

# Ignacity

## A critical guide to The Financial Services Bill

**The Financial Services Bill, currently before Parliament, will, among other things:**

1. *Require the FSA to introduce rules forcing firms to develop and implement remuneration policies that it finds acceptable*
2. *Allow the FSA to force the repayment of remuneration not permitted under these rules*
3. *Allow the Treasury to force firms to disclose details of executive remuneration*
4. *Allow the FSA to punish individuals it considers should have obtained its approval before carrying out actions it deems erroneous or worse*
5. *Allow the FSA to collect information from firms that are not authorised*
6. *Allow the FSA to provide other national authorities with information given to it in confidence, even when no reciprocal arrangement is in place, thus raising the spectre of this being used extensively for extradition requests to try British subjects for something they have done in London in other jurisdictions*
7. *Create a system of group actions. Rules could remove the ability of defendants to recover any costs from misconceived or mistaken actions brought in the Courts. The Treasury will be able to extend limitation periods. Formulae for damages may also be prescribed.*
8. *Allow the FSA to suspend a permission to carry on a regulated activity*
9. *Allow the FSA to prohibit short selling*

# **A King Henry VIII Act**

The most striking feature of this Bill is that it gives huge powers, mainly to the FSA, but to a lesser extent to the Treasury, to change the entire financial sector.

The FSA is to be given powers to lay down remuneration policies for every firm—from the largest bank to the smallest insurance broker—without Parliament having the least say. The Treasury is to be given powers to make regulations that alter long established principles of civil law—for example limitation provisions - without having to obtain the approval of Parliament.

The exercise of powers will be almost entirely in the hands of the FSA—the FSA will have discretion as to when to act and how to act. The FSA's track record does not exactly inspire confidence that it will avert the next major financial crisis. An altogether more likely outcome is continuing restriction on the ability of industry and commerce to obtain finance at the cost that current base rates would suggest and lasting damage to the City of London as other governments attract business by offering a more realistic regulatory regime.

The proposed powers are all embracing—while it is possible to argue a case for intrusive regulation of large institutions that enjoy an implicit taxpayer guarantee, there is no case at all for similar intrusion into smaller entities that cannot possibly cause a national or international crisis.

## **Lack of scrutiny of the FSA**

One of the more disquieting aspects of the current system is the absence of any effective scrutiny of the FSA. An instructive example of this weakness was provided by a Commons debate on 2 June 2009 which exposed a truly dreadful story of small businesses being ruined by an employee of HBOS and his associates. Five MPs raised matters of the gravest concern, including allegations that a senior employee of HBOS had been bribed and that prostitutes had been paid for from the funds of clients of the bank's stipulated management consultant. Mr James Paice made it clear that the MPs were seeking only a full inquiry into grave and apparently well founded allegations. Replying to the debate, a well briefed Economic Secretary was only able to promise to write to the FSA. If Parliament and Ministers are thus impotent, nobody else is going to be able to exercise control. Before the FSA is given more powers, we need to be assured that it issuing the powers it has to suppress wrongdoing, not to make the lives of honest men and women a bureaucratic misery.

# Too much scope for mischief

The credit crunch has indeed raised serious questions about the scope and content of regulation, and in particular what is necessary to avoid or at least minimise the risk of a general failure of the financial markets and/or very heavy costs falling on the taxpayer. Some legislation will be needed to minimise such risks in future.

The present Financial Services Bill goes a great deal further than could possibly be justified either by an analysis at national level of the measures we need to take in the British market or by the international agreements that are emerging from the G20. If the Bill is enacted these powers will inevitably be used not just to deal with a narrow range of problems in a small number of institutions but across the board—in the same way that local councils seem able to use anti-terrorist legislation to deal with litter and school admission problems or, closer to home, the FSA is using its current powers to re-shape the entire structure of retail distribution of financial products, surely not something envisaged when either the 1986 Financial Services Act or the 2001 Financial Services & Markets Act were before Parliament.

The provisions for control of remuneration are unlikely to satisfy those who think wholesale reform is needed and are unlikely to deter risk taking that can rebound on UK banks. The provisions to prohibit short selling—which include powers to force unwinding of ‘open’ positions—will simply encourage fund managers to re-locate to regimes that do not inhibit their ordinary activities. The provisions to allow the FSA to punish individuals who discharge ‘controlled functions’ without Approval threaten to discourage investment in the sector and take attention away from the responsibilities of persons who are approved and should be exercising control. The proposed scheme for group actions will obviously benefit lawyers and others pursuing claims for conditional fees and the lawyers defending actions—but are unlikely to do much for consumers.

Many of the proposals in the Bill have a superficial appeal. They will have a lasting benefit to lawyers and accountants. It is unlikely that they will do very much to benefit the country as a whole—and if they simultaneously shrink the financial services sector and reduce the availability of finance to the rest of the industrial and commercial sector, they will do a good deal of mischief.

# **The Bill and the Election: our hope is in the Lords**

**The Bill is in its Committee Stage in the Commons. The Committee will sit for a further 8 sessions in January, concluding its proceedings on Thursday 14th January so the Bill could receive a Second Reading in the Lords before the end of January without adequate Commons scrutiny.**

**If the Lords were only to spend one day on Committee and Report stages (which appears unlikely) then the earliest the Bill could receive a Third Reading under normal procedure is around 8th March—making it just possible for the Bill to receive Royal Assent by Easter. If the Lords take several days on Committee and/or Report, the prospect of the Bill returning to the Commons before Easter becomes slim.**

**The three most likely dates for the General Election are 25th March, 6th May and 3rd June. Usually the Government and Opposition agree to let some Bills through—in whole or in part—without full scrutiny. There will be a good deal of political pressure on the Conservatives to allow this measure through, especially if it has completed scrutiny in the Lords largely without amendment.**

**Apart from the concern that has been articulated by both Conservatives and Liberal Democrats already that this measure, by making the Treasury, the Bank and the FSA responsible for financial stability, will create a situation in which responsibility is fatally divided, it is clear that this measure gives the FSA and Treasury sweeping powers without any proper mechanism for Parliamentary control.**

**There is nothing in this measure that is genuinely urgent. Much will require drafting of detailed regulations. Everyone would have a clearer idea of what was necessary if the Treasury and FSA were to get on with drafting detailed proposals so that the Treasury Committee could properly evaluate the entirety.**

**The House of Lords will do everyone a service if it scrutinises this measure closely, and amends it where desirable, even if as a result the Bill is lost on dissolution. We propose to provide effective and timely briefing to members of the House of Lords to encourage them to give this measure the full examination it cries out for.**