Bulletin No 140 August 2014

Butterworths Financial Regulation Service

Bulletin editor
Abdul Karim Aldohni LLB, LLM, PhD
Lecturer in Law, Newcastle Law School

RECENT DEVELOPMENTS UK

HM Treasury News

Government takes action to modernise 100-year-old insurance industry rules

The government has introduced (on 21 July 2014) the Insurance Bill to Parliament, which will support the growth of Britain's insurance industry and help customers by updating the 100-year-old rules governing contracts between businesses and insurers.

The new Bill introduces a more modern legal regime which will benefit both insurers and their business customers by increasing transparency and certainty over the rules that govern contracts between them and reducing the number of legal disputes over time.

This will mean that British insurers are better equipped to compete against their global competitors, some of whom have already introduced more modern legal regimes for insurance, while businesses are expected to benefit by around £100m over the next ten years, as a result of factors such as lower litigation and transaction costs.

The Bill is the product of recommendations made to the government by the Law Commission and the Scottish Law Commission following eight years of consultation with businesses and insurers. HM Treasury informally consulted on the Bill in June 2014.

The reforms contained in the Insurance bill cover three main areas:

- Disclosure and misrepresentation in business and other non-consumer insurance contracts. The Bill amends the duty on business policyholders to disclose risk information to insurers before entering into an insurance contract, introducing a duty of 'fair presentation' of the risk. It also provides the insurer with a number of proportionate remedies for breach of the duty of fair presentation.

LexisNexis®

- Warranties. The Bill abolishes 'basis of the contract' clauses, which have the effect of converting pre-contractual information supplied to insurers into warranties without further discussion. It also provides that the insurer's liability should be suspended, rather than discharged, in the event of a breach of warranty, meaning insurance coverage is restored after a breach of warranty has been remedied
- Insurers' remedies for fraudulent claims. The Bill provides the insurer with clear, robust remedies when a policyholder submits a fraudulent claim

HM Treasury 21.07.14

Non-executive directors to Bank of England's Court appointed by Chancellor

The Chancellor announced three new non-executive directors to serve on the Court of the Bank of England. Dido Harding, Don Robert and Dorothy Thompson will join the Bank's governing body from August this year. Tim Frost, who has been a member of the Court since June 2012, has been reappointed for a further term.

The three new non-executives will replace Lady Susan Rice and Sir Roger Carr who stepped down in June, and Lord Adair Turner who stepped down last year.

The Court of the Bank of England is the Bank's governing body and is responsible for managing the affairs of the Bank, other than the formulation of monetary policy. Its members are appointed by the Queen on the recommendation of the Prime Minister and the Chancellor of the Exchequer.

The Rt Hon George Osborne, Chancellor of the Exchequer, said:

> 'I am delighted to be able to announce the appointment of Dido Harding, Don Robert and Dorothy Thompson to the Bank of England's Court. All three are highly qualified and experienced people who will strengthen and diversify the Bank's board.
>
> Tim Frost has been a valuable addition to the Court since he joined in 2012 and I am pleased to confirm that he has been reappointed for a further term.'

Anthony Habgood, Chairman of the Bank of England's Court of Directors, said:

> 'I am delighted that Dido Harding, Don Robert and Dorothy Thompson are joining the Court of Directors. Each brings valuable experience and business expertise that complement the skills of the existing Directors, and I very much look forward to working with them.'

HM Treasury 21.07.14

Stamp Duty Land Tax rules for property investment funds

At Budget 2014, the government announced that it will consult on the Stamp Duty Land Tax ('SDLT') treatment of the seeding of property authorised investment funds ('PAIFs') and the wider SDLT treatment of co-ownership authorised contractual schemes ('CoACSs').

The government is aware of requests to change the way in which SDLT applies to PAIFs and CoACSs investing in land and buildings (referred to as 'property'). Stakeholders suggest that relieving SDLT in certain circumstances could encourage more property funds to set up in the UK and facilitate greater collective investment in UK property.

This paper seeks to better understand the wider impact of introducing an SDLT seeding relief for PAIFs and changing the SDLT treatment of transactions in units of CoACSs investing in property. The evidence and data gathered will help to inform Ministers' decisions on whether these changes should be introduced.

The paper also sets out proposals for how these changes could be implemented, if the decision is taken to introduce them, and seeks views on their potential design. A priority of the government is that the changes do not create a new risk of tax avoidance and this paper therefore sets out a number of anti-avoidance provisions.

The government intends to evaluate the case for making the changes discussed against a set of clear criteria:

- the expected effect on the growth of UK-domiciled property funds;
- the economic impact of any change, including the likely effect on the property;
- the market and the asset management sector;
- the impact on policy holders and investors;
- the cost to the Exchequer;
- the effect on tax compliance and tax avoidance; and
- the wider costs or risks associated with making the changes mentioned.

HM Treasury 18.07.14

New employee shareholding vehicle

At Budget 2014 the government announced it would seek views on the Office of Tax Simplification's ('OTS') recommendation to introduce a new employee shareholding vehicle to make it easier for companies wishing to manage their employee share arrangements and create a market for employees' shares. This discussion paper explores the case for change made by the OTS and the potential issues that the introduction of an employee shareholding vehicle raises. It aims to develop the understanding of the scope to introduce a simpler vehicle by seeking views on:

- the level of demand for such a vehicle should it be introduced;
- the relative need and demand for the exemptions recommended by the OTS; and
- the effectiveness of the safeguards for the Exchequer recommended by the OTS and whether further safeguards might be necessary to protect against tax avoidance.

The government would like to receive evidence from anyone with an interest in employee share schemes, particularly employers, employees, tax professionals, and employee share scheme experts. The evidence provided will help the government decide whether or not to proceed.

HM Treasury 17.07.14

Government kicks off discussions with industry over future of North Sea tax

The government has called on industry, on 14 July 2014, to submit their thoughts on the future of the UK oil and gas tax regime.

The call for evidence will explore how the tax regime can continue to encourage investment in the North Sea and help maximise the value of the country's oil and gas resources for the UK, whilst ensuring the nation continues to receive a fair share of profits.

The call for evidence marks the beginning of 12 weeks of discussion with the oil and gas industry and other stakeholders about the long-term shape of the tax regime.

The review, which the Chancellor announced at Budget 2014, comes at an important time for the UK Continental Shelf. There is still a considerable amount of oil and gas left to recover – up to around 21bn barrels of oil equivalent.

The basin is currently attracting record levels of private investment – £14.4bn in 2013 – and there are around 125 groups of companies now involved as licensees in offshore exploration and production.

However, exploration and production is becoming harder and more expensive, and the UK is facing competition for capital from other countries.

As the independent Office for Budget Responsibility highlighted last week, tax revenue generated from the oil and gas industry will continue to decline over the long term.

The value of the industry to the country will increasingly come through wider economic benefits – through jobs, skills and exports.

The UK offers the strongest basis to maximise these benefits because of the size and diversity of its economy. It provides the stability and predictability needed for companies to invest and is able to adopt a long-term approach to the sector because of its broad shoulders.

Danny Alexander, Chief Secretary to the Treasury, said:

> 'This review offers the opportunity to put the fiscal regime on the best footing to ensure that the economic potential of the North Sea can be maximised for the UK and Scotland.
>
> The broad and diverse UK tax base means we are able to support the industry through, for example, certainty over decommissioning tax relief.
>
> A separate Scotland is unlikely to be able to provide the same level of support and risks missing out on the economic potential the North Sea has to offer.'

Nicky Morgan, Financial Secretary to the Treasury, said:

> 'The government is committed to supporting investment in the oil and gas industry, a vital sector that provides jobs and growth across the United Kingdom.
>
> Changes we have made have already unlocked billions of pounds of new investment. This review demonstrates the government's commitment to working with the sector on the long term future for the industry.'

There are some 300 offshore oil and gas fields in production. The sector:

- still provides nearly 40% of the UK's primary energy needs;
- directly and indirectly supports around 450,000 jobs across the UK; and
- paid £4.7bn in upstream taxation in 2013–2014.

Oil and gas companies operating in the North Sea are taxed at higher rates than other companies, to ensure the nation a share of the profits of production. Marginal tax rates are 62% or 81%, in comparison to the standard corporation tax rate which is currently 21%.

In recent years the government has introduced a number of tax reliefs to encourage investment, particularly in North Sea fields that are smaller or harder to access. These 'field allowances' unlocked £7bn of new investment last year, according to the industry.

The government has also signed decommissioning relief deeds to provide certainty over the tax relief available for decommissioning North Sea infrastructure when production ends. These deeds are worth over £20bn to the industry.

An independent Scotland would have to invest around £3,800 per head – over ten times more than when costs are spread across the UK – just to match the amount the UK government has committed on decommissioning.

The government estimates that there are between 11 and 21bn barrels of oil equivalent remaining in the UK Continental Shelf that could be economic to recover.

HM Treasury 14.07.14

More than £22m for business communities in North East announced

The Chancellor of the Exchequer, the Rt Hon George Osborne MP, announced (on 3 July 2014) £22.5m of funding to support business growth in the North East – with special focus on rural communities over the next five years from 2015.

The programme will operate across County Durham, Gateshead and rural Northumberland, with the investments made through two grant funds: the Small Business Growth Fund and the Economic Infrastructure Fund.

This will fund:

- the development of workspaces; this could include refurbishment of existing buildings, bringing redundant buildings back into use, and new build developments;
- the creation of rural 'enterprise hubs', providing flexible workspace for small businesses;
- investment in tourist attractions and accommodation; and
- investment in new equipment to help small businesses grow where they may have struggled to raise finance from other sources.

The money will be allocated over five years and be made up of £6m of government funding, private sector investment of £9.5m, and £7m of European funding.

The Chancellor made the announcement at a visit to Simpson Malt in Berwick-upon-Tweed.

More than 150 years old, Simpsons Malt is now managed by a team including two members of the fifth generation of the Simpson family and produces 280,000 tonnes of premium malt for brewing, distilling and food industries worldwide.

He was shown how the business has thrived since its foundation and has invested more than £90m in its core malting business during the past 30 years.

The Chancellor of the Exchequer said:

> 'Our long term economic plan is about delivering jobs and growth across all parts of Britain, and three quarters of the net new private sector jobs created since 2010 have been outside London.
>
> Backing small businesses here in the North East is a key part of this plan which is why we are creating this new fund for business communities in Northumberland, County Durham and Gateshead, totalling over £22 million.
>
> By supporting these business hubs across the region we can create a more balanced, resilient economy.'

HM Treasury 03.07.14

The UK government issues first Islamic bond

Britain becomes the first country outside the Islamic world to issue sovereign Sukuk.

The government (on 25 June 2014) has cemented Britain's position as the western hub for Islamic finance by becoming the first country outside the Islamic world to issue sovereign Sukuk, the Islamic equivalent of a bond.

The government confirmed that £200m of Sukuk, maturing on 22 July 2019, have been sold to investors based in the UK and in the major hubs for Islamic finance around the world.

The UK's first sovereign Sukuk received very strong demand, with orders totalling around £2.3bn, and allocations have been made to a wide range of investors including sovereign wealth funds, central banks and domestic and international financial institutions.

Investors from the major centres for Islamic finance in the Middle East, Asia and Britain were all represented in the final allocation. The profit rate on the Sukuk has been set at 2.036% in line with the yield on gilts of similar maturity.

The Chancellor of the Exchequer said:

> 'Today's issuance of Britain's first sovereign Sukuk delivers on the government's commitment to become the western hub of Islamic finance and is part of our long term economic plan to make Britain the undisputed centre of the global financial system.
>
> We have seen very strong demand for the Sukuk, resulting in a price that delivers good value for money for the taxpayer. I hope that the success of this government issuance will encourage further private sector issuances of Sukuk in the UK.'

By issuing sovereign Sukuk, the government has demonstrated that it is possible to create a successful British base for Islamic finance.

Britain's sovereign Sukuk uses the Al-Ijara structure, the most common structure for sovereign Sukuk, with rental payments on property providing the income for investors. The Sukuk is underpinned by three central government properties. This issue will settle on 2 July 2014, and will be listed on the London Stock Exchange.

MH Treasury 25.06.14

London housing zones to create 50,000 new homes

The Chancellor of the Exchequer, George Osborne, and Mayor of London, Boris Johnson announced (on 13 June 2014) that 50,000 new homes, across 20 new housing zones, will be created in London, while visiting a prospective new zone in Enfield, North London.

Housing zones are a new approach being used by the government to get new homes built quickly.

Local authorities identify and package together brownfield land which could be used for development into a housing zone, remove all unnecessary planning restrictions across it and partner with a developer to build new homes. The absence of planning constraints in these zones will significantly accelerate construction.

Central government supports housing zones by making loans available to local authorities for necessary infrastructure and other remedial work on the site. Last November the Mayor's Housing Strategy set out plans for ten potential housing zones, today's announcement will double that as central government and the Greater London Authority ('GLA') will each offer £200m for 20 zones.

The Chancellor and Mayor launched the scheme at Meridian Water, an 85-hectare former industrial site in Enfield that has the potential for 5,000 new homes, new schools, a library and commercial space, linking to the nearby Lea Valley regional park.

To ensure that developments in housing zones progress as quickly as possible, the government will grant the Mayor substantial powers, in the form of Mayoral Development Orders, to remove planning obstacles.

These new zones are in line with the major shake-up of planning rules to support house building announced by the Chancellor in his Mansion House Speech.

HM Treasury 13.06.14

Government introduces Bill to help working families with childcare costs

The government introduced (on 5 June 2014) the Childcare Payments Bill which aims to help working families by giving basic rate tax relief on childcare of up to £2,000 per year for each child.

The Bill would build on the £5bn per year the government already spends on early education and childcare and provide 1.9m working families with 20% of their childcare costs.

The scheme would be available from autumn 2015, and cover children up to the age of 12, as well as disabled children up to the age of 17. The scheme would be available to working families where all parents in a household are in work and earn less than £150,000 a year, and do not receive support through Tax Credits or Universal Credit. For the first time, government support for childcare would be available to parents who are self employed, and to those who work for smaller firms that did not previously offer Employer-Supported Childcare.

Financial Secretary to the Treasury and Minister for Women, Nicky Morgan, said:

> 'Today marks the first step in bringing forward Tax-Free Childcare. This will provide support for up to 1.9 million hard working families.

> As a working mother, I understand how difficult the choices are that working parents have to make. Nearly a quarter of employed mothers would increase their hours if they could arrange convenient, and affordable childcare, and this scheme will give parents the opportunity to return to work, should they choose to do so.'

HM Treasury 05.06.14

Bank of England and Prudential Regulation Authority News

Prudential Regulation Authority consults on implementing the Bank Recovery and Resolution Directive

The Prudential Regulation Authority ('PRA') has proposed (on 30 July 2014) changes to its rules to implement the EU Bank Recovery and Resolution Directive ('BRRD'). The BRRD provides a common set of tools and powers for dealing with failing banks and will take effect at the end of 2014.

Andrew Bailey, Deputy Governor, Prudential Regulation and Chief Executive Officer of the PRA said:

> 'The financial crisis demonstrated that the authorities did not have the powers or tools needed to deal with failing banks. This meant that public funds had to be used to prop up the banks, which is unacceptable. The UK authorities have taken a number of important steps since the crisis to increase the resilience of our banking sector, including stress testing the major banks and strengthening the capital framework. The BRRD provides a framework and tools to deal with banks in distress and builds on the steps we have already taken to ensure firms have recovery and resolution plans that minimise disruption to the wider financial system.'

The requirements in the BRRD will be addressed by developing the PRA's existing recovery and resolution planning framework, which has been in force since 1 January 2014. In the consultation paper published on 30 July 2014 the PRA proposes to make rules concerning recovery plans, resolution packs, intragroup financial support agreements, notification of failure or likely failure and contractual recognition of bail-in.

Although the Bank of England as the UK resolution authority already has a tool to bail-in liabilities of banks in distress, implementation of the BRRD means that this bail-in tool must be contractually recognised in liabilities governed by the law of a third country, and which are not excluded from the scope of bail-in. The PRA is therefore proposing that firms include a term in their contracts so that the creditor recognises that the liability may be subject to the UK bail-in regime. This will provide transparency for creditors and mitigate the legal risk of cross-border resolutions where it concerns bailing in creditors.

One further proposal is that firms should undertake scenario testing of recovery plan options. The PRA already expects firms to assess how successful different recovery options may be. Scenario testing, which should include an idiosyncratic scenario, a system-wide scenario and a combination of both, will help firms know which recovery measure would be most appropriate in different situations and allow them to take the best course of action. The PRA expects that the scenarios should be severe enough to activate the recovery plan while being plausible in considering the business and risk profile of the firm.

The consultation paper also sets out how financial support could be provided between entities within groups to improve the stability of the group as a whole without jeopardising the entity providing the support. The PRA proposes to require firms to make these agreements public at least annually and to allow them only if certain conditions are met.

These proposed rules will apply to banks, building societies and investment firms. They will also apply to the holding companies of these firms. The PRA's consultation closes on 19 September 2014 and final rules will be published by 31 December 2014.

Bank of England 30.07.14

PRA and Financial Conduct Authority publish review of barriers to entry for new banks

The PRA and the Financial Conduct Authority ('FCA') have published a review of the changes introduced last year which were put in place to reduce the barriers to entry for new financial institutions. The purpose of the measures was to enable increased competition in the banking industry, to the benefit of customers. The changes focussed on two key areas: reforms to and a simplification of the authorisation process for new banks; and a major shift in the prudential regulation, such as capital requirements, for new entrants.

The review shows that the changes introduced last year have led to a number of positive developments. In the 12 months following the changes, the PRA authorised five new banks and there has been a substantial increase in the number of firms discussing the possibility of becoming a bank with the regulators. In the 12 months to 31 March 2014 the regulators held pre-application meetings with over 25 potential applicants. These firms have a range of different business models from retail and wholesale banking to FCA-regulated Payment Services firms who are looking to enter the banking market and offer deposits and lending to their current client base (including small SMEs) and others who are proposing to offer a mixture of SME or mortgage lending funded by retail and SME deposits.

The review found that the new 'mobilisation' option (where authorisation is granted when a firm has met key essential elements but with a restriction on their activities due to some areas still requiring completion) has been helpful for applicant firms that may previously have faced challenges in raising capital or investing in expensive IT systems without the certainty of being

authorised. In the 12 months to 31 March 2014, three of the five newly authorised banks used the mobilisation option, and a number of firms in the pre-application stage have also shown an interest in this route.

Capital and liquidity requirements for new entrants are now lower than before, but are set against a requirement for a firm to show the regulators that it has a clear recovery and resolution plan in place in the event of it getting into difficulty in the future. These changes are a real reduction in the barriers to entry, and now mean that the minimum amount of initial capital required by a new entrant bank is £1m compared to £5m under the previous regime.

Commenting on the review, Andrew Bailey, Chief Executive of the PRA, said:

> 'It is clear that the changes introduced last year have been positive for new entrants and will make a contribution to increasing competition and thus benefit customers. Reducing barriers to entry can be achieved alongside continuing to ensure new banks meet basic standards that prevent risks to the safety and soundness of the UK financial system. The feedback we have received from the new banks has been very encouraging.'

Martin Wheatley, Chief Executive of the FCA, said:

> 'The changes will ultimately offer consumers greater choice and encourage innovation. In any sector newcomers to the market bring fresh thinking, and challenge established firms to consider how they can offer a better deal or improve the service they offer. I'm keen we maintain this progress, and want to see greater competition in retail banking work for the benefit of consumers.'

Bank of England 07.07.14

Bank of England consultation paper: The Financial Policy Committee's review of the leverage ratio

The Financial Policy Committee ('FPC') launched (on 11 July 2014) a consultation on the design of a leverage ratio framework for the UK. This forms part of the FPC's review of the role of the leverage ratio within the capital framework for banks, as requested by the Chancellor of the Exchequer in November 2013.

This consultation paper sets out the FPC's analysis of the policy choices that would determine the role of the leverage ratio within this framework. The responses to this paper will inform the final review, intended to be published in November 2014.

The review and this paper will not determine appropriate numerical values for the leverage ratio framework. These will be considered by the FPC at the point when the capital framework and too-big-to-fail priorities are concluded next year.

The FPC views the leverage ratio as an integral part of the capital framework and an effective complement to the existing framework of risk-weighted capital requirements and buffers. Adding a leverage ratio requirement would mean that the UK's capital requirement framework for banks would comprise:

- a risk-weighted capital framework, in which capital requirements are set in proportion to an assessment of risk in each asset class;
- a stress-testing framework, exploring banks' resilience to future adverse scenarios; and
- a leverage ratio framework, set in proportion to exposures regardless of their risk, to guard against under-statement of risk.

In combination, these measures can enhance the safety and soundness of firms and improve the resilience of the financial system as a whole by ensuring that institutions fund their activities with sufficient capital.

The consultation paper, published on 11 July 2014, considers a range of issues, including the following:

- Whether the leverage framework should mirror features of the existing risk-weighted framework. The main components of the risk-weighted framework include a minimum requirement, a capital conservation buffer, supplementary buffers for systemically important firms and a time-varying countercyclical capital buffer.
- The case for introducing a supplementary leverage ratio component to a subset of firms, for example ring-fenced banks and/or systemically important institutions, and whether this should be varied in proportion to the associated supplementary risk-weighted ratio.
- The merits of a time-varying leverage ratio component, which would be varied in a countercyclical manner as system-wide risks evolve over the cycle.
- The quality of capital needed to meet the possible components of the leverage framework.

The consultation paper sets out the possible costs and benefits of applying a leverage ratio to different types of firms, as well as some high-level considerations related to a cost-benefit analysis of a leverage ratio framework.

The paper also considers the allocation of responsibilities over the leverage ratio framework. Based on the analysis so far, the FPC is minded to recommend to HM Treasury that it be granted powers of direction over all components of the leverage ratio framework.

The FPC consultation will close on 14 August 2014.

Bank of England 11.07.14

Changes to the Bank Return

The Bank of England announced on 30 June 2014 that it will be replacing the Bank Return publication with a new Weekly Report.

The Bank Return provides a weekly snapshot of the Bank's balance sheet, identifying key components such as reserves balances and notes in circulation, as well as the total size of the Bank's balance sheet. It provides transparency about the Bank's financial operations and supports the Bank's objective of being open and accountable about its activities.

However, the Bank Return can also act as a vehicle for disclosing the existence of liquidity support operations. The provision of liquidity support to illiquid but solvent banks is a core function of the Bank and experience suggests that it is more effective for such operations to remain covert at the time, so as not to further undermine confidence in the institution receiving support.

The financial crisis that began in 2007 highlighted the risk of inadvertent disclosure of support operations via the Bank Return. In response, the government removed the legal requirement that the Bank had been under to publish the weekly Bank Return through the Banking Act 2009. In addition, the Plenderleith Review recommended that the Bank consider ceasing to publish the Bank Return in order to improve its ability to provide covert Emergency Liquidity Assistance ('ELA').

The changes announced address the disclosure risk which exists in the Bank Return while retaining transparency about the Bank's regular operations. A new Weekly Report will be introduced that will include additional detail across some parts of the Bank's balance sheet but omit data relating to bilateral operations. This will allow the Bank to carry out such operations but report them with a delay, whilst moving towards a more modernised approach to reporting in relation to its regular operations.

In designing the new Weekly Report, the Bank has sought to identify a format that will be helpful and relevant for users of this data. Overall, it will typically disclose over 90% of the Bank's balance sheet by value. The information it provides will be augmented on a quarterly basis, with a lag of five quarters, with data for other assets and liabilities completing the balance sheet.

The final Bank Return will be published on 25 September, with the first Weekly Report being published a week later.

The Bank is pre-announcing the change in this way to dispel any speculation that this alteration to reporting arrangements is tied to the provision of liquidity to a specific counterparty. This is not the case.

Further details about the Bank Return and the changes being made to it can be found in an explanatory article released on the Bank's website. A separate article, setting out in detail the changes to the Bank's statistical reporting, will be published in Bankstats.

Bank of England 30.06.14

Bank of England consults on implementation of loan-to-income ratio limit for mortgage lending

At its June meeting, the FPC made the following recommendation to the PRA and the FCA:

> 'The PRA and the FCA should ensure that mortgage lenders do not extend more than 15% of their total number of new residential mortgages at loan to income ratios at or greater than 4.5. This recommendation applies to all lenders which extend residential mortgage lending in excess of £100 million per annum. The recommendation should be implemented as soon as is practicable.'

The PRA Board set out proposals (on 26 June 2014) on how the recommendation will be implemented. A consultation paper has been published and will be open for comments until 31 August 2014. Final rules will come into effect on 1 October 2014.

The recommendation is one of two made by the FPC with the intention of capturing macroprudential risks associated with excessive household indebtedness. In response to the recommendation, the PRA's rules are not designed to capture all microprudential aspects of credit risk associated with the individual borrower or the other factors that a lender might take into account when making a lending decision.

Lenders should continue to apply whatever criteria they feel are appropriate and commensurate with their risk appetite when taking individual lending decisions. The PRA would not expect firms to vary their lending practices as a result of this policy unless they find that they would otherwise be in breach of the limit.

The limit will apply to the number of mortgages completed. While rules will not come into force until 1 October 2014, mortgage offers made or decisions in principle taken before the proposed rule comes into effect but which complete after 1 October 2014 will count towards the limit.

The PRA will apply a minimum threshold which will mean that the limit will not apply to firms which report less than £100m of new mortgage lending annually. This will be assessed on a rolling basis.

Bank of England 26.06.14

Bank of England launches new framework to test for cyber vulnerabilities

In a speech at the British Bankers' Association on 10 June 2014, Andrew Gracie, Executive Director, Resolution at the Bank of England, formally launched a new framework to help identify areas where the financial sector could be vulnerable to sophisticated cyber-attack. This is part of the Bank of England's response to the FPC's recommendation to test and improve resilience to cyber-attack.

The new framework, called CBEST, uses intelligence from government and accredited commercial providers to identify potential attackers to a particular financial institution. It then replicates the techniques these potential attackers use in order to test the extent to which they may be successful in penetrating the defences of the institution. On completion of the test there will be workshops for the firm to work through the results with the testers and supervisors.

CBEST provides the following:

- access to considered and consistent cyber threat intelligence, ethically and legally sourced from organisations that have been assessed against rigorous standards;
- access to knowledgeable, skilled and competent cyber threat intelligence analysts who have a detailed understanding of the financial services sector;
- realistic penetration tests that replicate sophisticated, current attacks based on current and targeted cyber threat intelligence;
- standard key performance indicators that can be used to assess the maturity of the organisation's ability to detect and respond to cyber-attacks; and
- access to benchmark information that can be used to assess other parts of the financial services industry.

The combination of these will allow a firm to understand where they are vulnerable. They will then be better prepared to implement remediation plans. The inclusion of specific cyber threat intelligence will ensure that the tests replicate, as closely as possible, the evolving threat landscape and therefore will remain relevant.

CBEST differs from other security testing currently undertaken by the financial services sector because it uses real threat intelligence and focuses on the more sophisticated and persistent attacks on critical systems and essential services. The implementation of CBEST will help the boards of financial firms, infrastructure providers and regulators to improve their understanding of the types of cyber-attack that could undermine financial stability in the UK, the extent to which the UK financial sector is vulnerable to those attacks and how effective the detection and recovery processes are.

In his speech, Andrew Gracie said:

> 'The idea of CBEST is to bring together the best available threat intelligence from government and elsewhere, tailored to the business model and operations of individual firms, to be delivered in live tests, within a controlled testing environment. The results should provide a direct readout on a firm's capability to withstand cyber-attacks that on the basis of current intelligence have the most potential, combining probability and impact, to have an adverse impact on financial stability.'

The Bank of England has worked with the Council for Registered Ethical Security Testers ('CREST'), a not-for-profit organisation that represents the technical information security industry, and Digital Shadows, a cyber-intelligence company, to develop new accreditation standards. This is the first time that commercial cyber intelligence providers will be subject to accreditation standards which are bound by enforceable codes of conduct and supported by a range of CBEST documents on security testing and cyber threat intelligence.

Bank of England 13.06.14

FCA News

Joint FCA/Competition and Markets Authority small and medium-sized business banking market study

The FCA and the Competition and Markets Authority ('CMA') have published a joint market study on banking services for small and medium-sized businesses ('SMEs'). The findings of the market study were arrived at by both authorities, which pooled resources and expertise in their first collaborative project.

There are over 4.5m SMEs in the UK, accounting for some 60% of private sector employment and almost half of the total turnover of private sector businesses. Effective competition to provide SMEs with high-quality and responsive banking services is critical to ensuring that SMEs are able to get what they need from their banks.

The study focused on the supply of core banking services to SMEs, namely:

- business current accounts ('BCAs') and overdrafts; and
- business loans (both secured and unsecured term loans but not including commercial mortgages).

It considered how competition was working in England and Wales, Scotland and Northern Ireland. It looked at the nature and effectiveness of competition in SME banking markets, SMEs' willingness to shop around, the level of switching and transparency including SMEs' ability to make effective comparisons across providers and informed decisions about products that best meet their needs.

Whilst there have been some positive recent developments, the FCA and CMA found that competition is not effectively serving the interests of SMEs. In particular:

- the markets remain concentrated with the largest four providers accounting for over 85% of BCAs and 90% of business loans;
- barriers to entry and expansion for newer and smaller banks remain significant including the need for a branch network;
- there is very little movement in the market shares of the largest banks (other than as a result of mergers and acquisitions) and there has only been one new entrant into full service SME banking in recent years;

- many customers see little difference between the largest banks in terms of the services they offer; and
- levels of shopping around and switching between banks remain low. Only 4% of SMEs switch bank each year. Perhaps as a result, very limited market share gains have been made in recent years by those banks with the highest levels of customer satisfaction (not what would normally be expected in well-functioning competitive markets).

The CMA has provisionally decided to refer both SME banking and personal current account markets for in-depth investigation. The CMA will consult on its provisional decision before making a final decision in autumn 2014. The FCA and the CMA will maintain their collaborative approach to boost competition in retail banking. This collaboration will also extend to the Payment Systems Regulator given the links between payment systems and retail banking.

Work already undertaken by the FCA includes: reducing regulatory barriers faced by new bank applicants who may provide more competition in the future; a market study into cash savings (the interim findings of which have now been published); and a programme of work to promote competition and innovation by making it easier for start-ups and established businesses to bring innovative ideas into financial services markets.

FCA 21.07.14

Price comparison websites failing to meet FCA expectations

In a thematic review published on 16 July 2014, the FCA found that price comparison websites did not always ensure that consumers were given the appropriate information to help them make informed decisions. This is particularly important as the FCA is concerned that consumers' focus on headline price and brand when using PCWs could distract from crucial product features such as policy coverage and terms.

By failing to provide clear information, the websites are increasing the risk that consumers may buy products without understanding key features such as level of cover or excess levels and purely focus on the price. While a few websites did provide this information clearly the level of clarity varied significantly depending on the provider.

Clive Adamson, FCA Director of Supervision, said:

> 'Price comparison websites have increased in popularity among consumers with an estimated one third of consumers buying their motor insurance policy through them. They provide an important service for millions of consumers bringing convenience and simplicity to buying financial products online.
>
> However, our review found that they were not meeting our requirements in delivering fair and consistent outcomes for consumers. We also found, through our consumer research, that consumers had a number of misconceptions about the services they provided.

> We expect price comparison websites to take on board the findings of the review. It is also important for consumers to understand that not all products are the same and the cheapest product may not always be the best for their needs.'

The other key findings of the FCA's review were:

- Price comparison websites did not make clear their role in the distribution of the product or the nature of service they provided. For example, some consumers mistakenly believe that the price comparison website had provided them with quotes on the best policy for their individual needs and had assessed the suitability of the policy for them.
- Not all comparison sites, those that were part of a larger group of an insurer or broker, disclose this potential conflict of interest, which is against FCA rules. However, the FCA found no evidence that these firms used this relationship to their commercial advantage.
- While some price comparison websites had taken steps to comply with their regulatory obligations they had failed to fully implement Guidance published in 2011.

The FCA has asked price comparison websites to take action on the specific areas identified where they are not meeting the required standards to ensure customers get a product that meets their needs.

FCA 16.07.14

Consultation paper CP14/14: Strengthening the alignment of risk and reward: new remuneration rules

In partnership with the PRA, the FCA is consulting on revisions to the current Remuneration Code following the recommendations put forward by the Parliamentary Commission on Banking Standards.

This joint FCA/PRA consultation paper seeks views on proposed changes to rules in the area of Remuneration. It is the view of the PRA and the FCA that deferral periods should generally be longer than current minima to align the risk horizons of key individuals further with the longer-term safety and soundness of the firms for which they work.

The paper follows both regulators' responses in October 2013 to the final report of the Parliamentary Commission on Banking Standards ('PCBS'), 'Changing Banking for Good'. It sets out proposals for revised rules on Remuneration which would be incorporated in the PRA Rulebook and the FCA Handbook.

The paper can be read alongside CP14/13, which sets out the joint proposals for increasing individual accountability in banking.

The closing date is 31 October 2014.

FCA 30.07.14

Consultation paper CP14/13: Strengthening accountability in banking: a new regulatory framework for individuals

In partnership with the PRA, the FCA is consulting on a new way to hold individuals to account, following the recommendations of the PCBS. The FCA and the PRA believe that holding individuals to account is a key component of effective regulation.

In this consultation they are proposing changes to the way individuals working for 'relevant firms' – i e UK banks, building societies, credit unions and PRA-designated investment firms – are assessed and held accountable for the roles they perform. The proposals reflect the recommendations of the PCBS and implement changes required by the amendments which the Financial Services (Banking Reform) Act 2013 made to the Financial Services and Markets Act 2000.

The paper can be read alongside CP14/14, which sets out the joint proposals for revisions to the current Remuneration Code.

FCA 30.07.14

FCA bans and fines

Phillip Harold Boakes

The FCA has commenced a criminal prosecution against Phillip Harold Boakes of Stratford-upon-Avon, Warwickshire, for 13 alleged offences relating to an unauthorised investment scheme he operated between 1 October 2004 and 4 June 2013.

23.07.14

Financial Group subsidiaries

The FCA has used its suspension power for the first time, banning two of the Financial Group's subsidiaries, Financial Ltd and Investments Ltd, from recruiting new Appointed Representatives and individual advisers for a period of four and a half months.

23.07.14

Lloyds Bank plc

The FCA has fined Lloyds Bank plc and Bank of Scotland plc, both part of Lloyds Banking Group, £105m for serious misconduct relating to the Special Liquidity Scheme, the Repo Rate benchmark and the London Interbank Offered Rate.

28.07.14

Micalizzi

The Upper Tribunal has published a judgment dismissing Micalizzi's appeal and upholding the decision of the FCA that Micalizzi failed to act with integrity in carrying out his functions in connection with his role at Dynamic

Decisions, a now defunct hedge fund. The Tribunal directed the FCA to impose a penalty on Micalizzi of £2.7m (reduced from £3m) and a full prohibition.

31.07.14

EU AND INTERNATIONAL

European Central Bank Announces Further Details of the Targeted Longer-term Refinancing Operations

The Governing Council of the European Central Bank ('ECB') decided (on 3 July 2014) on further technical details of a series of targeted longer-term refinancing operations ('TLTROs'), announced on 5 June 2014. The TLTROs are designed to enhance the functioning of the monetary policy transmission mechanism by supporting bank lending to the real economy.

Under the scheme, banks will initially be able to borrow an amount equivalent to up to 7% of a specific part of their loans in two operations in September and December 2014. After this, additional amounts can be borrowed in further TLTROs, depending on the evolution of the banks' eligible lending activities in excess of bank-specific benchmarks.

The additional borrowing allowance is limited to three times the difference between the net lending since 30 April 2014 and the benchmark at the time, it is claimed.

The Governing Council decided that:

- for banks that exhibited positive eligible net lending in the 12-month period to 30 April 2014, the benchmarks are always set at zero;
- for banks that exhibited negative eligible net lending in the year to 30 April 2014, different benchmarks apply. These are set as follows: the average monthly net lending of each bank in the year to 30 April 2014 is extrapolated for 12 months until 30 April 2015. For the year from 30 April 2015 to 30 April 2016, the benchmark monthly net lending is set at zero;
- banks that borrow in the TLTROs and fail to achieve their benchmarks as at 30 April 2016 will be required to pay back their borrowings in full in September 2016; and
- banks participating in a TLTRO will be subject to specific reporting obligations.

The initial operations will be conducted on 18 September and 11 December 2014, with the additional operations carried out in March, June, September and December 2015 and in March and June 2016.

By the beginning of August 2014 the ECB will publish a legal act that will form the basis of the series of TLTROs.

ECB 03.0714

Revised Principles for Supervisory Colleges Published by the Basel Committee

The Basel Committee on Banking Supervision issued revised *Principles for effective supervisory colleges*. The revisions reflect the experience of Committee members in applying the original principles, published in 2010, together with emerging good practice in the role and operation of colleges. They draw on consultations with home and host supervisors, as well as internationally active banks.

The financial crisis highlighted the important role played by supervisory colleges in the effective supervision of international banking groups. The principles aim to promote and strengthen international cooperation and supervision of internationally active banks by providing guidelines to support the operation of supervisory colleges. They supplement broader guidance issued by the Basel Committee on cross-border cooperation and information-sharing.

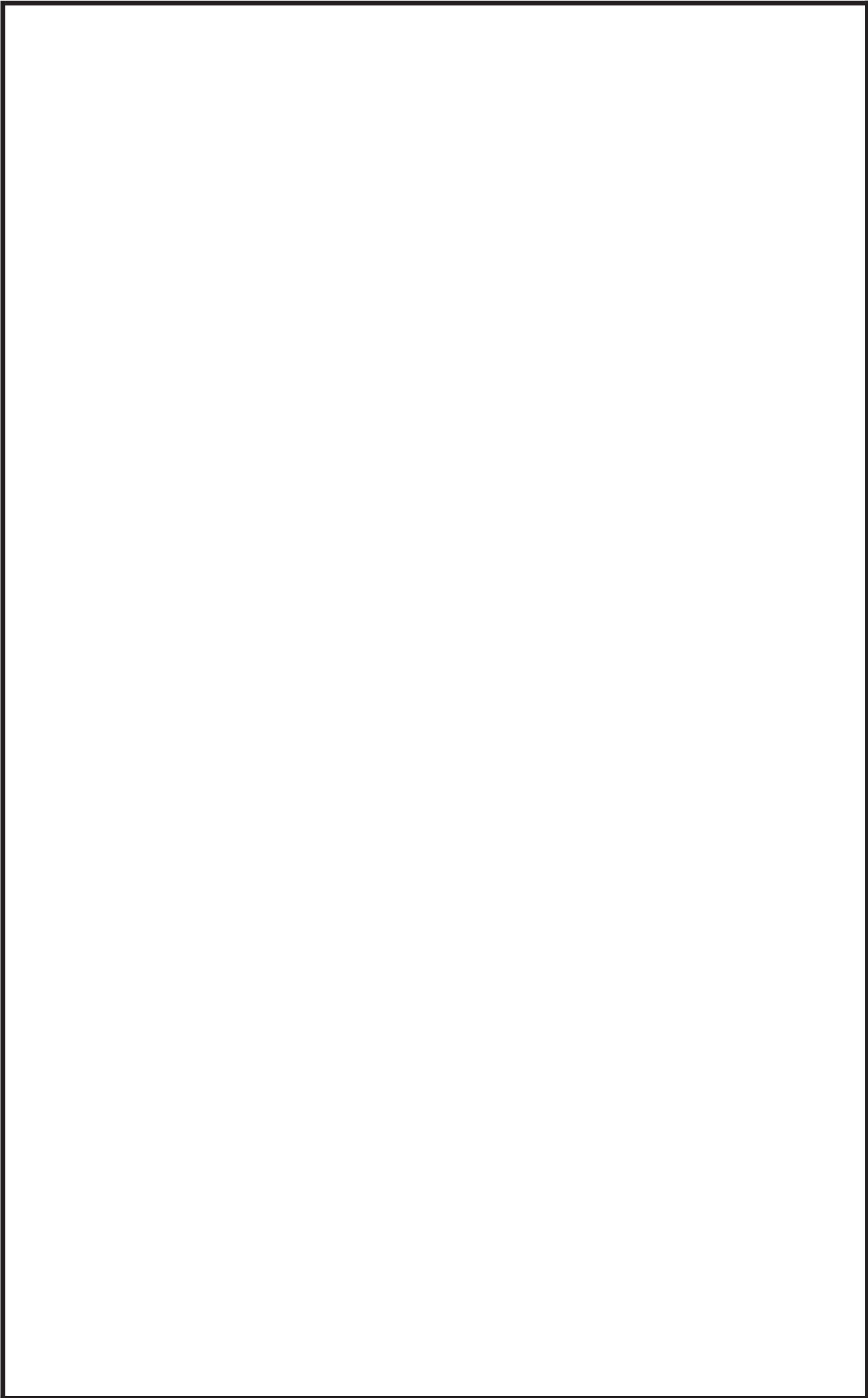
Key revisions include:

- greater emphasis on ongoing collaboration and information-sharing, as well as the expectation that home and host supervisors will put in place appropriate mechanisms and sufficient resources for effective and timely information exchange;
- differentiation between colleges and crisis management groups (‘CMGs’) for banks that are subject to both structures, e g systemically important banks, and guidance on possible communication and coordination between the college and the CMG on crisis preparedness; and
- alignment across the principles on how macroprudential information is shared and used.

Stefan Ingves, Chairman of the Basel Committee on Banking Supervision and Governor of Sveriges Riksbank, said:

> ‘Banks that operate on a cross-border basis present unique risks and supervisory challenges. The Basel Committee’s revised principles for effective colleges aim to help supervisors address those challenges by promoting continued improvements in the way supervisors communicate, cooperate and share information with each other.’

BIS 27.06.14



Correspondence about this Bulletin may be sent to Sarah Hanson in Editorial, LexisNexis, Lexis House, 30 Farringdon Street, London EC4A 4HH, (tel 020 7400 2500).

Subscription enquiries should be directed to LexisNexis Customer Support Department, (tel (0)84 5370 1234).

© Reed Elsevier (UK) Ltd 2014
Published by LexisNexis

ISBN 978-1-4057-7593-9