

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Second Delegated Legislation Committee

DRAFT FINANCIAL SERVICES AND MARKETS
ACT 2000 (REGULATED ACTIVITIES)
(AMENDMENT) ORDER 2018

DRAFT ELECTRONIC PRESENTMENT OF
INSTRUMENTS (EVIDENCE OF PAYMENT AND
COMPENSATION FOR LOSS) REGULATIONS 2018

Wednesday 4 July 2018

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The Committee consisted of the following Members:

Chair: SIR HENRY BELLINGHAM

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| † Bridgen, Andrew (<i>North West Leicestershire</i>) (Con) | † Reynolds, Jonathan (<i>Stalybridge and Hyde</i>) (Lab/Co-op) |
| † Davies, Chris (<i>Brecon and Radnorshire</i>) (Con) | † Smith, Jeff (<i>Manchester, Withington</i>) (Lab) |
| † Garnier, Mark (<i>Wyre Forest</i>) (Con) | † Stevens, Jo (<i>Cardiff Central</i>) (Lab) |
| † Glen, John (<i>Economic Secretary to the Treasury</i>) | † Stevenson, John (<i>Carlisle</i>) (Con) |
| † Hair, Kirstene (<i>Angus</i>) (Con) | † Walker, Thelma (<i>Colne Valley</i>) (Lab) |
| † Hayes, Helen (<i>Dulwich and West Norwood</i>) (Lab) | † Whittaker, Craig (<i>Lord Commissioner of Her Majesty's Treasury</i>) |
| † Linden, David (<i>Glasgow East</i>) (SNP) | |
| † McGovern, Alison (<i>Wirral South</i>) (Lab) | Kenneth Fox, <i>Committee Clerk</i> |
| † Mann, Scott (<i>North Cornwall</i>) (Con) | |
| † Menzies, Mark (<i>Fylde</i>) (Con) | † attended the Committee |
| † Murray, Ian (<i>Edinburgh South</i>) (Lab) | |

Second Delegated Legislation Committee

Wednesday 4 July 2018

[SIR HENRY BELLINGHAM *in the Chair*]

Draft Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2018

2.30 pm

The Economic Secretary to the Treasury (John Glen): I beg to move,

That the Committee has considered the draft Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2018.

The Chair: With this it will be convenient to consider the draft Electronic Presentment of Instruments (Evidence of Payment and Compensation for Loss) Regulations 2018.

John Glen: It is a pleasure to serve under your chairmanship again, Sir Henry. I am pleased to introduce two statutory instruments today, both of which will help to improve the way in which financial firms in the UK can operate and deliver efficient services that meet the needs of firms and consumers. The Government are determined to ensure that our laws keep pace with developments in market practice to ensure that consumers are appropriately protected, while securing the continued international competitiveness of UK markets.

The order amends the Financial Services and Markets Act 2000 to address a gap in the regulatory treatment of alternative finance investment bonds, covering sukuk or Islamic equivalent bonds. The gap arose because of changes in taxation applicable to debt traded on multilateral trading facilities made in the Finance Act 2018. Those changes took effect on 1 April this year, and we intend to close the gap as quickly as possible in the interests of clarity and consistency. It is stated Government policy to provide a level playing field for Islamic finance instruments. That means that although sukuk are not debt instruments, they are deemed to be debt-like for UK tax and regulatory purposes.

That approach has served the UK well, with the UK being recognised as the leading western centre for Islamic finance, and London being a global venue for Islamic capital market activity. To date, more than \$50 billion has been raised from sukuk listed on the London stock exchange. The instrument adds two additional types of financial trading venues—so-called multilateral trading facilities and organised trading facilities—to the list of permitted venues for alternative finance investment bonds. Conventional bonds can already be traded in the same venues. The order also amends the Financial Services and Markets Act so that a person administering a benchmark, as specified in the order, will be regarded as carrying on the activity by way of business. That is a minor, technical amendment, and is the final part of the legislation needed to complete the implementation of the EU benchmarks regulation into UK law.

The Joint Committee on Statutory Instruments reported the instrument for

“an unusual use of the enabling power.”

The Joint Committee raised concerns about the order’s coming into force immediately rather than 21 days afterwards. The Government treat the Joint Committee’s reports very seriously and give them full consideration. However, the Treasury has looked carefully at this matter and decided that an expedited approach was necessary for several reasons. First, the London stock exchange and UK-based advisers have warned that the continued failure to update the legislation for alternative finance investments bonds in regulation is causing issuers to look elsewhere. Secondly, the changes do not create any new cost for business, as the regulatory framework for alternative finance investment bonds has been in place since 2007.

I recognise the concerns raised by the Joint Committee that reasonable time should be provided for anyone to familiarise themselves with the changes made by the order, and to take steps to ensure compliance to avoid potential criminal liability. However, the criminal offence of carrying on a regulated activity without permission applies only to those people who are not already exempt or authorised by the regulators.

Instruments of such a nature are very sophisticated and highly unlikely to be traded in that manner by anyone without a significant level of expertise in financial services—in other words, firms already authorised by the Financial Conduct Authority. For those firms, carrying on an activity for which they are not authorised is contravention of a regulatory requirement, not an offence. The commercial reality is that it is a minor regulatory adjustment, rather than one that creates a new opportunity for criminal liability. In such circumstances, given that industry is eager to welcome the changes and the regulator foresees minimal impact from the amendments’ entering into force immediately, a longer waiting period was felt to be unnecessary and potentially even harmful to the markets.

I recognise fully, however, the concerns of the Joint Committee. I acknowledge that in this instance the Treasury could have done more to assure the House that its procedures are awarded due respect by the Government. The Treasury has taken on board the comments of the Joint Committee and will take steps to make improvements in future.

I now turn to the second statutory instrument: the draft Electronic Presentment of Instruments (Evidence of Payment and Compensation for Loss) Regulations 2018. Its purpose is to ensure that the electronic clearing of cheques has no detrimental impact on cheque users. Cheques continue to form a key part of the British payments landscape and, although one cannot deny that their use has declined over the years, cheques are still important for smaller charities, voluntary organisations and certain members of our society, often the most vulnerable. To illustrate the continued importance of cheques, I inform the Committee that in the first quarter of this year more than 65 million cheques were cleared, with a value in excess of £80 billion—an average of almost 1 million cheques cleared per working day.

In the existing anachronistic process of paper cheques being physically transported around the country, a cheque takes six weekdays to clear fully and for recipients to be

certain that the money is theirs. For that reason, in 2015 Parliament legislated to allow UK banks and building societies to accept receipt of cheques and similar instruments by electronic image. That innovation, now being delivered through the image clearing system, cuts down clearing times to the next weekday by sending a digital image of the cheque for clearing. Consumers, charities and businesses will therefore receive their funds more quickly. Cheque imaging will also facilitate further innovation in the industry—by enabling customers to pay cheques through their mobile banking app, for example.

I turn to the detail of the draft regulations, which provide for two measures to ensure that the electronic clearing of cheques has no detrimental impact on cheque users. The legislation seeks to protect customers as the image clearing system roll-out intensifies over the second half of the year. The first measure concerns the use of cheques as evidence of payment. In the existing model, customers may request from their bank a copy of the paper cheque that they wrote and that may be used as evidence of payment. To ensure that that right remains available, the measure will ensure that a copy of the cheque, along with some additional information, will be provided to the writer of the cheque on his or her request, and that copy has the same evidential value as a paper cheque.

The second measure concerns compensation. In cases of fraud or error, the rules for compensation are set out in scheme rules by the Cheque and Credit Clearing Company. No legislation, however, stipulates the circumstances in which customers must be compensated, or by whom. To prevent any harm to consumers from a fundamental change to cheque processing, the Government consider it necessary to legislate to ensure that cheque users are not left out of pocket if they incur a loss.

The second measure therefore provides that when a customer incurs a loss under the image clearing system, and prescribed conditions are met, including compensation not already having been received, the bank of the customer receiving the cheque must pay compensation. The Government believe that the existing industry-led approach works well. Indeed, the optimal solution is that the legislation need never be used because the scheme rules continue to effectively resolve losses from fraud or error.

In conclusion, the draft statutory instruments make necessary, albeit uncontroversial, changes to ensure that our financial services remain fit for purpose and work for the benefit of UK consumers. I sincerely hope that Members will join me in supporting the measures.

2.39 pm

Jonathan Reynolds (Stalybridge and Hyde) (Lab/Co-op): Neither of these two important draft statutory instruments is particularly controversial for the Opposition. The first one, the draft Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2018, relates to the admission of alternative finance investment bonds to different trading venues, as the Minister said, including multilateral trading facilities and organised trading facilities.

I am aware that our noble colleagues in the Lords have already considered the matter. I echo the points that my noble Friend Lord Tunncliffe made on 25 June. He said that the explanatory notes to the order could

have been clearer, as it took a bit of decoding to understand that it relates to sukuk. Transparency and clarity are important—not just for scrutiny in Parliament but so that people outside Parliament understand what we are doing. I appeal to the Treasury to bear that in mind in the future.

This is undeniably a positive initiative to promote and consolidate the UK as a hub for Islamic finance. I want the UK to be a hub for as many different categories of finance as possible. According to the Islamic Development Bank, the UK already has the largest Islamic financial sector of any OECD country. In 2014, it became the first ever non-Muslim country to issue a sukuk. In a post-Brexit environment, it is important that we continue to invest in and build on the City's strength to attract revenue from around the globe, as a world-class, world-leading financial centre, and to service our domestic financial market.

Islamic finance brings many advantages of its own. When London's Mayor, Sadiq Khan, opened a major conference on Islamic finance earlier this year at the London Stock Exchange, he said that it drives positive, ethical change around the world. The Opposition, therefore, do not oppose creating a level playing field in this area of finance, and we do not see any immediate issue with the changes before us today. The entire point of MTFs and OTFs, as introduced by the markets in financial instruments directive, is to create a more efficient and competitive trading environment. That cannot be the case if unintended restrictions exclude certain instruments. Sukuk is an important pillar of the Islamic finance market, representing 17% of the entire industry, and competition with other trading venues globally is fierce. Hopefully, the settling of this issue will bring much-needed certainty to any issuers who are considering listing in the UK.

Will the Minister explain why this oversight is being rectified today, given that it formed part of the amendment that the Finance Act 2018 made when it was implemented on 1 April 2018? Are the Government confident that there are no further gaps in that legislation that will require attention? I look forward to the Minister's response, and to the passage of this order, which will allow the UK to be promoted further as a centre for excellence for Islamic finance.

The second item for discussion today is the draft Electronic Presentment of Instruments (Evidence of Payment and Compensation for Loss) Regulations 2018. It is sometimes said that Back Benchers do not always find delegated Treasury business to be the most exciting business before them in the parliamentary week, but on this occasion I beg to differ. We are discussing a useful and enabling piece of technology, which has allowed banks to speed up cheque processing by using images, instead of physically transporting pieces of paper. I am fascinated by the way historical banking transactions and new technology can be brought together in ways that benefit the customer. We would surely never have dreamed, 15 years ago, that handheld phones could enable cheque deposits.

As with all exciting banking technology innovation, it is vital that we strike a balance between innovation and consumer protection. Sadly, as digital technology evolves, so too do the techniques of fraudsters looking to exploit customers at every link in the payments infrastructure. The Opposition support this regulation,

[Jonathan Reynolds]

which clarifies where compensation will come from if somebody is defrauded. However, it is a significant shift to transfer the liability from the paying bank to the payee bank, so it is important that that is monitored for any potential unintended consequences. The shift must be effective with regard to compensation where it is needed.

As it stands, the principal use of the image clearance system is in the banks themselves, but will the Minister encourage the further roll-out of the system to customers themselves? I am aware that some banks are already using this technology, but it is not standard yet. That would be especially valuable to customers with impaired mobility. I would be interested to know what consultation has taken place with the banking sector on progress towards that. Further safeguards may be needed to protect customers as the situation evolves. As ever, maintaining a strong regulatory framework must be our priority.

2.44 pm

David Linden (Glasgow East) (SNP): It is a pleasure to serve under your chairmanship, as always, Sir Henry. The Scottish National party will not oppose these statutory instruments. I rise to make a couple of brief points about one of them.

I very much welcome the image clearing system for cheques. Reducing cheque clearing times will bring cash flow benefits to firms and individuals. Contrary to what some people think, cheques are still a hugely important part of our economy. For example, in 2016, 477 million cheques were used for payments and to acquire cash in the UK, with a total value of £551 billion.

While the Minister is here, I ask Her Majesty's Government to take the opportunity to commit to retaining the cheque clearing system for as long as there is demand for the service; there was a bit of clash with the UK Payments Council back in 2009, I think, so I seek clarity from the Minister on that. I would also like the Minister to set a clear date for the reviewing and publishing of details of the measures taken. Regulation 10 of the draft Electronic Presentment of Instruments (Evidence of Payment and Compensation for Loss) Regulations 2018 provides that the Treasury should undertake periodic reviews of the measures taken, so Her Majesty's Government must ensure that it monitors the implementation of the measures and publishes those findings.

The Scottish National party will not oppose the draft orders. I thank Committee members for their forbearance.

2.45 pm

John Glen: I am grateful for the observations from the respective Front Benchers. I take seriously the observation of Lord Tunnicliffe, in the other place, on the adequacy of the explanatory notes. The Treasury always endeavours to make its explanatory notes as clear as possible, but I recognise the confusion and uncertainty caused. I will examine that and see what improvements can be made.

I welcome the support of both Front-Bench spokespeople for the draft orders. The gap and the delay are a matter of regret from the Treasury's point of view. It would have been preferable to introduce the draft orders earlier, thereby avoiding a gap in the regulation and taxation of alternative finance investment bonds. On this occasion, I have to concede that the Government fell short of the standard we wish to set. I will do all that I can to ensure that that is not repeated.

I am pleased that the hon. Member for Stalybridge and Hyde acknowledged the leadership that the Government showed in 2014 by the issuance of a sovereign sukuk of £200 million; we look forward to trying to develop that further in the future. I welcome the support of the hon. Member for Glasgow East for the improvements to the image clearing system. With respect to the future protection of the use of cheques, there are no plans at all to curtail their use. A consultation is ongoing about the use of cash. On whether people should be encouraged to use images of cheques rather than physical ones, I think that customer demand and banking innovation will lead the way.

There has been a significant transition in the last three years. Given the advance of open banking and FinTech, we are seeing more and more products and opportunities enabling people to behave differently with their financial products, and I believe that that will lead the way. However, I take seriously the concerns expressed about vulnerable consumers and the need to ensure that they have adequate provision to make the transactions they need to. I hope that I have addressed the substantive points raised and that the draft orders will now be passed.

Question put and agreed to.

**DRAFT ELECTRONIC PRESENTMENT OF
INSTRUMENTS (EVIDENCE OF PAYMENT
AND COMPENSATION FOR LOSS)
REGULATIONS 2018**

Resolved,

That the Committee has considered the draft Electronic Presentment of Instruments (Evidence of Payment and Compensation for Loss) Regulations 2018.—(*John Glen.*)

2.48 pm

Committee rose.

