies. The PRA and the FCA should publish practical plans that explain how they will ensure that they have staff with suitable skills and how they will develop careers for financial regulators in the public service. They should report against progress in this area in their annual reports. (Paragraph 201)

A.60 The Government agrees with the Joint Committee and a number of respondents to the consultation that the calibre of staff will be absolutely critical in ensuring that the shift change to a judgement-led approach is achieved. However, ultimately it will be an operational decision for the regulators to ensure they have the necessary staff in place to meet their objectives and

for them to decide on how to report on this. Autonomy on operational matters (such as staffing) is an essential safeguard on the independence of the regulators.

Accountability, transparency and engagement

Governance of the Bank

The evidence we received in the course of our inquiry indicated that the House of Commons Treasury Committee was right to conclude that the governance structures within the Bank need considerable strengthening. Our recommendations about the role of the FPC add weight to this. We support the idea that the Court should be replaced by a Supervisory Board with expert members some of whom should have experience in prudential policy. The new Supervisory Board would be empowered to scrutinise work of its sub-committees and conduct retrospective reviews of decisions taken by the FPC. The reforms in the draft Bill give the Bank significant new powers in macro- and micro-prudential policy. These powers must be paired with reforms to ensure that clear accountability processes are in place. In addition we recommend that the Chairman of the Supervisory Board should be consulted over the appointment of the Governor. (Paragraph 309)

A.61 The Government recognises that the proposed new structure for financial regulation places a great deal of addition responsibility within the Bank of England. This has the potential to stretch the Bank of England's current governance structures and capacity of senior management. Both the TSC and the Joint Committee, as well as respondents to the June 2011 public consultation have made a number of suggestions aimed at strengthening the governance of the Bank.

A.62 The Government agrees with the TSC that the current situation, whereby the Governor is subject to reappointment for a second five-year term, creates a risk of "instability and at least the perception of political interference in the Bank". As the Chancellor made clear in his evidence to the TSC in July 2011, the Government believes that the independence of the Governor of the Bank of England is vital. The Government has therefore amended the legislation to move the Governor to a single eight-year term, as recommended by the TSC.[5]

A.63 The Bank has published its own response to the TSC's recommendations[6]. The Government welcomes the positive and constructive set of proposals which the Bank has brought forward in this area and will consider the Bank's response carefully before deciding whether to bring forward further legislative changes in this area.

Scrutiny of macro-prudential tools

The macro-prudential tools to be used by the FPC are of considerable importance. Some of the tools being considered will have a direct effect on the economic circumstances of constituents. Parliament must have an opportunity properly to scrutinise these powers. On the other hand there must be flexibility to grant the FPC new tools quickly in rare and urgent circumstances. In non-urgent cases we recommend that the tools be subject to an enhanced affirmative procedure similar to that set out in Section 11 of the Public Bodies Act 2011. This would provide for consideration by the relevant select committees in both Houses and where appropriate would place a duty on the Treasury to consider those committees' recommendations before laying the final instrument. (Paragraph 315)

[5] *Accountability of the Bank of England,* paragraph 143.

[6] Available from www.bankofengland.co.uk

A.64 The Government agrees that proper Parliamentary scrutiny of prospective macro-prudential tools is important. The Bill already provides for macro-prudential tools to be subject to the affirmative procedure giving Parliament an appropriate level of scrutiny. In addition, the Government will consult publicly on its proposals for the FPC's initial set of policy tools. The Government believes that the enhanced affirmative procedure would not be appropriate for the FPC's toolkit, as even in non-urgent cases, enhanced affirmative procedure could cause excessive delay in updating and amending the FPC's powers.

> *All statutory instruments aimed at granting macro-prudential tools to the FPC should contain a sunset clause of one parliament. This will allow ongoing parliamentary scrutiny of the FPC's toolkit. (Paragraph 316)*

A.65 The Government agrees that the FPC's toolkit should be subject to Parliamentary scrutiny and as outlined above, secondary legislation will outline the detail of macro-prudential tools. Some tools may well be of use for a limited period of time, in which case the Treasury can create temporary tools that can be used for a fixed period. And if the FPC or the Government believe that a tool is no longer necessary or appropriate, the Treasury could easily remove it from the toolkit via secondary legislation. However, the Government believes that automatic sun-setting all macro-prudential tools would create unacceptable levels of uncertainty around the FPC's toolkit. In addition, given Parliamentary recesses and the high levels of activity at the beginning of a new Parliament, any delay in renewing the FPC's toolkit would risk the FPC being left without key tools when it needs to use them.

Membership of the FPC

> *FPC membership must include experts from across the financial services industry including insurance and the wider economy. The draft Bill should be amended so that there are a majority of non-executives on the FPC. The interpretation of the FPC code of conduct should not prevent individuals with current and recent industry experience from sitting on the FPC but the FPC should develop clear protocols for dealing with conflicts of interest as they arise. (Paragraph 325)*

A.66 The proposed model for the FPC follows as closely as possible that of the MPC, which has worked effectively. The MPC and FPC have a similar balance of Bank executives and external members. The FPC will include, as well as Bank executives, the CEO of the FCA, and four external members. The FPC also includes a non-voting Treasury member. The Government believes that this creates an appropriate balance between Bank expertise and external challenge.

A.67 The Government notes that independent members with extensive industry experience sit on both FPC and Court, including Michael Cohrs and Robert Jenkins.

Accountability and engagement of the PRA and the FCA

Transparency

> *We recommend that the draft Bill be amended to require the FCA to publish Board & Panel minutes and agendas, where possible and appropriate. Where the FCA board has considered an issue of public policy the minutes should set out clearly the arguments for and against the policy. (Paragraph 328)*

A.68 The Government notes these recommendations, but believes that this should be a matter for the regulator and does not require legislation.

> *We look forward to the outcome of the Treasury's review on section 348 of the Financial Services and Markets Act. This section should not be retained as currently drafted. Neither regulator should be unnecessarily restricted from disclosing information. Section*

348 should be amended to make it as unrestrictive as is possible within the confines of EU law. (Paragraph 330)

A.69 The Government committed to a review of section s348 as part of the PLS process. This review is still ongoing, but its conclusions and recommendations will be made available during the passage of the Bill.

Engaging with the industry and consumers

While we consider that it is vital for the PRA to consult with practitioners, and as far as necessary, consumers, we believe it is right that the PRA should not be obliged by legislation to establish panels on the same model as the FCA. In particular, we are concerned that an obligation to create such panels could lead to regulatory capture. However, in the absence of panels it is even more important for the PRA to demonstrate that it is undertaking fair and adequate consultation. We are concerned that there is not yet clarity on how the PRA intends to go about this. We recommend that details of the proposed consultation arrangements are made available for consideration alongside scrutiny of the Bill in Parliament. The PRA should, in addition to its duty to publish details of consultation arrangements, also have a duty to report annually on its consultation activities. (Paragraph 336)

A.70 The Government notes this recommendation and has made appropriate amendments to the Bill to ensure that the PRA reports on its consultation activities in its annual report. The Bank of England and FSA will publish details of the proposed consultation arrangements during the Bill's passage, as recommended.

The PRA Board must have a balance of expertise reflecting the sectors regulated by the PRA. The draft Bill should make particular provision for at least one member of the Board to have specialist expertise in the area of insurance. The distinct nature of the insurance role of the PRA has been explicitly recognised through an entire separate objective—it only follows that the prescribed membership of the Board should reflect this responsibility. (Paragraph 338)

A.71 The Government agrees with the committee that the PRA Board should contain a balance of individuals with the right knowledge and expertise, who can robustly challenge the PRA's strategy to ensure that it is delivering its statutory objective of promoting the safety and soundness of firms. But the Government does not believe that it would be appropriate to suggest that the PRA board should in some way be representative the interests of industry. The PRA will be independent of those it regulates, and must be seen to be independent. There must be no suggestion of regulatory capture.

Dealing with complaints

Given the shift in regulatory architecture and culture, it is vitally important for the new regulatory bodies to have effective, independent complaint systems. The arrangements in the draft Bill do not provide for a sufficiently independent system at the PRA. We believe that the PRA should, mirroring arrangements under the current system, have an independent complaints commissioner whose appointment must be confirmed by the Treasury. In order to ensure that complaints concerning co-ordination between the PRA and FCA are properly handled and resolved, we recommend a single complaints commissioner and system covering both the FCA and the PRA. (Paragraph 343)

A.72 The Government notes this recommendation and has made appropriate amendments to the Bill.

Appealing regulatory decisions

> *We acknowledge the concerns that in certain cases the Upper Tribunal will be confined to referring contested decisions back to the regulators, rather than substituting its own opinion. However, we believe that the PRA or FCA, as the regulators, will remain better placed to reach an informed judgement. Allowing the Tribunal to substitute its own opinion for that of the regulator would undermine the principle of judgement-based regulation. (Paragraph 348)*

A.73 The Government notes that the Joint Committee endorses its position on this issue. The provisions of the draft Bill are therefore retained.

Reports on regulatory failure

> *It should standard practice to publish a report after major regulatory failure. (Paragraph 349)*

A.74 The Government agrees, and has legislated to ensure that this will be the case in future. If a significant regulatory failure occurs, the PRA or FCA will required to submit a report to the Treasury, which will be laid before Parliament. The Bill sets out how such investigations will be triggered. The Treasury will also have the power to direct the regulators to carry out a report.

> *There are some advantages to have an objective set of triggers for regulatory failure inquiries, to ensure clarity and increase accountability. However, these would be very difficult to define. It is important to note that even if the FCA or PRA does not think the threshold for an inquiry has been met, the Treasury will, under the proposals, be able to direct the regulators to undertake an inquiry. Given this, we do not think that the Bill needs to contain more specific objective triggers. (Paragraph 358)*

A.75 The Government welcomes this conclusion. In order to provide greater clarity for the public, it has amended the relevant provisions to include a requirement on the regulators to set out in a statement of practice how these triggers might be met.

> *The Treasury should be required to consider impacts on other regulatory activity, including enforcement activity, when making directions to the regulator on the conduct of investigations into regulatory failure. We also recommend that the regulator should be required to consider the impacts on other regulatory activity, including enforcement activity, when deciding how to conduct a regulatory failure investigation. (Paragraph 362)*

A.76 The Government notes these recommendations and has amended the relevant provisions accordingly.

Independent Commission on Banking

> *The ICB recommendations on ring-fencing and higher capital requirements are extremely important. Parliament must consider the substance and get the detail right in the legislation that enacts the recommendations. We urge the Treasury to confirm that legislation will be subject to pre-legislative scrutiny in parliament. The legislation enacting the ICB recommendations on ring-fencing should be brought forward during the 2012–13 Session in order to give banks a clear framework to work to. The ring-fence should be implemented as soon as possible. There is a good case for allowing time to rebuild capital requirement adequacy. (Paragraph 8)*

A.77 As the Chancellor made clear following the publication of the *Government's response to the Independent Commission on Banking* on 19 December 2011, the Government will consider the case for pre-legislative scrutiny. The Government believes that it is vital to ensure that the

legislation is right, and for that reason will consult widely with the industry and other stakeholders on the overall statutory framework, and on the technical details of the ring-fence. The ICB itself undertook two rounds of consultation, and any rules that the future Prudential Regulation Authority (PRA issues will also require a consultative process. Parliament will also have an opportunity to debate these fully as part of the legislative process.

A.78 The Government has already committed to completing primary and secondary legislation related to the ring-fence by the end of this Parliament (in May 2015), and banks will be expected to be compliant as soon as practically possible thereafter. The Government will work with the banks to develop a reasonable transition timetable.

A.79 The Government agrees with the ICB's timetable that the final, non-structural recommendations relating to loss-absorbency should be completed by the beginning of 2019, in line with the Basel III timetable.

The impact of ICB recommendations on the PRA's responsibilities

The ICB recommendations are key to the work of the regulators established by the draft Financial Services Bill. For example, without the ICB reforms it will be harder for the PRA to meet its objective of minimising the impact of firm failure. The legislation enacting the ICB recommendations on ring-fencing should be introduced into parliament during the 2012–13 Session in order to give banks a clear framework to work to. The ring-fence should be implemented speedily. By contrast there is a good case for allowing banks to build up capital over time. Furthermore, the Government should think carefully about imposing on banks headquartered in the UK capital requirements relating to their overseas subsidiaries over and above that agreed by the international college of regulators. (Paragraph 185)

It should be for Parliament to define the ring-fence for retail banking. The definition may need adjusting from time to time and therefore should not be enshrined in primary legislation. Instead it should be set out in secondary legislation so it can be more easily reviewed and adjusted. It should not be left to the Bank or the regulators to define the ring-fence. (Paragraph 187)

A.80 The Government has already committed to completing primary and secondary legislation related to the ring fence by the end of this Parliament in May 2015 and banks will be expected to be compliant as soon as practically possible thereafter. The Government will work with the banks to develop a reasonable transition timetable. The Government agrees with the ICB's timetable that the final, non-structural recommendations relating to loss-absorbency should be completed by the beginning of 2019, in line with the Basel III timetable.

A.81 The ring fence will be defined in primary and secondary legislation, and so will be subject to full Parliamentary scrutiny.