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Public Bill Committee

BANK OF ENGLAND AND FINANCIAL SERVICES BILL [*LORDS*]

Third Sitting

Thursday 11 February 2016

(Morning)

CONTENTS

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

The Committee consisted of the following Members:

Chairs: † Mr Graham Brady, Phil Wilson

† Baldwin, Harriett *(Economic Secretary to the Treasury)*
† Burgon, Richard *(Leeds East)* (Lab)
† Caulfield, Maria *(Lewes)* (Con)
† Cooper, Julie *(Burnley)* (Lab)
† Donelan, Michelle *(Chippenham)* (Con)
† Fysh, Marcus *(Yeovil)* (Con)
† Hall, Luke *(Thornbury and Yate)* (Con)
† Kerevan, George *(East Lothian)* (SNP)
† McMahon, Jim *(Oldham West and Royton)* (Lab)
† McGinn, Conor *(St Helens North)* (Lab)
† Mak, Mr Alan *(Havant)* (Con)
Mann, John *(Bassetlaw)* (Lab)
† Marris, Rob *(Wolverhampton South West)* (Lab)
† Mullin, Roger *(Kirkcaldy and Cowdenbeath)* (SNP)
† Newton, Sarah *(Truro and Falmouth)* (Con)
† Skidmore, Chris *(Kingswood)* (Con)
† Tolhurst, Kelly *(Rochester and Strood)* (Con)
† Wood, Mike *(Dudley South)* (Con)

Matthew Hamlyn, Fergus Reid, *Committee Clerks*

† attended the Committee

Public Bill Committee

Thursday 11 February 2016

(Morning)

[Mr Graham Brady *in the Chair*]

Bank of England and Financial Services Bill [*Lords*]

Clause 12

Bank to act as Prudential Regulation Authority

11.30 am

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

The Chair: With this it will be convenient to discuss the following:

Clause 13 stand part.

That schedule 1 be the First schedule to the Bill.

Clauses 14 to 16 stand part.

That schedule 2 be the Second schedule to the Bill.

Clause 17 stand part.

That schedule 3 be the Third schedule to the Bill.

The Committee will see that I have not selected any amendments that would leave out clauses or schedules. That is because the more effective proceeding is simply to vote against the stand part question, but the amendments were a helpful and proper indicator. As clauses 13 to 17 and schedule 1 to 3 are all closely dependent on clause 12, no amendments to any of them were selectable. I propose that it is convenient to consider the clauses and schedules together in debating the question that clause 12 stand part of the Bill. Members will have the opportunity, should they wish, of dividing the Committee on individual clauses or schedules in turn.

The Economic Secretary to the Treasury (Harriett Baldwin): It is a pleasure to serve under your chairmanship, Mr Brady, on this sunny February morning. The clauses and schedules together end the subsidiary status of the Prudential Regulation Authority and integrate microprudential regulation more fully into the Bank of England. I hope I can make it clear that the changes increase the PRA's effectiveness, but do not undermine its independence.

First, I will talk about increasing effectiveness. Placing the Prudential Regulation Committee on the same footing as the Monetary Policy Committee—and, with our changes, the Financial Policy Committee—will elevate the status of the microprudential responsibilities of the Bank to the same level as monetary policy and macroprudential policy. That reinforces not only to Bank staff but to the public to whom the Bank must be transparent and accountable that the Bank is not simply an organisation dedicated to setting interest rates, but one with equally important macro and microprudential responsibilities.

The Bank has told us that closer integration has increased the feeling among PRA staff that they are integral to the Bank's mission and have broader opportunities for progression across the whole Bank. That can only assist recruitment of the best people to the supervisor. Another benefit is increased clarity of governance. As the Parliamentary Commission on Banking Standards noted in discussing the existing regime:

"The accountability arrangements of the new structures are more complex than those of the previous regulatory regime. The PRA is a subsidiary of the Bank, and the FPC is a sub-committee of the Court of the Bank."

Ending the subsidiary status of the PRA and establishing the PRC, MPC and FPC on the same statutory basis simplifies and clarifies Bank governance.

A further benefit of ending the PRA's subsidiary status is that it enables the members of the new committee to devote more time to microprudential policy and operations. As the Governor explained at the Treasury Committee, the change will

"liberate…a portion of the time of the members of the PRA Board that is spent duly exercising their responsibilities as directors of a company",

while noting the important responsibility PRC members will continue to have for ensuring the prudential regulation functions are adequately resourced. The Governor concluded

"that time is freed up to do their core job—what they are there for—which is to provide guidance on judgment-led supervision."

For example, the PRC will not have to spend so much time discussing IT provision since that will be a concern for the Bank at large, and ultimately for its governing body, the court. Equally, whereas the PRA board had to be involved in discussions on staff terms and conditions and recruitment, the new committee will be able to leave those important concerns to the wider organisation and focus more on supervision.

Secondly, in terms of protecting independence, the PRA is a wholly owned subsidiary of the Bank, staffed by Bank employees. The Bank appoints the non-executive directors of the PRA board, subject to the approval of the Treasury. The transfer of the PRA's functions to the Bank does not therefore transform the PRA from a body that is independent of the Bank to one that is not.

It may be worth explaining what "independence of the PRA" actually means. The Basel core principles on banking supervision state that legal safeguards should ensure that a regulator has

"operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources".

The Bill provides for all of those things. It provides that the Bank's PRA functions may be exercised only through the new Prudential Regulation Committee. The Bank may not exercise its prudential regulation role in any other way.

The Prudential Regulation Committee will have a clear majority of external members. There will be at least seven external members, including at least six appointed by the Chancellor plus the CEO of the Financial Conduct Authority, and five internal members, comprising four Bank officers and one member appointed by the Governor. It is important to note that that is an increase in the weight of external members from the PRA board, on which a majority of only one is required.

Continuing with the protections for the PRA's operational independence, the Basel core principles call for transparent processes and sound governance. The Bill sets out clear processes for the new committee's decision making. The core principles also stress adequate resources. Every year, the committee will report directly to the Chancellor on the adequacy of its resources and the independence of its operations. The requirement for the Bank to separate resolution and supervisory functions will ensure that the UK complies with the European Union directives that insist on separation.

Finally, the Bill grants a strong statutory role to the PRA's chief executive. He or she will be responsible for the day-to-day management and implementation of the prudential regulation strategy, and for determining how resources are allocated, managing policy development and overseeing supervisory decisions that do not reach the level of the committee. Our changes will increase the PRA's effectiveness without undermining its independence. I commend the clauses to the Committee.

Richard Burgon (Leeds East) (Lab): It is a great pleasure to serve under your chairmanship on this sunny day, Mr Brady, or indeed on any other day.

The effect of clause 12 will be to demote the PRA from being a separate authority to being a mere sub-committee within the Bank of England. We tabled an amendment to remove the clause and those that are consequential upon it. We think that the Treasury is dismantling another significant part of its regulatory reforms, which came into being through the Financial Services (Banking Reform) Act 2013. The clause would make the Bank of England as a corporate entity responsible for microprudential regulation. Our principal concern is with the manner in which microprudential regulation is to be conducted. We are concerned that the new PRC will be less independent than the PRA.

The risk is that the Government are demoting concerns about microprudential regulation by devolving the functions of the rule-making, free-standing regulatory authority, which is supposed to oversee that, to a sub-committee of the Bank. That is not a minor matter. The PRA is a separate corporate body and a distinct authority. It can be held separately liable and accountable for its actions and interactions. If it becomes merely a committee within a much larger corporate body, it will not be possible to hold it to account in the same way.

In the other place, my shadow Treasury colleague, Lord Tunnicliffe, said:

> "The thing that keeps it clean is the fact that the PRA is a subsidiary—an independent company, as mentioned, governed by company law—and, therefore, there has to be an arm's-length relationship between it and the FPC."—[*Official Report, House of Lords,* 1 November 2015; Vol. 765, c. 2005.]

I do not believe that moving the PRA closer to the Bank and, by definition, closer to the FPC is a good thing. The present separation works and should continue.

The former Treasury Committee Chair, Lord McFall, said that the clause is

> "downgrading the PRA to a mere committee".—[*Official Report, House of Lords,* 26 October 2015; Vol. 765, c. 1059.]

The desubsidiarisation—a bit of a mouthful—of the PRA may simplify the Bank of England's governance, as its current and outgoing chair, Andrew Bailey, said at the Treasury Committee. But will it make it more competent and more effective in carrying out its work? Our concern is that it will not, and there is no evidence that we are aware of to demonstrate that.

In Mr Bailey's discussion at the Treasury Committee, the Chair of the Committee, the right hon. Member for Chichester (Mr Tyrie), raised concerns that there will not be sufficient independence owing to the make-up of the committee's membership. He highlighted:

> "the Chairman of the FPC, who will also be the Chairman of the PRC, who will also be the Governor of the Bank."

Mr Bailey said,

> "We have to be very clear in our own roles and thinking which hat we are wearing at any given point in time".

He also said that the body will be more integrated into the Bank, but that it also has certain functions that it needs to carry out independently. The Governor was also pushed on this, again by a Treasury Committee member, the hon. Member for Wycombe (Mr Baker), who said:

> "In addition to being Governor, you chair the Financial Stability Board, you are a member of Court, and you chair the FPC, the MPC and soon the PRC."

He warned that,

> "the institutions are set up in such a way that they strongly depend on the Governor's capacity to act independently in different contexts."

Also at the Treasury Committee, the hon. Member for East Lothian asked the Governor whether the overlap of personnel meant there were grounds for conflict

> "if we have the PRC reporting on its independence from the rest of the Bank."

I am sorry to quote the Treasury Committee at such length, but the discussion there threw up contradictions, and it is not clear to me that those contradictions have been sufficiently resolved. So can the Minister say whether the body can be both more integrated and remain independent? We welcome joined-up thinking and ensuring a broad overview. We also heard about the dangers of groupthink in Committee the other day, and the Governor of the Bank told the Treasury Committee that the Bill did not specifically address that. If we have too many key persons juggling too many tasks, is there not a risk of oversight being impaired or conflict of interest setting in?

An authority employs its own staff who are therefore dedicated to the pursuit of its particular goals, in this instance microprudential regulation. By creating a committee of senior figures, microprudential regulation becomes simply another series of talking points among senior executives, as opposed to an ongoing regulatory activity. There are many very important functions that must be performed by a microprudential regulator in the wake of the last financial crisis: first, the conduct of stress tests to ensure that individual financial institutions are putting to one side sufficient capital. That is a microprudential activity that relates to the solvency of the institutions. We are surely not arguing that it is no longer important.

With the creation of new starter banks, there is a greater need than ever for microprudential regulation as those institutions start up in business. If we continue to

[Richard Burgon]

start new credit unions and new blockchain banks and so on, microprudential regulations remain fundamentally important. Also, there continue to be high street banks in financial difficulties, such as the Co-operative and Britannia. The danger of the Prudential Regulation Committee being appointed as is currently suggested makes it more likely that groupthink will develop.

The strength of having different agencies in existence simultaneously is that there is a useful tension between them as each of them considers the same question from a different angle in terms of the systemic risks, the risks to the solvency of individual banks, and in terms of activity on individual markets. So the political and economic context should be considered elsewhere beyond those regulatory bodies.

It is remarkable that we are witnessing what some commentators would call a downgrading of micro-prudential regulation UK at a time when financial institutions such as the Co-operative Bank and the Britannia, as I have just mentioned, face such serious solvency problems. The PRA was created for exactly that sort of situation. I therefore want to spend time on the arguments raised in relation to that change.

It has been stated that the PRA is being put on the same footing as other activities and that it is being taken back in-house. Taking the PRA back in-house is an odd idea. The PRA is currently a subsidiary of the Bank of England, so it is already in-house. A subsidiary is something that is owned by a parent company; the PRA was already a part of the Bank of England and in any event was answerable, through a statutory scheme, to the Governor.

11.45 am

There was a new post of deputy governor of the Bank of England, which was assigned to head up the PRA in the Financial Services Act 2012. So what is the problem with governance over it? What prompted this change from authority to committee in the first place? We wish to argue for the retention of the PRA as a distinct regulatory authority and believe that it ought to be given a shot in the arm, so that it comes out of the shadow of the FCA and begins to fight for microprudential regulation. We are of the view that the case to vest the powers of the PRA into the Bank, in a new committee called the PRC, is a good one and we will push our amendment to leave out clause 12 to the vote.

I now move on to the rest of our comments about clause 13. Once a Division has been held on clause 12, as you say, Mr Brady, that guides us on the following clauses, which are consequential upon it. However, I wish to take a moment here to say that the question is: why does it matter whether the PRA is an authority or a committee? We have discussed that in relation to clause 12. The Treasury is empowered to give a notice in writing to the new prudential regulation committee, making recommendations about aspects of economic policy.

At one level, that is dangerous, because it allows economic policy to influence microprudential regulation. The importance of microprudential regulation is that it must continue to assess the solvency of individual banks without outside influence. If it allows itself to ask whether it would be better in economic terms for a bank to continue operating or not, that would distract it from deciding whether or not the bank actually has sufficient assets to stay solvent.

The only strength of the 2013 regulatory reforms, which were introduced at the European level originally, is that they require different agencies to consider each problem from a different perspective, so that groupthink, which I mentioned earlier, is less likely to develop.

Given the discussion on clause 12 that we have already had, I will leave it there on clause 13.

We have nothing further to add to clause 14, on "Accounts relating to Bank's functions as Prudential Regulation Authority" and evidently we will not push our amendment to a vote. The same is true of clause 15.

In relation to clause 16, Mr Brady, you will be aware that we have tabled an amendment to schedule 2, which is introduced by clause 16, to rename the Bank of England's "Court" as a "Board". We will now propose that amendment at a later stage, which I am sure the whole Committee is anticipating eagerly, in a new clause alongside the SNP's discussion on the bank's name. I do not know which one the Committee will consider the more radical proposal; I do not want to get into a competition with the hon. Member for East Lothian for radicalism or moderatism, if that is the phrase. However, our plan is one that would put the Bank on a similar footing to some of the major financial institutions in the City. On that basis, I have nothing further to add to clause 16 now and we will not push our amendment to a vote.

Finally, I can confirm that again we have nothing further to add to clause 17 and schedule 3, which has been grouped with these clauses, and will not push amendments to them to a vote.

George Kerevan (East Lothian) (SNP): Like other Members, I add my delight at serving under your chairmanship on this bright morning, Mr Brady.

There is no best way of constructing the Bank and its regulatory functions. In this instance, however, having set up a structure, I think we should let it work itself out and see what the issues are, rather than tear it up so quickly. From that perspective, I will support the line of argument followed by the hon. Member for Leeds East.

May I remind the Minister and the Committee that we have been here before? There was a long period when the Bank was effectively the prudential authority, and it did not do a good job. One can mention the Bank of Credit and Commerce International. One can mention Barings. The Bank failed at the very simple task of examining the imminent failure of major banking institutions and not ensuring that that did not happen before it became a public catastrophe.

For that reason, in the Bank of England Act 1998, prudential conduct responsibility was taken away from the Bank and invested in the Financial Services Authority. That model, as we saw subsequently, did not work, in the sense that completely separating prudential conduct from the Bank led to a chasm between the two agencies in terms of who was letting whom know and who was responsible for tidying up.

In a sense, the halfway house that we now have, where we have put prudential conduct into the orbit of the Bank but kept it semi-discrete, is better than what we had before. Will it work in the long run? I doubt that any bureaucratic system ever works in all circumstances, but we have set it up; let us test it to destruction before we make another bureaucratic change. From that point of view, we have a model that seems to work.

The issues brought up in the Treasury Committee related particularly to the resources that were deployable to the PRA to conduct its activities and whether the main board of the Bank was providing sufficient financial and staff resources to the PRA to allow it to do its work. My worry is that the change proposed by the Government makes it too easy for the Bank's main board to ration resources for the soon-to-be PRC. It would be better to leave a degree of independence within the PRC, so that if it comes to a debate over resources, the PRC has some muscle and can go public if it feels that it is not getting the physical and staffing support it needs from the main board.

We may need to come back to the structure of the Bank at some point; the Minister may want to reflect on that. As I said in the previous sitting, we are in danger of creating too many committees of the Bank. We may be in danger of reinforcing a silo mentality, even though the Governor serves on all the different committees. We may have to discuss at some point whether we need to separate the Monetary Policy Committee and the Financial Policy Committee, but we should certainly test the prudential part of the administration in its present form. Changing it now simply because we will get a better and prettier bureaucratic chart is not a sufficient reason.

Harriett Baldwin: As I am sure you are aware, Mr Brady, desubsidiarisation of the PRA is not something they talk about very often down at the Dog and Duck, but it is incredibly important. Committee members have raised important issues, to which I would like to respond.

If one were in the pub discussing the Bank of England, the extent of people's knowledge of what it does probably would stop with the changing of interest rates; the hon. Member for Leeds East made that point clearly. He said that the change represented a downgrade of the incredibly important microprudential responsibilities of the PRA, but I would argue that it is an upgrade, in the sense that it gives the PRA the status of a committee—the Prudential Regulation Committee—that has the same status as the Monetary Policy Committee. That reinforces to not only Bank staff but drinkers in the Dog and Duck and the public at large that it is an incredibly important function. I completely agree with hon. Members who raised that point.

The microprudential responsibilities of the prudential regulator are extremely important. The hon. Member for East Lothian made the important point that, in the 300 years of history of the Bank of England, until its independence under the Bank of England Act 1998, there were obvious failures. Firms did fail, and no one should be under the illusion that we are in a zero-failure regime for banks.

However, it is clear that the decision to separate that microprudential function and move it to the FSA created a system that was tested to destruction. That separation under the failed regulatory regime of tripartite arrangements meant there was insufficient communication between the microprudential regulation at the FSA and the day-to-day liquidity challenges that banks were experiencing in the markets in the run-up to the crash. That seems to me the strongest possible argument for having moved the microprudential function back to the Bank of England. I am glad that Committee Members have supported that important change. By following the logic of that argument, one is compelled to see that it makes sense to go one step one further, and change the PRA from being a subsidiary into being at the heart of the Bank with the same status as the Monetary Policy Committee.

By making the points he did, the hon. Member for East Lothian has made my argument for me—for having that much closer feeling of all staff being part of one Bank, which is the agenda that the Governor has set out. That not only gives a much higher status within the organisation to the incredibly important function of microprudential regulation but it reinforces the ability of the organisation to communicate with the important other parts of the organisation, and gives them more time to do it. They will not have to worry about all of the responsibilities of being a separate company.

George Kerevan *indicated assent.*

Harriett Baldwin: I am glad to see that the hon. Gentleman, a thoughtful and intelligent man, is nodding vigorously as I make my argument.

The hon. Member for Leeds East asked what prompted the decision. It was very much the one-Bank agenda that the Governor has followed. He argues that it makes sense to have different points of view and not be captured by groupthink. Although I agree with the importance of having a range of views on these committees, I would counter that argument by saying that the tripartite arrangements were so clearly inadequate that that difference meant that no one spoke to each other about what they were seeing.

I hope that the Treasury Committee returns to evaluate how the transition has worked. I want to reassure hon. Members on resources, because they are incredibly important. We want to ensure that the microprudential function does not have to compete for resources or find itself starved of them. It is important to note that the levy will continue to provide those resources. No changes are being made under this legislation to the available resources for microprudential regulation.

The hon. Member for Leeds East mentioned the importance of the role of the Governor. Of course, the Governor is an incredibly important person who sits on all the committees. That is an important function of having a one-Bank organisation. He is obviously a very responsible person. With those responsibilities comes accountability, not only through the Chancellor but to Parliament through the Treasury Committee. I emphasise that that arrangement does not change as a result of these clauses.

Having reviewed all the questions raised against making the changes, I insist that the changes will improve the Bank of England's governance.

12 noon

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

The Committee divided: Ayes 10, Noes 7.

Division No. 2]

AYES

Baldwin, Harriett
Caulfield, Maria
Donelan, Michelle
Fysh, Marcus
Hall, Luke
Mak, Mr Alan
Newton, Sarah
Skidmore, Chris
Tolhurst, Kelly
Wood, Mike

NOES

Burgon, Richard
Cooper, Julie
Kerevan, George
McMahon, Jim
McGinn, Conor
Marris, Rob
Mullin, Roger

Question accordingly agreed to.

Clause 12 ordered to stand part of the Bill.

Clause 13 ordered to stand part of the Bill.

Schedule 1 agreed to.

Clauses 14 to 16 ordered to stand part of the Bill.

Schedule 2 agreed to.

Clause 17 ordered to stand part of the Bill.

Schedule 3 agreed to.

Clause 18

Financial Conduct Authority

Rob Marris (Wolverhampton South West) (Lab): I beg to move amendment 37, in clause 18, page 16, line 12, leave out paragraph (a) and insert—

"(a) publish any notice under subsection (1) within one month of giving such a notice, and".

The Chair: With this it will be convenient to discuss amendment 38, in clause 18, page 16, line 14, after "before", insert

"and make a statement to both Houses of"

Rob Marris: It is a ray of sunshine to be serving under your chairmanship on this bright day, Mr Brady. Amendments 37 and 38 are straightforward, and I am sure that the Government will accept them, so perhaps we can move on to debate the clause. Proposed new section 1JA(1) gives the Treasury the power to give directions to the Financial Conduct Authority. The rest of the new section deals with how that power shall be exercised at least once in each Parliament, and with the publication of those directions. Our straightforward amendments would tidy that up.

One must recognise that there is a balancing act between the FCA's independence and the need for public accountability, refracted through the Treasury. That is always difficult, and we accept that, but there is a bit of a problem with the Financial Conduct Authority. Immediately after Second Reading a couple of weeks ago, there was a debate for more than two hours in which I think it would be fair to say that Members from both sides of the House expressed grave concerns about some of the actions or inaction of the Financial Conduct Authority. It is purportedly independent of the Government and the Bank of England, but there is so much cosy overlap.

We have Dr Bailey, who now seems to have all kinds of hats. I stand to be corrected, but I think he is the deputy governor for prudential regulation and has been the chief executive officer of the Prudential Regulation Authority since April 2013. He is therefore also a member of the Bank's board of directors, the PRA board and the Financial Policy Committee, and now he is going to the Financial Conduct Authority. There are questions not about that gentleman's integrity, but about perceived conflicts of interests and so on. There is someone on the FCA board, Jane Platt—she also joined in April 2013—who is the chief executive of National Savings and Investments. Sir Brian Pomeroy, CBE, joined the FSA board in November 2009. I think that he may still be on the FCA website.

The FSA was abolished because it was, shall we say, pretty useless. *Private Eye*, correctly in my mind, used to characterise it as the Fundamentally Supine Authority. If we look at the prosecutions, or the lack thereof, and the steps taken by the FSA after the crash in 2008, or the lack thereof, it did not exactly cover itself in glory as an institution. I make no comments on the individuals within it; I am referring to the institution. The Government recognised that, and therefore we had the Financial Conduct Authority.

It is all a bit cosy. The noun of this Committee thus far seems to be groupthink. That refers to the risk that those who have a cosy relationship will start to be blinkered in the way in which they exercise their regulatory functions. The FSA has been characterised by Professor Alastair Hudson, whom I thank for his assistance in tackling what is quite a technical Bill. He said, "The FSA previously began to think of itself as being in partnership with the financial institutions which it was supposed to regulate." I think he had a point. So, I suspect, did the Government, which is why we now have the FCA, not the FSA.

However, there is still a big question mark over the FCA's relationship with the Government, which is to do with how independent it is. The Minister has previously told the House that the FCA's decision to abandon its investigation into the culture of banking, which had not actually started, had nothing to do with the Treasury. That, of course, touches on questions of groupthink, blinkered thinking and so on. I do not impugn her for saying that, but looking at it from the perspective of Labour Members, that is a surprising situation. It is relevant to what we are discussing, because of course proposed new section 1JA, to be inserted by clause 18, talks about the Treasury giving directions to the FCA in certain circumstances.

The FCA, in its business plan for 2015-16—the year we are in—said that it would do a culture review:

"In 2015/16 we will conduct a new thematic review on whether culture change programmes in retail and wholesale banks are driving the right behaviour, in particular focusing on remuneration, appraisal and promotion decisions of middle management, as well as how concerns are reported and acted on."

It would have been very useful to have had the fruits of that culture review before us when debating the Bill.

Roger Mullin (Kirkcaldy and Cowdenbeath) (SNP): Is the hon. Gentleman aware that there are quite a number of studies that indicate that approximately 70% of major organisational failures can be attributed primarily to cultural problems?

Rob Marris: I was not aware of that statistic, but it does not entirely surprise me. I thank the hon. Gentleman for that.

We have the chair of the FCA's foreword to its business plan for 2015-16—as I said, the current year. That is John Griffith-Jones, who by the way worked at KPMG from 1975 to 2012; we all know that KPMG has questions to answer about what it was doing in relation to the financial institutions in the lead-up to the meltdown in 2008. I was talking about cosiness; he comes from KPMG, and he said in that foreword:

> "In our last Risk Outlook we identified the seven most important forward-looking areas of focus in our view. We do the same again this year. Unsurprisingly, given the long-term nature of these risks and the underlying drivers, the list is largely unchanged. Poor culture and controls continue to concern us, notwithstanding the efforts being made by firms to improve both."

So there he is, in his foreword to the business plan, less than 12 months ago, stressing again the concerns about "poor culture and controls". The FCA said in the business plan that would investigate the culture of banking and financial institutions and then, in a whiff of smoke, it was gone—no investigation whatsoever. The Minister says that is nothing to do with the Treasury, but I hope she will recognise that the Opposition are a little concerned about the relationship between the Treasury and the FCA. We are concerned about how much control and direction the Treasury can give the FCA.

The FCA is constitutionally a creature of statute, hence the Bill and previous legislation, but in everyday terms it is somewhat a creature of the Treasury. It would be helpful if, when addressing clause 18 and the minor amendments 37 and 38, the Minister said a little more about the current relationship between Her Majesty's Government, refracted through the Treasury, and the FCA, and what she foresees that future relationship being in the changed landscape that the Bill introduces.

Harriett Baldwin: Clause 18 is effectively about remit letters, which I think is why the hon. Gentleman took the opportunity to bring a lot of fairly extraneous issues into discussion. I will respond to some of them in the course of my remarks.

It is important that regulation takes account of both the implications of the economic environment for the regulators and of the regulators' own impact on that economic environment. I am sure all members of the Committee agree with that. That is reflected in the statutory remits of the regulators. For example, both regulators have a duty to have regard to the desirability of sustainable economic growth in the medium or long term. The objectives of both regulators recognise the importance of effective competition, and I trust that members of the Committee do not wish to raise any controversy or have any criticism about that.

Clearly, therefore, both regulators need to understand how the Government's economic policy may affect their work. I want to be absolutely clear that the recommendations in the letters that the Government will be able to send to the regulators will indicate the Government's economic policy. They will be recommendations and will not be binding. They will certainly not be what the hon. Gentleman termed "direction". They will not compromise, modify or override the regulators' statutory objectives in any way, nor, importantly, will they relate to individual firms or cases.

The hon. Gentleman raised one of his favourite topics: the fact that the FCA had a bank culture review in its business plan for the year ahead. Despite my assurances to him in the Chamber that the first the Treasury heard of that was when it was covered in the media over the new year, he does not seem convinced by what we have said. We have replied to numerous written questions with the same response, and I repeat it for his benefit today.

The FCA is clearly operationally independent. It took an operationally independent decision to change what it is going to focus on over the coming year, and that decision was made completely separately from the Government.

Rob Marris: I take what the hon. Lady says. Is she comfortable that that was the right decision for the FCA to take? It was made by a body that is so incompetent that it could not even monitor the share dealings of its own staff.

Harriett Baldwin: The hon. Gentleman cannot have it both ways. If he thinks that I should have no operational interference in whether the FCA does a cultural review study, obviously I should not have any operational interference in whether it reinstates the study. That is the situation in which operational independence results. Where the Government have a role is through sending these non-binding remit letters and through the power to appoint the chief executive and the board. The hon. Gentleman has described the history of the predecessor organisation, the FSA, and obviously we had to abolish that organisation—that is the power of the Government of the day. His party's Front Benchers have a range of different and fairly eccentric ideas about the independence of the Bank of England, which are on the public record. I will not entertain the Committee by talking about them.

Rob Marris: Not me, guv.

Harriett Baldwin: The hon. Gentleman is serving in the team of a shadow Chancellor who wants to end the independence of the Bank of England.

12.15 pm

Roger Mullin: I hear and accept entirely what the Minister says about not interfering in operational matters. However, I invite her to indicate whether, at some stage, a review of the culture would help the Government.

Harriett Baldwin: I think we can all agree that that would be a fascinating study to read, but I will not get involved in directing the FCA to change its business plan. That would be interfering with the operational independence of the FCA, which I am sure Opposition Members do not want me to do.

Rob Marris: I thank the hon. Lady for being so generous in giving way. Actually, I never said anything about not interfering in operational matters. She rightly says that, in theory, the Government could abolish the FCA. This clause does not cover a directive to the FCA; it talks about a recommendation. A recommendation from the Treasury, a body that could abolish the FCA,

[Rob Marris]

is something akin, in everyday parlance, to a directive. Pursuant to proposed new section 1JA(1)(b) of the Financial Services and Markets Act 2000, such recommendations could be on "how to advance" one or more of its operational directives.

Harriett Baldwin: I have outlined some of the things that the Government put in their remit letter, which is not binding on the organisation but provides important context for what the Government, elected by the British people, want to focus on.

Let me now turn to the amendments. Amendment 37 would require the Treasury to publish the recommendations it makes to the FCA within one month, and amendment 38 would require the notice laid before Parliament to be accompanied by a statement to each House. The amendments raise the important issue of transparency, which is at the heart of the Government's proposals for these remit letters. The remit letters themselves form an important element of transparency, and they provide a transparent and formal means of conveying Government economic policy to the regulators, so it is an important part of the provision that the Treasury must publish its recommendations and lay a copy before both Houses of Parliament.

These probing amendments have been useful to confirm how the process will work. I assure members of the Committee that I cannot foresee any circumstances in which the notification for either regulator would not be published and laid before Parliament within a month. I am happy to commit the Government to that practice. I am not going quite as far as accepting the hon. Gentleman's amendment, but I am happy to commit the Government on the record to that practice. I hope my assurance will be sufficient.

We need to retain flexibility about the best way of informing the House. For example, the updated recommendations might be issued as part of the Budget statement. In that case, it would be more appropriate and efficient for the House to be informed of the new recommendations in the Budget speech, as has happened when the FPC remit letter is updated at that time.

The hon. Gentleman raised a few other points, and it might be helpful if I respond to them. Without criticising Mr Andrew Bailey in any way, the hon. Gentleman did imply that he thought he was doing too much. However, I can assure the hon. Gentleman that Mr Bailey will stop being the chief executive of the PRA on the day he moves over to be chief executive of the FCA. The hon. Gentleman referred to conflicts. I hope that he is not alluding to any specific conflict of interest, because that would be inappropriate in terms of impugning Mr Bailey's integrity.

The hon. Gentleman mentioned a "cosy" relationship. There were a lot of allegations relating to the fact that many individuals involved have worked with, and have experience of, other organisations. However, that is where the operational independence, structure and framework of statutory duties and responsibilities, as set out by Parliament, is so important. FSMA, for example, made it clear that the terms of all appointments have to ensure that the appointee cannot be directed by the Treasury or any other person, including the Bank.

When we make appointments, we consider the appointee's current and previous background—of course we do—including any material conflicts. In our view, it would be entirely appropriate for people who are appointed to these important functions to have extensive experience of a relevant institution. Therefore, I do not think that the hon. Gentleman is right to talk about "cosiness"; he ought to be saying how important it is to have experience and wisdom in the statutory framework that we are discussing.

Without more ado, I hope that my points on the amendment and the clause have been sufficient to satisfy the hon. Gentleman. I am very grateful for his probing amendments. I hope I have been able to address the concerns and that the clause may stand part of the Bill.

Rob Marris: I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Clause 18 ordered to stand part of the Bill.

Clause 19

DIVERSITY

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

Harriett Baldwin: The clause shows how valuable it can be for Ministers to have their Bill start in the House of Lords, given that we often find that we benefit from their insights as the Bill proceeds through the other place, particularly on subjects on which their lordships have so much wisdom.

The clause amends the general regulatory principles that apply to both the Financial Conduct Authority and the Prudential Regulation Authority. That is a direct way of ensuring that the regulators fully consider the differences between types of business, including—importantly—mutual institutions, across the breadth of work that they undertake, when it is appropriate to do so. The clause makes it clear that both regulators must take into account the differences between the varying forms of business organisation adopted by firms, including—importantly—mutual societies, where appropriate whenever they are discharging their general functions.

I hope that introducing the clause, which puts consideration of mutuality and other types of business organisation into the regulators' guiding principles, provides reassurance that the Government strongly support a diverse financial services sector and the part that mutuals play in achieving that. We are building on previous action that the Government have taken to support the sector, including: carving out the building societies from the Independent Commission on Banking ring-fencing regulations; increasing the maximum interest rates that credit unions may charge on loans from 2% to 3% a month; spending £38 million in the credit union sector through the Department for Work and Pensions credit union expansion project; and ensuring that universal credit and pensions payments may be paid into a credit union account.

Moreover, Government support for the Mutuals' Deferred Shares Act 2015, which received Royal Assent in March 2015, underlined our commitment to fostering growth and competition in the sector by seeking to address mutual insurers' inability to access external capital without the need to demutualise.

Clause 19 provides a further step to ensure that regulators fully consider the particular issues that relate to mutual institutions and other forms of business across all their work. It highlights the role of mutual financial institutions in the UK's evolving financial services marketplace and ensures that, where appropriate, the specific challenges that the mutuals sector faces are taken into consideration when the regulators are discharging their general objectives.

Rob Marris: We on the Labour Benches—I do not know about colleagues in the Scottish National party—welcome clause 19. I say that as someone who first joined a credit union more than 40 years ago. Diversity is important in the financial sector, as in many sectors. The parallel that some of us may remember from our schooldays is crop rotation, for which we need ecological diversity. If we go for monoculture with crops, it is seriously bad news if a pest comes, because our one and only crop is gone.

There is a parallel with financial institutions. By and large, the mutuals sector, including building societies, fared better than mainstream, privately owned banks in the crisis. Where there were problems, in particular, was with some former building societies that had demutualised. I say that as someone who voted against demutualisation for at least three building societies. Two of those were the Staffordshire and the Cheltenham & Gloucester. We lost both of those, but we won with the Nationwide building society—it is still a mutual, and I still have an account there. It is a very big mutual—a very big financial institution. At the other end of the spectrum are institutions such as the Wolverhampton credit union—I am not sure what it is called now, because it keeps changing its name—of which I have been a member for many years. Compared with the Nationwide building society, it is a very small institution, but that is part of diversity.

I am pleased that this Government and their predecessor, the coalition Government, have embraced diversity. The Minister mentioned some of the things that have been done: the £38 million for credit unions and the £2 million. I salute the work that the coalition Government did, and that I hope this Government will continue to do, in relation to the mutuals sector. For example, the previous Government supported disclosure of lending data by the main high street banks to understand patterns of lending across the UK. There has been the lowering of barriers to entry to the financial services market to help to increase competition—challenger banks and so on. I do not think that the Minister mentioned the good work on schools-based financial literacy programmes, which were brought in. That is not directly about mutuals, but it has to do with that concept of a broader view to financial services than simply the high street banks.

A few more things need to be done, and if you will indulge me briefly, Mr Brady, I will mention one or two of them. I am indebted to the Community Investment Coalition for some of these suggestions. A review of existing affordable financial tools would assist, as would supporting and encouraging FinTech innovation, which the Government are starting to do—it is likely to be a growing sector—but it needs to be done in a way that will also benefit people on lower incomes. Also needed is a clear direction to economic regulators—something we discussed in our debate on the previous clause—to ensure that the financial services market provides easily understandable and appropriate products. There is a constant battle there, because products keep mutating and so on. Broadening and strengthening the existing voluntary framework for disclosure of lending data would take further what the Government have already done.

It would be useful to have stressed by the Government—practising some of their recommendations to the FCA, not directions—the value and importance of community finance. They need to ensure some competition and diversity in the financial services sector, which should benefit all communities if it works properly. A review of community finance provision across the UK would be very helpful to identify where there are strong and sustainable community finance providers, but also where there are gaps in provision. Again, that would be carrying on the work of the previous Government, which this Government, in their nine months, have carried on with clause 19 on diversity.

The final suggestion is about trying, inasmuch as Government can, and they have a role to play—the Minister mentioned the £38 million for the credit union sector given by the previous Government—to scale up the community finance sector. For example, there could be assistance with investment in IT infrastructure—not the FinTech stuff, just IT infrastructure for the community finance sector. Computers are still quite expensive, let alone programming and so on. If the Government could assist with that, with their push towards diversity, as exemplified in the clause, that would be very helpful.

12.30 pm

Harriett Baldwin: I will respond briefly because we are now in an area where harmony is breaking out. I welcome the hon. Gentleman's comments on diversity in the financial sector and the points he made about community finance. That is something we feel strongly about. He mentioned some of the aspects such as the challenger bank agenda. He did not mention the new bank unit that has just been set up between the FCA and the PRA, shortly to be the PRC.

The hon. Gentleman did mention the importance of affordable financial tools. We have set up the financial advice market review, which is designed to make advice more affordable and accessible. He also mentioned FinTech, and we are enthusiastic about ensuring that the UK remains the best place in the world to locate a FinTech business. We are seeing a dramatic growth in that sector at the moment. He will also be aware of the importance of the peer-to-peer sector in providing community finance across the country, and what we are doing to encourage that.

There is a range of different things and he highlighted some of them. Interestingly, he mentioned a review. I am not convinced by that idea, based on the fact that in the 13 years of Labour government there were 20 reviews into competition in banking, but only one new bank was set up. In the previous Parliament, eight firms got banking licences, and we have set ourselves the ambitious goal of 15 new firms to get banking licences during the course of this Parliament. That is something we are very focused on and I appreciated the hon. Gentleman's comments on that.

Question put and agreed to.

Clause 19 accordingly ordered to stand part of the Bill.

Clause 20

EXTENSION OF RELEVANT AUTHORISED PERSONS REGIME TO ALL AUTHORISED PERSONS

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

Harriett Baldwin: I fear that the harmony in the Committee might diminish with clause 20, which introduces schedule 4, making provisions to extend the senior managers and certification regime across the financial services industry to all authorised firms, replacing the discredited approved persons regime.

Before setting out the reasoning for that, it is worth outlining the history and development of the senior managers and certification regime. Currently, individuals who work in the financial services industry are regulated through the approved persons regime. Under that regime, authorised financial services firms may not employ a person to perform "controlled functions", by which is meant functions specified by the Prudential Regulation Authority or the Financial Conduct Authority in their rules, unless that person has been approved by the appropriate regulator following an application by the firm concerned.

The financial crisis in 2007-08 and more recent events have highlighted concerns about the performance and behaviour of many of the individuals working in the financial services industry. It is clear that the approved persons regime has not been a successful way of regulating individuals working in the industry.

As the Parliamentary Commission on Banking Standards argued, the regime is too broad and insufficiently focused on senior management. In fact, it called it a "complex and confused mess". Specifically, the commission criticised the approved persons regime for being mostly

"an initial gateway to taking up a post, rather than serving as a system through which the regulators can ensure the continuing exercise of individual responsibility at the most senior levels within banks".

In addition, the commission noted that there was a lack of clarity around the responsibilities of individuals at the senior level, and that institutions did not take enough responsibility for the fitness and propriety of their own staff at more junior levels. It is clear, therefore, that the approved persons regime is not fit for purpose. It is being replaced from March by the senior manager and certification regime for firms in the banking sector.

This regime requires the regulatory pre-approval of individuals at the top of the firm, along with statements of responsibility setting out the areas of the firm's business for which they are responsible. It also requires certification for other key individuals upon hiring, and thereafter annually.

This new regime represents a significant strengthening of personal accountability among the top senior management in firms. It will improve corporate governance, thereby advancing the safety and soundness of regulated firms. It also provides a more effective and proportionate means to raise the standards of conduct of key staff more broadly, supported by robust enforcement powers for the regulators.

It is important to recognise, however, that the activities of firms outside the banking sector can pose significant risks to market integrity or to good outcomes for consumers, and the Parliamentary Commission on Banking Standards expected that the deficiencies of the approved persons regime would not be confined to the banking sector.

Consequently, the Government have decided to extend the senior managers and certification regime to all authorised financial services firms in all sectors of the financial services industry. This action is also supported by the recommendations of the fair and effective markets review, which argued that misconduct in fixed-income currency and commodity markets had not been limited to banks. Indeed, the review noted that extending the senior managers and certification regime would emphasise the personal responsibility of individuals working in all firms to observe proper standards of market conduct.

The application of the senior managers and certification regime to all authorised financial services firms will bring in a stronger, more comprehensive regime across the financial services industry. It will enable the effective and efficient regulation of groups with a variety of financial services firms within them, and it will support a level playing field for competition. Therefore, extending the senior managers and certification regime to all authorised firms is covered by clause 20.

Rob Marris: Mr Brady, I seek your guidance. We on the Labour Benches have no problem with a schedule 4 being added to the Bill, which is what clause 20 would do—we are therefore content with clause 20. However, regarding the exact content of schedule 4 and the attendant linked debates, we wish to have an opportunity —in a moment—to put our views, after the stand part debate on clause 20, I would suggest.

The Chair: I can reassure you, Mr Marris, that there will be an opportunity subsequently to do exactly that.

Rob Marris: Thank you.

The Chair: Do you have any further comments?

Rob Marris: Not on clause 20 itself, no.

Question put and agreed to.

Clause 20 accordingly ordered to stand part of the Bill.

Schedule 4

EXTENSION OF RELEVANT AUTHORISED PERSONS REGIME TO ALL AUTHORISED PERSONS

Rob Marris: I beg to move amendment 33, in schedule 4, page 58, line 2, leave out paragraph 18.

The Chair: With this, it will be convenient to discuss the following:

That the schedule be the Fourth schedule to the Bill.

Clauses 21 to 23 stand part.

Amendment 34, in clause 24, page 19, leave out lines 29 to 34.

Amendment 31, in clause 24, page 19, line 34, at end insert "and insert new subsections (6), (7) and (8)—

'(6) Where the authorised person mentioned in subsection (5) is a relevant authorised person, as defined under section 71A of the Financial Services and Markets Act 2000, subsection (5)(d) does not apply and subsections (7) and (8) do apply.

(7) If the FCA satisfies itself that a person (P), who is a senior manager in relation to a relevant authorised person, is guilty of misconduct by virtue of subsection (5)(a)-(c), then P shall be guilty of misconduct, subject only to subsection (8).

(8) But P is not guilty of misconduct by virtue of subsections (5)(a)-(c) and (7) if P satisfies the FCA that P had taken such steps as a person in P's position could reasonably be expected to take to avoid the contravention occurring (or continuing).""

Amendment 35, in clause 24, page 20, leave out lines 1 to 6.

Amendment 32, in clause 24, page 20, line 6, at end insert

"and insert new subsections (6), (7) and (8)—

'(6) Where the PRA-authorised person mentioned in subsection (5) is a relevant authorised person, as defined under section 71A of the Financial Services and Markets Act 2000, subsection (5)(d) does not apply and subsections (7) and (8) do apply.

(7) If the PRA satisfies itself that a person (P) who is a senior manager in relation to a relevant PRA-authorised person is guilty of misconduct by virtue of subsection (5)(a)-(c), then P shall be guilty of misconduct, subject only to subsection (8).

(8) But P is not guilty of misconduct by virtue of subsections (5)(a)-(c) and (7) if P satisfies the PRA that P had taken such steps as a person in P's position could reasonably be expected to take to avoid the contravention occurring (or continuing)."

Clause 24 stand part.

Rob Marris: The lead amendment in this group, amendment 33, stands in my name and that of my hon. Friend the Member for Leeds East. Unless the Government accepts this amendment—I hope they do—we will seek your permission to divide the Committee, Mr Brady.

I thought that I would start with this group with what may be some of the less contentious material; the contentious material is likely to focus on schedule 4 and particularly on clause 24, the reverse burden of proof, and so on. Starting with the perhaps more straightforward stuff—that does not mean that we should all be friends and agree on this—it would help if the Minister could provide clarification regarding clause 21(3)(a), which states that the Treasury may

"confer functions on the FCA"

by regulations. What kind of "functions" do the Government have in mind that the Treasury might confer?

Much more important and perhaps more contentious is clause 21(3), which says:

"Regulations under subsection (2)"—

that is, made by the Treasury if it so chooses—

"may…modify, exclude or apply (with or without modifications) any primary or subordinate legislation (including any provision of, or made under, this Act)."

So clause 21(3)(b) gives the Treasury regulatory power to modify, exclude or apply primary legislation, as well as other powers. I am uneasy about that as a constitutional way forward. No doubt, the Minister will tell me that that has been done by Governments when I served as a Back Bencher, the previous coalition Government and so on, but I still think that, on a constitutional basis and particularly on something as important as the financial stability of our economy, an explanation from the Minister of why the Government are seeking powers under the Bill by regulation to be able to amend primary legislation would be helpful.

Overall, clause 21, "Rules about controlled functions: power to make transitional provision", seems fairly sensible. Examples of controlled functions include being a director of a regulated firm, overseeing the firm's systems and controls, being responsible for compliance with rules and so on. One would expect a Government to ensure that there were proper rules about such controlled functions. However, there is that concern about regulations making primary legislation.

Clause 22 deals with the administration of the senior managers regime, part of the senior managers and certification regime which, as hon. Members know, I prefer to call SMACR, or "smacker", because it suggests what may on occasions metaphorically need doing to those involved in financial services who step out of line. The clause makes a number of changes to the senior managers regime, and perhaps, because these have been wisely grouped together, that will come out in the wash during the debate on reverse burden of proof.

Clause 23, "Rules of conduct", is not so controversial, I suspect, but there is a question mark for me. I draw the Committee's attention to subsection (3)(c) which omits section 64B(5) of the Financial Services and Markets Act 2000. I stand to be corrected, but as I understand it, section 64B(5) imposes a duty to report when a manager or senior person knows or suspects that someone in their firm or organisation has failed to comply with conduct rules, and clause 23 is about rules of conduct. If the rules of conduct clause in the Bill omits what appears to be a strong and central provision of previous legislation, that is prima facie extraordinary. If a duty to report actual or suspected wrongdoing is to be removed, I scratch my head. Perhaps the Minister can reassure me and the Committee either that I have misunderstood what the soon-to-be-omitted section 64B(5) does, or that, although that subsection does what I think it does, other provisions are being brought in that strengthen or are at least equivalent to that provision of the 2000 Act.

12.45 pm

Clause 20 introduces schedule 4, which will extend the relevant authorised persons regime to all authorised persons. Committee members will be relieved to hear that I do not propose to repeat what I said on Second Reading—namely, that the Labour party's position is that removing the reverse burden of proof, albeit as part of a suite of changes that the Government are introducing, is a mistake. Our position is in between that of the Government and that set out in the Scottish National party's amendment. There are two interlinked issues here: whether the reverse burden of proof on senior managers should exist, and, if so, whether it should extend to all managers or, as the acronym SMACR implies, just to senior managers. That is the substance of it. Should we have the reverse burden of proof? If so, to whom should it extend?

As I understand it, and I stand to be corrected—I find it a bit difficult to hold these things in my head, so somebody, perhaps my hon. Friend the Member for Leeds East, can nudge me if I am getting it wrong—the Government are saying, "We will extend this part of the regime to everyone. SMACR will apply to everybody in financial services, but the reverse burden of proof will no longer apply to anybody, senior or junior." At the other end of the spectrum—again, the hon. Members for East Lothian and for Kirkcaldy and Cowdenbeath can correct me if I am wrong—the Scottish National party is saying, "Extend SMACR to everybody, but retain the reverse burden of proof." Our position, given that it is harder for smaller organisations to comply with what, frankly, can be labyrinthine regulatory controls, is that the reverse burden of proof should be retained for senior managers, but not for junior managers; extend the regime to junior managers, but not the part of it that pertains to the reverse burden of proof.

The Labour party, as is so often the case, finds itself in tune with the Institute of Directors—not on the particular issue, but on the general background. Paragraph 10 of its helpful written submission states:

> "Confidence and trust in banking is at an all-time low. We accept that the behaviour and culture within the banking community contributed to the last financial crisis."

To be absolutely clear, the Institute of Directors, in paragraph 13 of its written submission, welcomes the Government's proposals to remove the reverse burden of proof from the legislation. The Government and their coalition partners introduced that legislation recently, but it has never got beyond the statute book and been put into practice, so there is no evidence one way or the other about whether the reverse burden of proof has altered behaviour. As I understand it, it would only have applied—and will only apply, if the Government generously accept our amendments—from 7 March, which is when the SMACR regime comes into force. The Government's position, although perhaps the Minister will announce a change of heart today, is that the Bill will be close enough to the statute books by 7 March that any investigation into wrongdoing that takes place after that date will be against the backdrop of the normal burden of proof, rather than the reverse burden of proof.

The reverse burden of proof places a higher duty of care on the individual who is accused of engaging in wrongdoing to demonstrate that they did not in fact do so. It is not as strict as what we lawyers—there are several in this room—call strict liability. An example of strict liability in England—I do not know about Scotland; I am a bit rusty on this area of law—is that if a customer under the age of 18 is served alcohol by a member of staff in licensed drinking premises unbeknown to the licensee, which we can imagine happening in many pubs, the licensee is strictly liable for the offence, even though they might have been in a different room or even been on holiday. That is partly to drive managers or licence holders of licensed premises to ensure their staff are aware of the law and apply it. It is called strict liability, and it is very strict. It happens in certain other areas of the law. I venture that most hon. Members have, in their time—I know the Minister has, because she told us earlier that she frequents the Dog and Duck—been to drinking establishments, when over the age of 18 of course, and so will be able to understand that.

The reverse burden of proof is not strict liability. It is a higher threshold that requires a greater level of engagement by the accused—the person it is suggested has engaged, in the scenario of financial services, in wrongdoing. The reasons put forward by the Government in Lord Bridges' letter were not convincing to Labour Members, and clearly not to SNP Members either. That is why, albeit using different wording, we have tabled a package of amendments, of which amendment 33 is a more minor one, to reverse the reversal of the reverse burden of proof—that is, to maintain the reverse burden of proof—in order to drive higher standards in the banking and financial services sector.

Lord Bridges, the Minister in the other place, was, from reports from my colleagues there who dealt with the Bill, open, flexible and interested in ideas to improve the Bill. The Minister here today has already referred to one such idea: clause 19 on diversity was inserted in the Lords, and clearly the Government found it helpful because they have retained it in the Bill. On the reverse burden of proof, which is a thorny issue, Lord Bridges helpfully explained in a letter the Government's position and thinking. He said that senior managers were busy organising themselves so that it would be difficult to impose liability on any individual. That is the problem: when things went wrong in the lead-up to 2008, it was very difficult, because of the regulatory regime—much of it introduced by my own party's Government—to assign individual culpability, let alone criminal culpability, to an individual. An institution may have acted in a very irresponsible way, but drilling down to the level of the individual proved almost impossible. That has an echo in this Bill, because there is widespread agreement—as I always say, that does not mean it is true, but it is a bit of an indication—that were we to have a regime that stressed individual responsibility more highly and ensured that it obtained more widely, conduct would be likely to be better than it was by some individuals leading up to 2008.

We need a system where there are what in other spheres are called accountable officers, so that it is no good just to say, "I didn't know what was going on." One ought to say, "You are culpable because you should have known what was going on." I think the Government agree with that concept. I am not at all sure that the legislation and the amendments to the legislation introduced by the Bill go in the right direction in translating that theory—"You should have known and therefore you are culpable"—into practice in a way that will not lead to loads of people going to prison but will dissuade them from undertaking risky activities that affect us and many of our constituents. That is what we want. Probably no members of the Committee are hangers and floggers. We do not want loads of people caught out; we want them to act responsibly, so that they cannot be caught out and, more importantly, so that the risks are not manifested as meltdowns in the financial system.

The Government have also expressed a fear that were the regime not to be changed as proposed in the Bill, there would be a checklist mentality. I have to say that a lot of people are alive today because of checklists. Where introduced, they have transformed surgery. The surgeon, or whoever is the accountable officer in the operating theatre—it might be the senior nurse—goes through a checklist, for example to check that the spare blood is of the right blood group. We all make mistakes and it can on occasion be too easy to make mistakes; in a team it can be too easy to think that something is someone else's responsibility. Checklists are not the be all and end all, but they help.

I have in my mind—only some in the room will remember this—the 1974 World cup final, refereed by a man who lived in my constituency, Jack Taylor—a lovely man, whom I have met. He went out on to the pitch just before the World cup final started and he went through a mental checklist. Looking around, he found that there were no corner flags. Jack was arguably the best referee in the world, and he knew that the problem with having no corner flags was that when it was discovered, the game would have to be restarted. It was not simply a matter of 10 minutes in, "Oh, no corner flags. We will just bang one in each corner." Restarting any top-class game is difficult; restarting the World cup final would be severely embarrassing for everyone concerned, including Jack Taylor. However, he went through a mental checklist and disaster was averted. You will not remember that, Mr Brady, because you are too young, but some of us do. That story demonstrates that checklists can on occasion be helpful as part of a regime. Jack Taylor did not referee that game—in which, from memory, he gave two penalties, one early on—through a checklist. He refereed the game using his judgment, training, wisdom and experience, but part of what he did to ensure that he did so properly was to use a mental checklist.

As I mentioned earlier, the Government wish to change a regime that they introduced little more than two years ago and that has never been brought into force. Some say, "Well, we have never had any prosecutions, so what are we going to do?" Well, of course we have not had any prosecutions; the provision was never brought into force. In the hope, perhaps vain, of evidence-based decision making by legislators in all parts of the House, bringing something into force is often, although not always, helpful. The hon. Member for East Lothian earlier today referred to testing something to destruction—but I am not sure that I want to test banking regulation to destruction, because it could get a bit messy. He was perhaps talking in a slightly different context.

The real point is that we should have adequate regulation. The difficulty with the Bill is not only to do with the removal of the reverse burden of proof—the double reverse ferret, as I called it on Second Reading. The problem is that even after this Bill is enacted, and even if the Government wisely accept our amendments, the regulatory regime, sadly, will still need a big overhaul, because the wrongdoing that led up to and contributed to the meltdown in 2008 has continued since then to the tune of fines of almost £3 billion levied this year, seven and a half years after the big crash, for wrongdoing in the financial services sector in the United Kingdom, or by UK institutions, that took place after the meltdown in 2008.

1 pm

So the Government are right to recognise in the Bill that the current regulatory regime is not working. However, they are wrong in shying away from a complete overhaul and to some extent tinkering with this authority becoming that committee, and with this reverse burden of proof being removed but more people being brought in. I think we need a bit more of an overhaul. I will not spell out the kind of overhaul that I think we need, Mr Brady, because you would quite properly rule me out of order.

We have the PRA being downgraded in the Bill, which is unfortunate. We have a dilution of individual managers' responsibility, particularly senior managers, and the reverse burden of proof removed. That measure was part of the Government's response to the Parliamentary Commission on Banking Standards, which had three main recommendations: the first was the reverse burden of proof; the second was extending the time limit for commencing disciplinary action against senior persons; and the third was giving regulators the power to make approvals of senior persons subject to conditions or time limits. So it was not a big overhaul that was suggested by the Parliamentary Commission on Banking Standards, but one of the three legs of that three-legged table—the reverse burden of proof—is being removed and we therefore fear that the table may fall over, to the cost of us all, particularly our constituents.

My excellent researcher, Imogen Watson, has dug out a series of quotes from 2013 from people such as the Chancellor of the Exchequer. She has dug out quotes—if I may put it this way—from the top all the way down, extolling the virtues of this new regime of the reverse burden of proof. I will not read them all out, but any hon. Member can come to me if they want to see them. There are people still in the Cabinet, besides the right hon. Member for Tatton (Mr Osborne), who were extolling the virtues of this kind of regime, and yet it has never been fully brought into force, and now it is going to be undone. That is most regrettable.

Our amendments are very reasonable. As I set out earlier, on the spectrum of the two interlinked issues to which I referred—the reverse burden of proof and the width of the net—we are in between the Scottish National party, which is a bit too far one way, and the Government, who are a bit too far the other. Therefore, as reasonable people—as moderates, no doubt—the Government will think again and accept our excellent amendments, although I appreciate that when they do that, they may say to us, "On Report, we will need to tweak the wording a bit."

George Kerevan: I will be reasonably brief, because the hon. Member for Wolverhampton South West has covered a lot of the points. The burden of our amendments 34 and 35 is to preserve the existing Financial Services (Banking Reform) Act 2013, which has not yet come into force—it comes into force next month—with regard to the reverse burden of proof. I think that at this stage, before the reverse burden of proof has been tried, to take it out of the legislation sends the wrong signal to the financial community. That is the most serious issue. We could argue the rights and wrongs of what is the best possible kind of regulatory regime, but much of this depends on mood, culture and signals.

The senior managers in the financial community in the City of London have been worried about the import of this legislation—there is no doubt about that. I understand that in their circumstances, because I have met many of them and they are not going out of their way to impose regulatory infractions. I think there is a new mood in the City, with people trying to get it right. Some senior managers were fearful of the extent of the legislation, but it would have been better to have tried to talk to them and explain it than, by withdrawing it, to imply that something was wrong and that it was too onerous. The signals were all wrong.

First, given the fragile nature of public opinion about the banking system, one would implore the Minister that withdrawing the legislation is not a good thing to do. What we are engaged in today is not an exercise in bank bashing, but trying to find a regulatory system

[George Kerevan]

that not only works, but finds the public confidence we desperately need. We need only look at the fact that since the autumn banking shares across western Europe, including the UK, have collapsed by about 37%. That shows that the markets are jittery about what is going on in the banking system. I press that on the Minister.

Secondly, where did the idea of the so-called reversed burden of proof come from? It has got into the legislation, and it came through the Parliamentary Commission on Banking Standards. We then have to ask: did the commission come up with the idea? Did its members suddenly think, "That would be a good idea"? There was lobbying on behalf of key figures in the regulatory community and the political sphere who said, "This is a good idea and you should look at it." I gently say to the Minister that some people who raised that idea originally have now run for cover, and I think that sends the wrong signal. It suggests that in the regulatory family and within Government people are willing to press legislation home. That is dangerous for clarity in such a regime.

Thirdly, the one argument that has been brought up that one should pay heed to about the reverse burden of proof is proportionality. In widening the senior managers and certification regime through the legislation, which is the correct thing to do, there is a danger that we place onerous burdens on smaller companies or make them fear that such burdens will be put on them. I accept, as the hon. Member for Wolverhampton South West said, that there is a reasonable case for splitting the application of the reverse burden of proof between senior managers in the major systemic institution banks and funds and the smaller companies. How far I am prepared to press my amendments will depend on how emollient the Minister will be, but even if that is to be applied as a blanket rule, it is ultimately up to the PRA and the FCA to decide at what point they use their powers.

I remind the Minister that there has to have been a regulatory infraction before the reversed burden of proof comes into play—something serious has to have been proved to have gone wrong by either the FCA or the PRA, or by both. The senior named managers in their sphere of operation are already culpable for something having gone wrong, so all the legislation says is, "You have to prove why you got it wrong. You were in charge, you were on the deck and something has gone wrong." It does not pick on that manager randomly. Something has gone wrong in their sphere of operation, so it says, "Why did that happen? You were responsible. Tell us what went wrong." Even in the sphere of the current legislation and widening the certification regime, it is still up to the FCA or the PRA to say to a senior manager, "Tell us."

I am willing to say that if that makes things clearer and helps get over the proportionality argument so that we can keep the degree of scrutiny and responsibility for the same managers in the systemic institution, that might be the way to go. So far, the Government have been in wholesale retreat from the original legislation of only two and a half years ago. They are sending the wrong signal in doing that, and the Minister has to explain why, when there are alternatives, she feels the need to take this measure off the statute book.

Harriett Baldwin: It is important that I take this opportunity to send a strong signal on financial services. The financial services sector is vital to the strength and health of the UK economy. We have seen what the opposite looks like, and we know we do not want that to happen again. I emphasise that we are very committed to effective, strong regulation of financial services, to ensure financial stability, market integrity and strong protection for consumers. There can be no more important element of that regulation than the surrounding conduct. Conduct, and responsibility for conduct, are vital to the financial services sector. I welcome this opportunity to send that strong signal.

I also reiterate, for the Committee's benefit, that we have done a number of other things outside the scope of the Bill. For example, we have introduced a new criminal offence to ensure that criminal penalties, including imprisonment, can be imposed upon people who manipulate key financial benchmarks such as LIBOR. We have brought in the toughest rules of any major financial centre when it comes to clawing back bank bonuses. Bringing in the senior managers and certification regime for the whole financial sector, which I remind the Committee includes a duty of responsibility to cover all financial services firms, is a very important strengthening of the failed and lacklustre approved persons regime. We are also bringing in new criminal offences so that criminal penalties can be imposed on senior managers whose reckless misconduct in managing a bank results in that bank's failure.

The group of provisions we are considering cover, in a number of clauses and in one schedule, changes to the senior managers and certification regime, as well as amendments tabled to the provisions relating specifically to the replacement of the reverse burden of proof with the statutory duty of responsibility. I will explain briefly the purposes of the provisions in the group before addressing the amendments tabled by Opposition Members and trying to respond to points raised by the hon. Member for Wolverhampton South West.

Schedule 4 makes detailed technical changes to the Financial Services and Markets Act 2000 that are needed to extend the senior managers and certification regime to cover all authorised financial services firms, including removing the definition of a relevant authorised person. It also makes a small number of consequential amendments to the Financial Services (Banking Reform) Act 2013.

Clause 21 gives the regulators expanded powers to include transitional provisions in their rules when they make rules that create new controlled functions or change the definition of an existing controlled function. They will need those powers when they specify the new senior management functions that will form the basis for rolling out the senior managers and certification regime to all authorised persons. Clause 21 also gives the Treasury a power to make any additional provision needed in connection with those rule changes through regulations.

1.15 pm

The hon. Member for Wolverhampton South West asked specifically about the conferring of functions. For example, that power could be used when responsibility for certain controlled functions is switched from one regulator to another, or when other changes are needed that effectively alter the boundary between what the

PRA, or the PRC as it will be after the Bill becomes law, and FCA regimes do. We do not think it would be appropriate for the regulators themselves to have that power. Another example would be giving the regulators power to make rules allowing for grandfathering new controlled functions, or allowing changes between regulators. That is an example of what the powers might be.

It is not unusual to amend legislation in regulations along these lines. The affirmative resolution procedure is required. The provision was reported to the Delegated Powers and Regulatory Reform Committee in the usual way, and it did not express any concerns about it.

Clause 22 makes a number of technical changes to the detailed legislation underpinning the senior managers regime, including corrections to put right minor errors or omissions in the original legislation in 2013. The hon. Gentleman had some technical questions on subsection (2), which ensures that when statements of responsibilities are changed, both regulators will, where relevant, receive copies. Subsection (3) allows time limits imposed on an approval to subsequently be varied. At present, only the conditions imposed on approvals can be changed, so time limits are an important addition. Subsection (5) makes a technical change to ensure that the PRA can bring disciplinary proceedings for the failure to provide an updated statement of responsibilities. Again, the clause is important yet technical.

Clause 23, which is where all the controversy is today, gives effect to the Government's reforms of the senior managers and certification regime provisions relating to rules of conduct. Although the hon. Gentleman was restrained in not reading out quotes from various different people on the controversy, I want to highlight the fact that Lord Turnbull, who was on the Parliamentary Commission on Banking Standards, said that the Bill's proposal

"tackles directly the difficulty with establishing personal liability and the Pontius Pilate defence…In future, senior managers will have to take responsibility for what goes on in the teams for which they are responsible and for the actions of the people whom they have appointed and thereby given accreditation."

The proposal gives that responsibility to the senior manager. He also said that

"I still fail to see why the reverse burden of proof is the only way to get people to understand that."—[*Official Report, House of Lords,* 15 December 2015; Vol. 767, c. 2026.]

The Archbishop of Canterbury also served on the Commission. His representative, the Lord Bishop of Southwark, said in the other place that he was at one with the Archbishop of Canterbury

"in supporting the Government's intentions on the reverse burden of proof…This goes against the ancient common-law principle of 'innocent until proven guilty'…It is absolutely right that the individual is obligated to ensure that they take reasonable steps to prevent regulatory breaches in their financial institution but, as with other parts of society, it is right that the burden of proof should sit with the regulator to prove such breaches beyond reasonable doubt."—[*Official Report, House of Lords,* 11 November 2015; Vol. 765, c. 2018-19.]

It is also worth reminding the Committee that we had a discussion on clause 19 about the importance of diversity in financial services. By broadening the senior managers and certification regime to include all financial services firms, we get a very consistent regime. It is important to highlight the fact that the credit union movement has welcomed the changes, as has the building society movement. Those important, diverse groups of financial institutions have welcomed the fact that the senior managers and certification regime clearly spells out where responsibility lies and what it is, and does not include a reverse burden of proof, which would make it increasingly hard, in the opinion of the Building Societies Association, to find the right people to take up senior roles in management or on the boards of those organisations.

On clause 23, which is about the rules of conduct for directors, I clarify that the Government legislated in the Financial Services (Banking Reform) Act 2013 to enable the regulators to apply the rules of conduct to all senior managers and all employees. That does not necessarily cover all non-executive directors, as some will not be senior managers and they will not normally be employees of the firm concerned. The clause addresses that issue by allowing the regulators to make rules of conduct for all directors.

Rob Marris: I wonder whether the Minister has a chance now or in a moment to deal with a concern I expressed about clause 23(3)(c), which is to omit section 64B(5) of the Financial Services and Markets Act 2000, about the duty to report wrongdoing and so on.

Harriett Baldwin: I fully intend to address that. The hon. Gentleman will have to bear with me, I am afraid. I am getting a little confused with all my different subsections, as he did in his remarks. I will, however, be addressing that.

On the hon. Gentleman's earlier question about why we did not simply implement the reverse burden of proof, allow time for it to bed down and see how it worked, my colleague in the other place, Lord Bridges, has pointed out that evidence had already started to emerge that unhelpful effects were becoming apparent as firms prepared for its introduction. We were losing the essence of the purpose of the regime, which is to ensure that everyone knows and understands their responsibilities and what they are for. We therefore felt that there was no need to wait before making the changes.

Clause 23 also removes a provision that requires firms to report all known or suspected breaches of rules of conduct to the regulators. That requirement is unnecessary, because the regulators can use their existing powers to require firms to notify them of matters that they want to know about. The provision, which requires notification of all suspected, as well as confirmed, breaches of rules of conducts, is unnecessary because it goes much further than the principles we want to operate. It would be unnecessarily onerous for firms and regulators.

As the hon. Gentleman can imagine, such a provision could effectively force firms to work out a point at which the possible indications of a breach of rules of conduct might amount to a genuine suspicion. Firms would need systems to ensure that the information is captured and transmitted to the regulators, and having been notified of a suspicion, the regulators would have to decide whether to investigate and, if appropriate, consider what action to take. In many cases there would be nothing more than suspicion, so no action would be taken, but meanwhile the regulators would have to consider and prioritise all notifications received. That would

[Harriett Baldwin]

be bound to limit their ability to respond appropriately in real cases, thereby imposing costs and burdens on the regulators and using up their time. Similarly, it can be argued that the suspicious activity reports used in the money laundering regime generate many false positives.

The Government thought hard about the provision and decided that removing the requirement would help to ensure that the regulatory system can work proportionately, without putting potentially costly burdens on firms that are disproportionate to any regulatory gain. Regulators will continue to be able to require firms to notify them of matters that they want to know about. The provisions introduced by the 2013 Act as section 64C of the 2000 Act remain. The requirement that firms must report disciplinary action that they take against employees will therefore remain in force. I hope that reassures the hon. Gentleman.

Amendments 31 and 32 would reinstate the reverse burden of proof for banking sector firms—the banks, building societies, credit unions and systemically important investment firms regulated by the PRA. Amendment 33 would allow the definition of the "relevant authorised persons" to remain in the Financial Services and Markets Act, which would be needed for amendments 31 and 32 to work as intended. Amendments 34 and 35 would apply the reverse burden of proof to all authorised persons across the entire industry. I will address the specific problems that each amendment would cause.

It is important that the Committee understands that the reverse burden of proof is simply not necessary to embed senior manager accountability in the senior managers and certification regime. The Parliamentary Commission on Banking Standards clearly established that the approved persons regime was wholly inadequate. We believe that the senior managers and certification regime clarifies the responsibilities of individual senior managers, which is something that any effective regulatory regime must deliver. Moreover, it will deter senior managers from taking a reckless or negligent approach to managing their responsibilities in the first place. I know that the whole Committee will agree with that. The duty of responsibility is a powerful incentive that encourages senior managers to take effective action to prevent such failings.

I have already set out how the new regime will deliver a step change in senior manager accountability. Regulators and firms will have the necessary clarity about who is responsible for what, and there will be no wriggling off the hook. Senior managers will need to take full ownership of their respective areas of responsibility. Each bank will have to submit to the regulators a responsibilities map, which will set out how responsibility for the business of the firm as a whole is allocated and minimise the risk of any responsibilities falling through the cracks between different senior managers.

The new regime places tough obligations on senior managers to act responsibly, and imposes stringent penalties if they fail to do so. For example, under the duty, a senior manager can be found guilty of misconduct by the regulator if a breach of regulation occurs in the area of the firm's business for which they are responsible and they did not take reasonable steps to avoid the contravention. It does not matter whether they were aware of the regulatory breach. As in the example that the hon. Gentleman raised earlier, ignorance is not a defence. What matters is whether they took reasonable steps to prevent the breach. If they did not, they are guilty of misconduct. They will not be able to avoid liability simply because the email trail has gone cold.

Removing the reverse burden of proof does not change the penalties that can be applied. If found guilty of misconduct under the statutory duty of responsibility, a senior manager will face an unlimited fine or prohibition from working in the industry. As the chief executive officer of the Prudential Regulation Authority, Andrew Bailey, said, introducing the statutory duty of responsibility instead of the reverse burden of proof

"makes little difference to the substance to the new regime…This change is one of process".

The Government are rolling out the senior managers regime to all authorised firms, including the fixed-income currency and commodities market. In the light of that extension of the regime, we must consider whether it is appropriate to apply the reverse burden of proof to every single firm in the financial services regulated sector, given how rigorous the regime is.

I sense you are getting slightly restless, Mr Brady, but I am nearing the end of my remarks. Amendments 34 and 35 would apply the reverse burden of proof to all authorised persons, the vast majority of which are small firms. It would be simply disproportionate to apply it to senior managers in all of those firms. I have spoken about the overly legalistic approach. We think it could lead to a perverse outcome, leaving senior managers in the largest firms less exposed to legal risk under the reverse burden of proof than those in small firms.

I have spoken at length about the clauses and set out why I strongly disagree with the Opposition's amendments. I hope I have convinced everyone of the merits of my argument. I ask the Committee to oppose the amendments and accept the clauses.

Ordered, That the debate be now adjourned.—*(Sarah Newton.)*

1.29 pm

Adjourned till this day at Two o'clock.