

# Financial Services Bulletin

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## Section one – news

### Financial Services Bill

The Financial Services Bill was introduced in the House of Commons on 19 November 2009. The purpose of the legislation is to ensure that the financial system that emerges from the crisis is rebuilt on a stronger, sounder and fairer footing. The Bill includes measures to strengthen and reform financial regulation, and protect and support consumers.

This Bill takes forward the legislative proposals set out in the Government's consultation paper *Reforming Financial Markets*, which was published in July 2009. It follows action already taken to ensure the UK authorities have powers to deal with failing banks and protect consumers and taxpayers (the Banking Act 2009), reform of banking regulation (the Turner Review), reform of remuneration and corporate governance (the Walker Review), reform of international regulation, and measures to clean up banks' balance sheets and restore lending.

The Bill consists of a number of proposals, including:

- The creation of a Council for Financial Stability to consider emerging risks to the financial stability of the UK and global financial system;
- Strengthening the FSA's powers and objectives,

including providing it with an explicit financial stability objective;

- Placing a duty on the FSA to take action in respect of remuneration, aligning it with effective risk management and the FSB's implementation standards, and implementing Sir David Walker's recommendations on disclosure and transparency;
- Placing a duty on the FSA to make rules requiring firms to produce recovery and resolution plans, which aim to reduce the probability of firm failure, and reduce the impact of such a failure if it does occur;
- Requiring the FSA to establish a new independent consumer financial education body, to increase consumer education and awareness and coordinate existing consumer education activities, including the rollout of a national Money Guidance service from 2010;
- Enabling better routes to redress for consumers who have suffered detriment, by enabling a representative to bring an action through the courts on behalf of a group of consumers, and streamlining the FSA's powers to order a review of past business and secure compensation if there have been legal or regulatory breaches.



HM TREASURY

## Update on the Capital Requirements Directive

CRD4, which was expected November 2009, and CRD5 will now be rolled together. The new proposals will be put forward in July 2010, with a consultation sometime before that. This will provide scope for taking into account developments from Basel and the International Accounting Standards Board. The July 2010 package is ambitious and will cover:

### A) National discretions

i) Maximum harmonisation: A proposal to make Pillars 1 and 3 of the CRD maximum harmonisation. Pillar 2 would remain minimum harmonisation. This covers the discretion of national supervisors to make idiosyncratic adjustments of capital requirements for firms, where justified by risks.

ii) Removal of national options and discretions: The proposal is to bring the CRD close to a single rulebook. We are supportive of this, but have concerns over the effects on risk weightings on both residential and commercial property.

### B) Dynamic provisioning

Involves estimating and applying long-run expected losses on assets rather than actual current loan losses. This means that banks will in effect hold more reserves in the good times when actual loan losses are below the long-run average. Banks would build an accounting treatment buffer during the expansion that they would be able to draw down when conditions deteriorate. The Commission proposes it would work through a formula determined by regulators.

### C) Leverage ratio

At this stage there is no firm idea of the detail of the proposal, but its starting point would be where Basel has got to so far. That is, a hard leverage ratio based upon core tier 1 biting initially in Pillar 2 and moving to Pillar 1 when calibrated effectively.

### D) Residential mortgages denominated in a foreign currency

The Commission is proposing additional capital requirements for residential property loans that are denominated in a currency other than that of the income of the borrower. The additional requirements would apply above a specified loan to value ratio (starting at LTV 50%) and slide upwards (LTV 100% = 1:1 risk weighting).

### E) Simplification of the Branch Accounts Directive

The proposal is to amend the Bank Branch accounts Directive so that Member States can no longer require the publication of additional information by branches of credit institutions established in other Member States.

### F) Definition of capital

Basel is currently working on proposals to define core tier 1, tier 1, tier 2 and tier 3 capital. It is also considering the role of contingent equity.

### G) Counter-cyclical capital buffers

Following a G20 commitment, Basel is currently developing proposals to introduce a capital buffer that can be built up in good times and eroded in bad times. It is likely that capital restrictions would be required in the build up phase. A Basel proposal on a simple buffer is expected at the end of the year and on a macroprudential buffer mid way 2010.

### H) Liquidity

The Basel Committee intends to put a global standard for liquidity regulation in place and the plan is to develop two quantitative minimum standards:

- A liquidity coverage ratio that compares a credit institution's stock of high quality liquid assets to the hypothetical liquidity drain under a standardised 30-day regulatory stress scenario.
- A structural liquidity ratio to address funding reliability concerns over a longer-term horizon (such as one year), either setting a standard for the composition of a credit institution's liabilities or setting a standard for coverage of funding needs by stable funding sources.

### I) Systemically important institutions

The G20 has agreed to tackle systemically important financial institutions. The Commission has suggested that items to consider should be: greater supervision; development of cross-border resolution tools; living wills; additional capital; contingent capital and additional liquidity.

### J) Counterparty Credit Risk

Incorporating the work on Over The Counter derivatives and expected changes to risk weights.

## Lending support to the UK economy

A fair and competitive credit market is a key component of a successful economy. Maintaining the flow of lending to creditworthy businesses and individuals is essential to growth and prosperity. The Government has taken a number of steps to support responsible lending and to promote best practice in the treatment of borrowers. The aim is not to return to the irresponsible lending practices of the pre-crisis period, but to ensure that the supply of credit meets recovering demand from creditworthy borrowers.

It is important that creditworthy households and businesses should not suffer from constraints on the supply of lending, especially as demand recovers. To support access to competitively priced finance, the Government has secured legally binding lending commitments from RBS and Lloyds to lend an additional £25 billion and £14 billion respectively, subject to demand and on commercial terms, to mortgage customers and businesses. Both RBS and Lloyds have already made substantial amounts of lending available to borrowers. The Government expects both banks to continue to meet demand for lending from creditworthy households and businesses.

To help provide continued confidence to businesses in accessing bank finance, the Royal Bank of Scotland (RBS) and Lloyds Banking Group (Lloyds) lending commitments will remain in place until March 2011.

The Government also recognises that some small and medium-sized enterprises (SMEs) are still having problems accessing affordable finance. To help address this issue the Government has agreed Customer Charters with RBS and Lloyds. The Charters increase the transparency of pricing for SMEs, which will help these businesses understand the conditions of their loan and how the price they are paying has been arrived at. The Charters also include promises to cap fees on lending for the majority of SMEs. The Charters apply to over 98 per cent of these banks' customer base. More information can be found on the Lloyds and RBS websites.

## Update on the Banking Act 2009

On 10th November, the Treasury laid in Parliament in draft the Banking Act 2009 (Exclusion of Insurers) Order 2009. This Order excludes insurance companies from the scope of the special resolution regime (SRR) established by the Banking Act 2009. The Government considers that it is appropriate to exercise the power under the Act to exclude insurers from scope, as the SRR was not designed for use in relation to insurers.

On 11 November 2009, the Treasury made The Banking Act 2009 (Commencement No. 4) Order 2009, which brings into force various provisions of the Banking Act. Article 3 specifies that Part 6 of the Act is brought into force on 23 November 2009. Part 6 of the Act repeals existing provisions about permission to issue banknotes in Scotland and Northern Ireland and replaces those provisions in respect of banks with permission to issue banknotes. Article 4 specifies that the remaining provisions of Part 5 of the Act are brought into force on 31 December 2009. Part 5 of the Act makes provision for a new regulatory regime for the oversight by the Bank of England of inter-bank payment systems specified by the Treasury as recognised systems under section 184(1) of the Act. Sections 181 to 187, 204 (in part) and 205 came into force on 4th August 2009 in the Banking Act 2009 (Commencement No. 3) Order 2009.

Further information about these Orders is available from <http://www.opsi.gov.uk>.

## Council Agreement on New European Supervisory Architecture

EU Finance Ministers reached agreement on a complete package for a new supervisory framework in the European Union at the 2 December ECOFIN meeting. The European Parliament will now discuss the proposals under the ordinary legislative procedure (the procedure formerly known as the co-decision procedure before the entry into force of the Treaty of Lisbon). The European Council on 10-11 December called for “a swift adoption by the European Parliament so that the new system can become operational during the course of 2010.”

The legislative proposals are designed to help improve the quality and consistency of financial regulation and supervision in Europe, and better identify risks in the financial system. A new European Systemic Risk Board will provide the European Union with a system for monitoring macro-prudential risks and issuing risk warnings and recommendations for remedial action when such risks are significant. The three new European Supervisory Authorities for banking, insurance and securities markets will develop common technical standards, enforce EU legislation, co-ordinate national supervisors and settle disagreements between national supervisors.

The Government will work closely with the European Parliament to ensure that the final co-decided package of legislation is good for the UK and for the City of London, as well as the EU.

Concurrently, Council negotiations continue on the amending legislation (the so-called “Omnibus Directive”), which amends 10 existing financial services directives to enable the new supervisory architecture to be put in place and the new supervisory Authorities to work effectively. The draft Omnibus Directive can be found on the European Commission website via the link below:

[http://ec.europa.eu/internal\\_market/finances/docs/committees/supervision/20091026\\_576\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/committees/supervision/20091026_576_en.pdf)

## Walker Review

In February 2009, Sir David Walker was commissioned to review the corporate governance framework in the UK banking sector and address the governance failures that contributed to the onset and severity of the financial crisis. Sir David’s interim findings were published on 16 July, and his final report and recommendations were published on 26 November 2009.

His final recommendations cover:

- board size, composition and qualification;
- the functioning of the board and the evaluation of performance;
- the role of institutional shareholders and shareholder communication and engagement;
- governance of risk; and
- remuneration.

The Government will move quickly to implement the Review recommendations, working closely with other bodies to which the Review has directed recommendations for implementation. The detail of the recommendations and the specific means of implementation may be subject to further development or consultation as appropriate.

## Report of Asset Management Working Group

The Asset Management Working Group (AMWG) has published Asset Management: the UK as a global centre, a report into the medium and long-term challenges facing the asset management industry.

The AMWG was convened by the Chancellor of the Exchequer, Alistair Darling, to look at what needs to be done to ensure that the UK remains a global centre for asset management. Co-chaired by Chancellor of the Exchequer, Alistair Darling and Robert Jenkins, Chairman of the Investment Management Association, the Group represented practitioners from across the asset management industry.

In the Report the Group highlights the contribution and importance of the asset management industry to the UK and notes the positive results of recent Industry and Government work on fund taxation.

The Group recommends that the industry and Government should continue to work together to ensure the UK remains competitive and takes advantage of the opportunities, for example by making the UK a domicile of choice for collective schemes and developing a viable onshore hedge fund regime. The Report sets out that the industry must ensure that its clients have realistic expectations, and provides recommendations for the distribution chain that would be of benefit to consumers across Europe. The Report also covers the importance of a domestic savings pool and savings incentives, as well as opportunities within Europe, and the importance of considering the buy-side in capital market issues.

In Pre-Budget Report 2009, the Government announced that the Chancellor will convene a new advisory group on financial and professional services, as a smaller and more focused successor to the former High-Level Group. It will act as a critical sounding board for the Government with respect to policies pertaining to the long-term future of the sector and their cumulative impact, and will ensure that the conclusions from the competitiveness reports, including the AWMG's report, are followed through.

The report can be found on the HM Treasury website at [http://www.hm-treasury.gov.uk/fin\\_assetmanagement\\_index.htm](http://www.hm-treasury.gov.uk/fin_assetmanagement_index.htm).

## Money Guidance

A £12m pilot or 'pathfinder' Money Guidance service, covering the North West and North East of England, was launched in April 2009 to test the recommendations of the Thoresen Review of Generic Financial Advice, published in 2008. The service is available through the Moneymadeclear website, helpline and via face-to-face sessions.

Money Guidance is free and impartial, offering guidance on everything to do with personal finance. The service does not recommend products or courses of action; it simply explains the option available to an individual, empowering them to make their own decisions. For more complex issues the service will refer individuals on to specialist partners (such as the Pensions Advisory Service or specialist debt

caseworkers) and independent financial advisors for more in-depth financial advice.

The pilot has already helped 265,000 people in the North West and the North East of England and is on track to reach over 500,000 people by March 2010.

Interim evaluation findings from the pathfinder clearly demonstrate that the service is filling a need for a 'one-stop-shop' on money and that it includes topics which are not well covered by other sources of impartial advice (such as budgeting, credit and borrowing, and pensions and retirement planning). In the past month, people have most frequently used the website and helpline to ask about mortgages and credit and borrowing. In face to face sessions they have been seeking help on budgeting and benefits and tax credits.

The pathfinder has also proven that it is successfully engaging those who are especially vulnerable to the consequences of poor financial decision making. Half of those reached in the pathfinder are from the groups that can benefit most from the service.

In the light of the pathfinder's success to date, the Government and the FSA will provide £20 million in 2010-11 to fund the national rollout of the Money Guidance service from spring 2010. This will enable the service to help one million people by March 2011. The Government will also commit at least 25% (up to £100 million) from Dormant Accounts Scheme over a number of years to support delivery of Money Guidance service, subject to the final volume of funds available for distribution in England and alongside funding other priorities through the scheme, including youth facilities and a Social Investment Wholesale Bank.

## Dormant Accounts Scheme update

To ensure progress towards the release of dormant account funds, the Cooperative Financial Services (CFS) has agreed to support the Government and industry efforts to take forward the Dormant Accounts Scheme, by preparing a plan for the establishment of the Reclaim Fund. The CFS intend to submit an application to the FSA for authorisation to establish and administrate the Reclaim Fund, subject to work going ahead as planned.

The Cooperative Financial Services (CFS) is proposing to submit an application to the FSA for authorisation for a body to be a reclaim fund. The establishment and authorization of a reclaim fund is a key stage in the Dormant Accounts scheme. Once the body is established banks and building societies will be able to seek its agreement to the transfer of balances of dormant accounts.

The Government confirms its commitment to direct the majority of the investment from dormant accounts funds to deliver new and improved youth facilities across the country, with at least 25 per cent and up to £100 million of the fund for financial capability, and up to £75 million for the establishment of a Social Investment Wholesale Bank, subject to the final volume of funds available for distribution in England.

## Information Gateway

The Financial Services and Markets Act 2000 (Disclosure Of Confidential Information) (Amendment) Regulations 2009, which came into force on 18th November 2009, amends the Financial Services and Markets Act 2000 (Disclosure of Confidential, Information) Regulations 2001 to add the Claims Management Regulator to the list of persons in the 2001 Regulations to which confidential information, not subject to single market directive restrictions, may be disclosed by the Financial Services Authority.

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## Section two – live consultations

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### Establishing resolution arrangements for investment banks

On 16 December the Government published 'Establishing Resolution Arrangements for Investment Banks'. The paper sets out the Government's proposals for enabling the orderly wind-down of an investment firm. In particular, the proposals are aimed at reducing the impacts of an investment firm's failure on clients, creditors, counterparties and the wider UK economy. The Government is committed to ensuring that the UK market for

investment banking services remains competitive and believes that the proposals being consulted on will enhance the UK's reputation as a safe place for investors to invest.

The deadline for responses to this consultation is 16 March 2010.

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## Section 3 – web links

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### **Update on the Banking Act 2009**

<http://www.opsi.gov.uk>

### **Council Agreement on New European Supervisory Architecture**

[http://ec.europa.eu/internal\\_market/finances/docs/committees/supervision/20091026\\_576\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/committees/supervision/20091026_576_en.pdf)

### **Walker Review Website**

[http://www.hm-treasury.gov.uk/walker\\_review\\_information.htm](http://www.hm-treasury.gov.uk/walker_review_information.htm)

### **Walker Review Final Recommendations**

[http://www.hm-treasury.gov.uk/d/walker\\_review\\_261109.pdf](http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf)

### **Report of Asset Management Working Group**

[http://www.hm-treasury.gov.uk/fin\\_assetmanagement\\_index.htm](http://www.hm-treasury.gov.uk/fin_assetmanagement_index.htm)

### **Information Gateway**

[http://ec.europa.eu/internal\\_market/finances/docs/committees/supervision/20091026\\_576\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/committees/supervision/20091026_576_en.pdf)

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hmtreasury.gsi.gov.uk](mailto:fsma.bulletin@hmtreasury.gsi.gov.uk)

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