3 Reforming financial services

A strong and sustainable financial services sector supports strong, sustainable economic growth. Delivering this positive contribution, and ensuring that the benefits of efficient financial services accrue to businesses and consumers, requires an effective framework of regulation and competition (both domestically and internationally), and good governance and accountability among financial institutions themselves.

The Government is taking a leading role in the international reform agenda, working with its G20 and European partners. Budget 2010 announces:

- **principles to guide international work on a systemic risk tax which will ensure that the activities of financial institutions reflect the costs associated with systemic risk as well as helping to meet the wider costs of crises; and**
- **the Government will formally consult on draft regulations to require enhanced disclosure of remuneration in the financial services sector, and will consider whether the tools available to shareholders to effectively control executive remuneration need to be strengthened, including greater upfront approval of the terms under which employees are remunerated.**

The Government is committed to ensuring that the supply of lending to the economy supports the recovery. Budget 2010 announces:

- **the agreement of Lloyds Banking Group and The Royal Bank of Scotland to lend £105 billion to homebuyers and businesses over the next 12 months. £41 billion of this will be lent to small businesses;**
- **the creation of a new Small Business Credit Adjudicator with statutory powers to enforce its judgements. The Adjudicator will work closely with an expanded Financial Intermediary Service to ensure that small businesses are treated fairly when applying for loans; and**
- **steps to help companies diversify sources of finance to non bank lending channels.**

The Government is committed to promoting competition in the financial services sector in order to drive efficiency and choice for consumers. Through the divestments from Lloyds Banking Group and The Royal Bank of Scotland, and the return of the Northern Rock bank business to the private sector, competition and diversity in the marketplace will increase substantially.

Effective competition is also promoted by informed consumers, and the Government is committed to ensuring that consumers have access to appropriate financial services and are properly equipped to exercise a choice. Budget 2010 announces that the Government will:

- **introduce a new right to open a basic bank account;**
- **increase the contribution made by the banks to the community lending sector; and**
- **ask the Retail Financial Services Forum to consider to what extent financial services firms' staff targets and incentives lead to poor outcomes for consumers and employees and how they can be reformed.**

3.1 The UK economy has returned, after the most severe financial crisis in 60 years, to modest growth. Rather than let the banking system collapse, the Government took decisive action to recapitalise a number of systemically significant banks; protect depositors in the banking system; guarantee selected assets held by banks; protect jobs by making changes to the tax system to support small businesses; and ensure a flow of credit to creditworthy businesses. The scale and range of these measures reflected the importance of the financial sector to economic growth.

3.2 The global nature of the crisis required a global response. The UK Government led the way, during its Presidency of the G20, in worldwide efforts to stabilise the financial system, and is now leading and shaping the reform of international regulation in order to maintain stability and support economic recovery.

3.3 The Government is announcing a series of measures that, within a framework of international cooperation and reform, ensure that the UK remains financially stable and that lending in the economy meets demand. The long-term competitiveness of the UK financial services industry also remains a key objective. The costs associated with the rescue of the global financial system in 2008 have prompted an international debate on the balance of risk and reward between the financial sector and society. This chapter sets out principles for a systemic risk tax coordinated internationally to avoid jeopardizing the UK's competitiveness, and designed to mitigate moral hazard and take account of the cumulative impact of recent reforms on financial sector firms.

LEADING AND SHAPING INTERNATIONAL REFORM

3.4 The global financial crisis has demonstrated the need for an overhaul of the international regulatory architecture. International cooperation is central to strengthening the financial system for the future, and the Government is working closely with international partners to address potential systemic risk, protect the taxpayer and enable the financial sector to play its part as a key driver of economic prosperity.

G20

3.5 The UK was at the forefront of efforts to promote international financial regulatory reform during its Presidency of the G20. The Government will continue to work closely with EU and international partners to implement the G20 commitments in a robust and internationally consistent manner that minimises the scope for regulatory arbitrage and strengthens the global financial system for the future. The challenge in 2010 is to maintain momentum behind the implementation of the G20 agreements, and ensure that domestic and international efforts are well coordinated.

Basel

3.6 At their meeting in Pittsburgh in September 2009, G20 leaders agreed a package of major reforms of international rules on capital, leverage and liquidity, while emphasising the importance of ensuring that the transition to strengthened regulatory standards should not impede the pace of recovery. The Basel Committee is currently consulting on a set of detailed reform proposals and aims to agree a final package by the end of the year, with a phased implementation thereafter. The Government believes that it is important that G20 leaders are given the opportunity to assess the final Basel proposals at their summit in November.

Protecting taxpayers from the cost of future financial crises

3.7 The rescue of the global financial system in 2008 required substantial support from taxpayers, and has prompted a debate on how the balance of risk and reward between the financial sector and society should be adjusted.

3.8 The UK is leading an internationally coordinated approach to this issue, with the Prime Minister putting it firmly on the global agenda in a speech to the G20 in November 2009. A range of policy options has been put forward for discussion, including contingent capital, systemic levies and transaction taxes. These all deserve careful consideration in terms of their economic impact and ability to be delivered on a global scale. The IMF, at the request of the G20, is reporting on possible ways to ensure that the financial sector makes a fair and substantial contribution to the wider costs associated with government interventions to repair the banking sector. The Government looks forward to receiving this report later this year.

3.9 In parallel, the Government is continuing discussions with international partners. HM Treasury published *Risk, Reward and Responsibility: the financial sector and society*[1] in December 2009, and held a seminar in January 2010 that brought together the Bank of England, the FSA and international policymakers.

3.10 One approach on which the Government believes progress could be made soon is an internationally coordinated systemic risk tax. Box 3.1 outlines how this work could be taken forward. The UK will continue to work closely with the G20 and IMF on the development of this and other proposals, and will seek agreement on a process to coordinate further work internationally.

Box 3.1: Principles to guide international work on a systemic risk tax

As the financial crisis has shown, the failure or distress of large and interconnected financial institutions can pose significant risks to financial stability. The Government is developing a package of regulatory measures to reduce these risks and the impact of systemic crises. A systemic risk tax could be an important means of both ensuring that financial institutions take into account the cost of the systemic risk of their activities, and of meeting the wider costs of crises.

There are several key principles that the Government believes should guide further international work on systemic risk taxes:

- first and foremost, a systemic risk tax should be **coordinated internationally** to minimise competitive distortions, and issues of double-taxation and arbitrage risk will need to be resolved;
- a systemic risk tax should **complement but not substitute for existing G20 regulatory initiatives aimed at addressing systemic risk**. The work of the Financial Stability Board (FSB) on both reducing the probability and impact of an individual firm's failure, and on streamlining the process of dealing with failures if they nevertheless occur, remains of vital importance;
- while internationally coordinated, the proceeds of such a tax should be for **national governments to use**. A systemic risk tax should not be seen as an insurance policy to benefit individual institutions, shareholders or creditors. To minimise moral hazard the proceeds of such a tax should go into **general taxation** rather than a stand-alone fund;
- **calibration and implementation must take account of the wider regulatory reform programme** and the cumulative impact of all reforms to strengthen financial stability, as well as **the timing and strength of the economic recovery** to ensure that the impact of any tax is proportionate and measured;
- the tax base should be **as simple as possible**, to minimise arbitrage and help international replicability, while taking account of the **characteristics of a firm's business that give rise to systemic risk**. In particular it should take into consideration size, interconnectedness, and substitutability, while accepting that a precisely calibrated measure might not be achievable; and
- a systematic risk tax should cover **all financial institutions that might contribute significantly to systematic risk**, to address level-playing field concerns and minimise arbitrage.

[1] *Risk, Reward and Responsibility: the financial sector and society*, December 2009 is availably at www.hm-treasury.gov.uk

Systemically important financial institutions

3.11 The Government believes it is crucial to explore additional measures with respect to those financial institutions that pose the greatest systemic risk to financial stability. Various proposals have been put forward, including requiring systemically important financial institutions to hold more capital and to limit certain risky activities or investments. The UK supports the work of the FSB, working together with standard setting bodies, to propose measures to address the risks posed by systemically important financial institutions, by October and ahead of the G20 November Summit.

Recovery and resolution plans

3.12 Recovery and resolution plans (RRPs, also known as 'living wills') are an important tool in mitigating the systemic risk that some firms pose to the system and in promoting long-term financial stability.

3.13 The Government believes that it is essential to ensure alignment with international work on RRPs in order to avoid regulatory arbitrage and potentially detrimental effects on UK competitiveness and the wider economy. The G20 have agreed that major financial institutions with cross-border crisis management groups should develop internationally consistent RRPs by the end of 2010, and the Government continues to work with the FSB and international partners in developing these.

Investment bank insolvency

3.14 The Government is taking forward appropriate measures to improve the UK's insolvency regime for investment banks, to reduce the impact on the financial system of investment bank failures, and to provide better protection for client monies held in investment banks. As part of ongoing consultation, the Government will bring forward detailed proposals – including draft secondary legislation for a new insolvency regime – in the summer.

3.15 The global financial crisis also exposed the absence of an effective EU crisis management framework for cross-border banks. Work is underway to improve Europe's crisis management capacity, and the European Commission has consulted on potential policy responses. The UK has stressed the importance of a common EU framework for resolution, consisting of a series of agreed objectives and a common minimum set of national resolution tools capable of delivering outcomes comparable with those achieved by the UK Special Resolution Regime.

European regulation and supervision

3.16 The Council of the European Union agreed legislative proposals in December 2009 to establish a European Systemic Risk Board and three new European Supervisory Authorities strengthening the EU's regulatory and supervisory architecture in light of the financial crisis. The Government looks forward to the swift agreement of the proposals with the European Parliament.

Solvency II

3.17 The Solvency II Directive aims to develop an EU-wide system of prudential regulation for insurers and reinsurers. It will introduce a stronger and more sophisticated risk-sensitive approach to capital adequacy and supervision than current Solvency I requirements, reducing the likelihood of an insurer failing, and enhancing policyholder protection.

3.18 These proposals will necessitate changes to the UK tax rules. Following initial discussions with the industry, the Government launched a consultation[2] on 10 March to capture views from the industry and others on some key aspects of the future framework, and looks forward to those responses. More broadly, the Government continues to provide support for the UK insurance sector by working to ensure that its interests and concerns, including those relating to the impact on annuities, are heard.

[2] *Solvency II and the Taxation of Insurance Companies* is available at www.hm-treasury.gov.uk

Tackling non-cooperative jurisdictions

3.19 The Government has played a strong international role in agreeing new and robust processes for tackling non-cooperative jurisdictions. This month, the Global Forum for Transparency and Exchange of Information for Tax Purposes began a programme of rigorous peer reviews to ensure that its members have fully implemented the international standards on tax information exchange. In February, the Financial Action Task Force issued a public list[3] of jurisdictions with deficiencies in their approach to combating money laundering and the financing of terrorism. The Government has issued advice to UK companies, with guidance on steps to take when conducting business with countries on the list. The FSB also launched its evaluation process this month to promote global adherence to information exchange and supervisory cooperation standards, and has developed possible positive and tougher countermeasures to address weaknesses in compliance or cooperation by jurisdictions.

Foot Review

3.20 Following the independent review of British Offshore Financial Centres by Michael Foot last year, the Government looks forward to updated action plans from the UK's Overseas Territories. These should demonstrate a public commitment to making good progress against global standards on tax transparency, financial regulation and financial crime, and set out plans for more sustainable revenues over the long term.

Reforming banking remuneration and governance

3.21 Good corporate governance and market discipline are central to well-functioning financial markets, and the UK is taking a leading role in the reform of banking remuneration and governance practices.

FSB Peer Review Report

3.22 Effective, consistent and transparent implementation of the FSB's remuneration principles and implementation standards during 2010 is essential if global remuneration policies are to be aligned with sound risk management, and regulatory arbitrage avoided. The FSA *Code on Remuneration Practices*,[4] consistent with FSB requirements, came into force at the beginning of this year, and will be reviewed during the year. The FSB will shortly publish a peer review of progress towards implementation by G20 countries.

Bank payroll tax

3.23 The Government has made clear to the banking sector that it needs to develop sustainable long-term remuneration policies. Consistent with this, the Government announced at 2009 Pre-Budget Report that a bank payroll tax would apply to banks awarding discretionary bonuses from 9 December 2009 to 5 April 2010.

3.24 There is evidence that bonuses have been reduced to some extent because of this tax. It is only fair that those who still choose to award substantial payments should contribute more to the fiscal consolidation of the economy. This is a one-off tax designed to reinforce progress towards the longer-term regulatory changes being implemented following *The Walker Review of Corporate Governance in UK banks and other financial industry entities*[5] and the measures set out in the Financial Services Bill.

Response to the Walker Review

3.25 Sir David Walker was commissioned by the Government in 2009 to review governance practices in the financial services sector. The Government, in collaboration with other bodies with a governance remit, will implement Sir David's recommendations throughout 2010. Consequently, the FSA is consulting on changes to its 'significant influence controlled functions' regime. The Financial Reporting Council (FRC) is consulting on revisions to the Corporate Governance Code,[6] and separately on the adoption and coverage of a Stewardship

[3] The list is available at www.fatf-gafi.org
[4] The FSA code is available at www.fsa.gov.uk
[5] *The Walker Review of Corporate Governance in UK banks and other financial industry entities: Final recommendations*, July 2009, is available at www.hm-treasury.gov.uk
[6] The FRC Corporate Governance Code is available at www.frc.org.uk

Code for investors. As part of the development of the Stewardship Code on which the FRC is currently consulting, the Government will also consider whether the existing institutional investor voting disclosure regime should become mandatory as provided for in section 1277 of the Companies Act 2006.

3.26 On 10 March 2010 the Government published draft Regulations to require enhanced disclosure of remuneration in the financial services sector. After the Financal Services Bill gains Royal Assent, the Government will formally consult on those Regulations. As part of that process, and given the key role that owners should play in managing remuneration contracts, **the Government will consult on whether further practical measures can be identified to facilitate the consent, by owners, of executive remuneration in the financial services sector.**

Financial services taxation

Asset management

3.27 The UK's asset management industry remains a key priority for the Government, reflecting both its direct contribution to the economy and the broader economic role it plays in providing those with capital to invest with profitable investment opportunities. In recognition of the importance of this sector, the Government will continue to insist that the EU Alternative Investment Fund Managers Directive be made proportionate and workable, and provide a level playing field for fund managers.

3.28 Dialogue over recent years between the Government and the asset management industry has resulted in various tax reforms with the aim of enhancing the UK's competitiveness in this area. The Government remains open to further discussion on the relative impact of different drivers on the location of asset management activity, and further possible reforms including on stamp duty reserve tax schedule 19. Any such reforms should be affordable and result in tangible benefits for the UK economy.

3.29 The Government will:

- **work with industry to ensure that stamp duty reserve tax schedule 19 only applies to investments in underlying funds where those underlying funds are themselves primarily invested in UK equities;**
- **launch a working group to consult on whether establishing a tax-transparent contractual fund vehicle would be beneficial for the UK;**
- **work with industry to address issues for Authorised Investment Funds (AIFs) investing more than 20 per cent in both reporting and non-reporting funds under the Funds Investing in Non-Reporting Offshore Funds (FINROFs) regime; and**
- **launch a review of the tax rules relating to Investment Trust Companies in s842 of ICTA 1988, with a view to modernising the rules. A consultation document will be issued in summer 2010.**

Islamic finance

3.30 The Government remains committed to promoting the UK as a centre for Islamic finance. Work with the industry over recent years has led to a number of tax changes aimed at facilitating growth in this area. **The Government intends to provide clarification of how the capital allowances regime will interact with these changes.**

Reforming financial instruments

Mortgage-backed securities

3.31 In early 2010, HM Treasury, the Bank of England and the FSA launched an extensive series of discussions with relevant market participants on mortgage-backed securities. This is part of a wider work programme, announced at the 2009 Pre-Budget Report and reporting to the Council for Financial Stability, to develop a shared evidence base that the authorities will use to formulate and evaluate potential reforms.

3.32 The authorities are engaged with the many international initiatives focusing on securitisation markets, recognising that securitisation markets are an important source of funding. The authorities will continue to work together to shape domestic and international regulatory outcomes to encourage the development of more robust securitisation and covered bond markets.

PROMOTING LENDING TO THE ECONOMY

3.33 A fair and competitive credit market is a key component of a successful economy. In order to support lending in the UK economy during the downturn, the Government took a number of actions, including securing legally binding lending commitments from Lloyds Banking Group (LBG) and The Royal Bank of Scotland (RBS). Chapter 4 sets out the wider steps that the Government has taken, and will continue to take, to improve access to finance for businesses.

Lending commitments

Year one performance

3.34 In signing up to the lending commitments, LBG committed to lend an additional £14 billion on commercial terms over the 12 months from March 2009. RBS committed to lend an additional £25 billion on commercial terms during the same period.

3.35 In setting up the lending commitments, the Government was clear that its assessment of delivery against the commitments would be subject to market demand and economic conditions. It is important that all lenders take appropriate account of risk and creditworthiness in their lending decisions, ensuring a sustainable supply of credit that drives economic growth.

3.36 Both LBG and RBS have exceeded their lending commitments for mortgage lending.[7] During the 12 months to February 2010, LBG exceeded their lending commitment by £1.4 billion. During the same period, RBS also exceeded their lending commitment by £2.7 billion.

3.37 The fact that the lending commitments were exceeded for mortgage lending reflects the levels of demand for new mortgages, more competitive pricing from LBG and RBS in the higher loan to value market and the banks' development of innovative products.

3.38 Business lending across the economy has been more subdued than mortgage lending. This reflects a number of factors, including a reappraisal of risk by lenders, investors and borrowers; uncertainty about the prospects for the economy reducing the demand for finance; financial institutions restructuring to deliver higher capital levels and more conservative loan exposures; larger businesses turning to reviving corporate bond and equity markets as an alternative source of external finance, raising £41 billion in net funds from January to December 2009;[8] and businesses restructuring and paying off debt during the recession (described in greater detail in Box B6 'Funding for corporates' in Chapter B).

[7] The Royal Bank of Scotland annual results are available at www.rbs.com and the Lloyds Banking Group annual results are available at www. lloydsbankinggroup.com
[8] Source: Bank of England

Repayments of business loans have, in 2009, been £19 billion greater than the total level of new lending.[9] There is evidence that large businesses have, in particular, been using money they raised from capital markets to repay bank lending.[10]

3.39 LBG and RBS have, in this context, fallen short of the net lending levels set out in the lending commitments. Between them, they delivered £79 billion in gross lending to businesses and both banks increased their market share of business lending (LBG lent £38 billion across their business customers in the period from March 2009; RBS lent £41 billion in gross lending facilities to businesses during the same period). At the same time, however, the banks together received repayments of £92 billion. For LBG, the active capital markets and high levels of repayments mean that their net lending to businesses in the year from March 2009 was £5.7 billion. For RBS, capital markets and revived high repayments of borrowing by businesses mean that net lending in particular was negative; RBS lending fell by £6.2 billion across all business sectors.

3.40 The banks have also taken steps to help business customers to understand the way that loans are priced and to set out a clearer set of standards that businesses can expect from their banks. In December 2009, LBG and RBS both launched Customer Charters for small and medium sized enterprises (SMEs). The Charters,[11] which cover 98 per cent of the SME customer base, commit LBG and RBS to cap arrangement fees on overdrafts and loans at 1.5 per cent of the overall facility and not to increase margins on existing loans without a material increase in risk.

Year 2 lending commitments

3.41 While conditions have made it hard for LBG and RBS to meet their net lending targets, the Government continues to believe it is essential that UK banks, including those in which it has a stake, are lending appropriately to businesses and households. Budget 2009 announced that the lending commitments would last for a two-year period and that they would be reviewed at the one-year point in order to ensure that these commitments reflected the economic circumstances at that point in time.

3.42 The Government today announces that **LBG and RBS have agreed legally binding lending commitments for the twelve-month period from March 2010. Lending provided under these commitments will remain on commercial terms and subject to market demand.** Over this period, LBG have agreed to a lending commitment of £47 billion; £3 billion in additional mortgage lending and £44 billion in total gross lending to businesses. RBS have agreed a lending commitment of £58 billion; £8 billion[12] in additional mortgage lending and £50 billion in total gross lending to businesses. The Government will report to Parliament on the delivery of the year two commitments at the end of the period. If the Government's judgement is that either bank has failed to meet its lending commitments for year two, or has seriously breached the behaviours set out under their SME Customer Charters, the Government will inform UK Financial Investments Ltd (UKFI), which will work with the remuneration committees of the relevant banks to determine the appropriate consequences of the breach of the year two commitments or the Customer Charters for the relevant executives.

Supporting lending to businesses

Small Business Credit Adjudicator

3.43 To help SMEs that need access to credit, **the Government has today announced the creation of a new statutory Small Business Credit Adjudicator.** The Adjudicator will work

[9] Source: Bank of England

[10] Source: Bank of England

[11] The Royal Bank of Scotland SME Customer Charter is available at www.rbs.com and the Lloyds Banking Group SME Customer Charter is available at www.lloydsbankinggroup.com

[12] An £8 billion lending commitment in year two reflects an adjustment within the two year lending commitment framework (the mortgage lending commitments for RBS for year one was increased from £9 billion to £10 billion).

closely with a newly enhanced Business Link Financial Intermediary Service,[13] in order to ensure that SMEs are treated fairly when applying to their bank for finance. The Adjudicator will have statutory powers as soon as possible to ensure that the judgements its makes are enforceable.

Non-bank lending channels

3.44 After the 2009 Pre-Budget Report, the Government launched a discussion paper on developing non-bank lending channels for large and upper mid-sized businesses.[14] Respondents noted evidence that companies were interested in diversifying their sources of finance away from a dependence on a single lender and seeking a longer-term maturity for some of their finance. This could help reduce their refinancing risk and help improve macroeconomic resilience in the longer term.

3.45 Borrowing from banks has, for most companies, typically been less costly than borrowing from non-bank channels. The future development of non-bank channels is however, likely to be driven primarily by the recent shift in the relative prices of these two channels. There are, however, areas where the Government can play a role in encouraging market-led solutions and a wide range of stakeholders have voiced support for this. Evidence and feedback from the discussion process has brought to light a number of areas of interest, as described below.

Corporate awareness of lending channels

3.46 There is evidence that companies are often unaware of the full range of financing channels and how best to access them. **The Department for Business, Innovation and Skills (BIS) will lead work across government to increase awareness of the diverse sources of finance available, working with companies, Business Link, the Association of Corporate Treasurers (ACT), and the industry.**

Corporate bond market

3.47 In line with its objective of improving financial market efficiency, the Government **will seek to support the work of the industry, including the ACT, the International Capital Market Association (ICMA) and the Association of British Insurers (ABI), to improve bond market access for more issuers including by encouraging better adaptation and standardisation of bond documentation, and encouraging better market information flows.**

Private placement market

3.48 The market for private placements in the UK is small, although UK issuers and investors have been active participants in the large US market. As a complement to this existing market, the Government is interested in encouraging potential UK issuers and investors to work together to evaluate the feasibility of a sterling-denominated private placement market and seeks to encourage the market-led development of a broader, more sustainable and wide-ranging issuer and investor base. **The Government will seek to work with parties, including M&G, Standard Life Investments, Aviva Investors and others, to help with the development of a sterling private placement market, and with price and risk benchmarking to improve transparency and liquidity so that it can become a more established asset class.**

3.49 Other issues raised in the discussions included loan pricing transparency, where feedback indicated a range of views around the impact on upper mid-sized companies and potential investors; bond trading platforms, where recent development of a platform by the London Stock Exchange is encouraging and some respondents supported further developments such as a trading platform for mid-sized company bonds; and non-bank involvement in the loan markets, where feedback suggested some investor appetite. The Government will continue to engage in these areas on ways to reduce further barriers to non-

[13] The Financial Intermediary Service is part of Business Link and offers advice and guidance to SMEs who are having problems accessing finance.
[14] *Discussion paper on developing non-bank lending* is available at www.hm-treasury.gov.uk

bank lending channels. HM Treasury will continue to be advised in this work by the Bank of England and the FSA, working with BIS.

Promoting competition in the banking sector

3.50 Effective competition is central to driving efficiency and ensuring that the financial services sector delivers choice for consumers and businesses.

Framework for competition in financial services

3.51 The Government has a strong framework for competition policy. The Office of Fair Trading (OFT), the Competition Commission and the FSA cooperate closely in this area as and when required.

3.52 The Government notes the progress made by the OFT and the banks in addressing concerns about unauthorised overdraft charges. New entrants to the market, including well-known brands, are expected to stimulate further competition in products, services and charging structures. Nevertheless, the Government continues to monitor developments and will take action if a voluntary approach does not deliver the changes required.

3.53 The Government welcomes the announcement by the OFT of a short review of barriers to entry in retail banking. This work will consider whether there are any obstacles to entrants providing a competitive stimulus, focusing on personal current accounts but considering banking for SMEs and other issues as appropriate.

3.54 The Government welcomes the FSA's intention to deliver further improvements to the bank licensing process, for example, improved guidance on initial applications and more structured communication on the status of applications. This builds on advances already made, particularly in the pre-application process, and will help to ensure new entrants continue to drive a vibrant and competitive marketplace.

3.55 More broadly, the Government remains committed to encouraging competition between existing banks and building societies, and between incumbents and new banking entrants or other challengers. Through the divestments from LBG and RBS, and the exit of the Northern Rock bank business from the public sector, competition and diversity in the marketplace will increase substantially.

Divestments

3.56 The Government is a strong supporter of the EU state aid framework. In this context, the divestments by LBG and RBS will have significant benefits for competition. Taken together over 900 UK branches will be available for purchase, representing a significant ready-made branch footprint for potential purchasers.

3.57 The agreed divestments from RBS represent a unique opportunity for the purchaser to grow in the UK business banking market. RBS is divesting 318 retail branches along with further SME and corporate banking infrastructure. The divestment includes a book of over 200,000 SME customers.

3.58 The agreed divestments from LBG are focused on the retail sector. LBG will divest around 600 branches, representing around 4.6 per cent of the personal current account market and 19 per cent of the Group's mortgage book.

3.59 As agreed with the European Commission, the divested assets may only be acquired by a new entrant or small challenger in the SME banking (RBS) and personal current account (LBG) markets.

Northern Rock

3.60 Northern Rock was successfully restructured in January 2010. The business was split between two companies with the mortgage back book managed separately to the rest of the business. The restructuring resulted in the creation of a new and healthy mortgage bank with a continued high street presence. The remainder of the business continues in the form of Northern Rock (Asset Management) plc (NRAM).

3.61 The success of the restructuring meant that, following a review in consultation with the FSA, the Government decided that HM Treasury's temporary guarantees for retail deposits in Northern Rock were no longer required. It was therefore announced on 24 February that these guarantees would be lifted from 24 May 2010. Every Northern Rock customer will continue to have the first £50,000 of their deposit guaranteed by the Financial Services Compensation Scheme (FSCS), as is the case for retail depositors of all banks authorised in the UK. This marks the next step in Northern Rock's return to independent, commercial status.

3.62 UKFI will, on behalf of the Government, look to return Northern Rock plc from the public sector into the private sector in due course. In so doing UKFI will have regard to its overarching objective to protect and enhance value for the taxpayer, while at the same time promoting competition in the banking market and preserving financial stability. For the eventual purchaser, Northern Rock will present a springboard for growth from an existing branch network, mortgage platform and retail deposit book.

Northern Rock Asset Management and Bradford and Bingley management

3.63 **The Government today announces its intention to integrate two of its wholly owned companies, NRAM and Bradford & Bingley plc, under a single holding company.** The integrated business will be committed to providing excellent customer service, leading arrears management and efficient operations. Both companies will remain as separate legal entities under the new holding company, each with its own balance sheet liabilities and government support arrangements. The Government believes this is the optimal solution to maximise value for the taxpayer and to create a solid platform for the orderly management of both companies' mortgage books.

Building societies and other financial mutuals

3.64 In 2009, the Government convened an experts group to address the strategic issues affecting the building society sector, including access to capital. The Government intends to publish a discussion paper on building society capital shortly.

3.65 The Government proposed in the 2009 Pre-Budget Report the introduction of a specific governance code for building societies and other financial mutuals. It also announced that it would consider the introduction of a regular independent review of financial mutuals' adherence to the code. HM Treasury has commissioned a working group to take this work forward and to make recommendations to Ministers. The objectives are to ensure that an appropriate code is there for those that need it; the Walker recommendations are appropriately reflected in guidance for mutuals; there is independent input into this process; the governance and ownership characteristics of the mutual model are fully reflected in governance guidance; and the guidance provides a useful resource in promoting good governance among financial mutuals. The Government will update on the group's work in the Pre-Budget Report.

Industrial and provident societies

3.66 **The Government intends to consult widely on whether the exemption currently available to industrial and provident societies which provide a financial service (insofar as they accept deposits in the form of withdrawable share capital) should be removed.** This would mean that members of failed industrial and provident societies would qualify under the FSCS and would have access to the Financial Ombudsman Service. **The Government also intends to seek views on raising the current share capital limit for industrial and provident societies from £20,000 to £35,000, enabling societies to raise more capital from members to further their objectives. It will also consult on proposals to facilitate the use of electronic communications by mutual societies.**

Disclosure of banking coverage

3.67 The Government is determined to secure greater transparency in the coverage of retail banking services. It is exploring with the FSA the best way to ensure that the banks provide public information about the geographical distribution of banking services to personal and small business customers. This transparency requirement would highlight differences in coverage and therefore the people most at risk of financial exclusion.

SUPPORTING CONSUMERS

Improving access to financial services

Financial inclusion

3.68 Financial exclusion affects some of the most vulnerable members of society. The Government believes that everyone should be able to access appropriate financial services in order to participate fully in modern day society and the economy.

3.69 The Government is committed to 'mainstreaming' financial inclusion into departmental budgets and strategic objectives from March 2011. Full details will be set out following the next Spending Review.

3.70 In October 2009 the Government announced that it had met its shared goal with the banks to reduce the number of adults without access to a current account by half.[15] The Government believes that it is possible to make further reductions in the number of adults without access to banking services, potentially by up to half over the next five years, and that one step towards achieving this would be to introduce a new right to open a basic bank account. **The Government intends to introduce a new 'universal service obligation', giving people the right to a basic bank account under certain conditions and will consult on the details.**

3.71 A renewed strategy for financial inclusion will require support from a wider group of organisations. Local authorities, social landlords, advice agencies and community lenders all have a strong interest in improving financial inclusion and can play a valuable role in delivery. Since the end of 2008, the Financial Inclusion Champions have created financial inclusion partnerships engaging over 2,180 local organisations. The Champions have built financial inclusion into 45 local area agreements, supported or started over 200 new financial service projects, and trained 5,500 front line staff in tackling financial exclusion.

3.72 The Government also believes that the Post Office has a key role to play in bringing financial services into the heart of our communities. It will shortly set out a response to the recent Post Office Banking Consultation.

Affordable credit

3.73 The Financial Inclusion Growth Fund has enabled credit unions and community development finance associations to make over 240,000 affordable loans, totalling £104 million, to poorer households since 2006.[16] A full evaluation of the Growth Fund initiative will report this year, providing new evidence on delivering affordable credit sustainably to excluded households.

3.74 The Government will continue to work to improve the supply of affordable credit for low-income households, including by supporting third sector lenders. **It will consult on options to make sure banks make an appropriate contribution to community lenders, through regulatory action or a new community levy to be funded by retail banks.**

3.75 The Social Investment Wholesale Bank will also have a key role to play in supporting further growth in community lending.

[15] Official Government Statistics are available at: www.hm-treasury.gov.uk/financial_inclusion_bankaccounts.htm in a statistical briefing

[16] Government management information

3.76 The Government wants to see projects that can provide access to affordable credit on a national scale, and notes with interest the recent proposals from the National Housing Federation to develop and deliver a £3 million regional, not-for-profit financial services provider.

Insurance

3.77 Since 2008 the ABI has led work to improve access to contents insurance among financially excluded tenants. Its website now provides information about the benefits to landlords of promoting contents insurance to their tenants, and it has started to engage with those social landlords with more than 1000 housing units who do not already help their tenants to access affordable insurance. It has also held workshops with social housing officers. The ABI will continue to work to improve access to insurance by developing guidance for insurers on how to treat customers with criminal convictions.

Savings

3.78 The Government will continue to support poorer households in building savings. The 'Save Xmas Campaign', delivered by the Office of Fair Trading, reached an estimated 80,000 people in 2008/09.[17]

Empowering consumers

Money Guidance

3.79 The Government wants to ensure that every adult in the UK can access practical, impartial information and advice about money. This will help consumers to approach financial decisions confidently and knowledgably and to manage their financial affairs better. The Government and FSA have successfully piloted Money Guidance service 'Moneymadeclear' in the North West and North East of England. The service has helped more than half a million people since April 2009 on a wide range of money issues.[18]

3.80 On 11 March, the Chancellor announced the rollout of the Money Guidance service across the rest of the UK. This is now available online and over the phone and will be supported by a national marketing campaign, beginning later this spring. Face-to-face sessions will continue to be available in the North West and North East and a phased rollout of face-to-face services across the rest of the UK will begin shortly, targeting vulnerable areas.

3.81 The Government and the FSA have committed £20m in 2010-11 to fund the rollout of the service, enabling it to help one million people to manage their money better in the coming year. The FSA will establish a new independent consumer financial education body to lead the national implementation of the Money Guidance service.

Simple, transparent products

3.82 The Government wants to ensure that consumers can access products that are simple and easy to understand. It consulted on high-level proposals in *Reforming Financial Markets* in July 2009 and asked the Retail Financial Services Forum (RFSF) to develop policy options, bringing together industry and consumer groups' expertise to advance practical solutions that work well for consumers. **The Government welcomes the publication this week of a discussion paper by the RFSF, setting out emerging conclusions on simple, transparent products. The Government looks forward to the RFSF's recommendations in the autumn, and informed by these, will consult in further detail on a new approach to simple and transparent products by the end of this year.**

Financial education in schools

3.83 The Government believes that every child should learn personal finance skills in school so that they have the confidence and motivation to deal with the financial choices and challenges of adult life. Financial capability has been taught as part of the non-statutory framework for Personal, Social, Health and Economic education (PSHE) in the school curriculum in England since 2008. From this year, financial skills will also be assessed as part

[17] Ipsos Mori, *Evaluation of the Save Xmas Campaign Year 2*, available at www.oft.gov.uk/news/campaigns/savexmas

[18] Management information collected by the FSA. First announced on 11 March in press notice: www.hm-treasury.gov.uk/press_23_10.htm

of GCSE maths. Financial capability, as a component of PSHE, will be a statutory subject in the curriculum in England from 2011.

Paper share certificates

3.84 The Government has been asked by some members of industry to look at the removal of the requirement for paper share certificates and share transfer forms in order to transfer shares. **The Government will establish a working party to clarify the benefits of this proposal for shareholders and others who will be affected. This working party will report to the Financial Services Secretary to the Treasury.**

Protecting consumers

Mortgage regulation

3.85 The Government is taking action to strengthen mortgage regulation, following consultation earlier this year.[19] **The Government intends to transfer the regulation of second-charge mortgage lending to the FSA, including the regulation of existing second charge loans.** This will create a single regulator for residential mortgage lending, ensuring consistent standards of consumer protection across all mortgages and simplifying the regulatory environment for lenders. **The Government is also continuing to explore how best to protect consumers in the buy-to-let market and those whose mortgages are sold on to unregulated firms.**

Home Finance Forum

3.86 During 2010 the Home Finance Forum, which meets monthly, has continued to encourage high standards of industry best practice in UK mortgage markets and to promote awareness of industry and Government initiatives. It has helped to agree a new approach to monitoring voluntary repossessions with the Council of Mortgage Lenders (CML), and changes to the Civil Procedure Rules (to be implemented from April 2010) to help address concerns over interactions between first and second charge lenders. **Budget 2010 announces that HMRC will open discussions with mortgage lenders on the formal introduction of an income verification service for mortgage lenders to provide them with greater certainty about those to whom they lend.**

Northern Irish credit unions

3.87 The Government is exploring ways in which Northern Irish credit unions can be brought within FSA regulation at the earliest opportunity, and intends to consult widely later this year on reform of industrial and provident societies in both Great Britain and Northern Ireland.

Administration regime for insurers

3.88 Both the insurance industry and the UK's prudential regulatory regime for insurers have stood up well during the global financial crisis. The Government in the light of its review of other insolvency regimes, is seeking to refine the administration regime for insurers to ensure continuity of payments and protection for policyholders, should an insurer go into administration. The proposed changes also include legislation that introduces regulation making powers. These powers will ensure that if the FSCS takes action to protect policyholders in life assurance contracts, there will be broadly the same tax treatment in place as if the FSCS had not intervened.

3.89 **The Government will therefore launch a consultation on proposals to strengthen the administration regime for insurers, ensuring consistent treatment for policyholders of insurance contracts under the insolvency and administration regime.**

Changing bank staff incentives to deliver better consumer outcomes

3.90 Building on the RFSF's remit to make financial services work better for consumers, the Government will ask it to consider to what extent financial services firms' staff targets and incentives lead to poor outcomes for consumers and employees and how they can be reformed. **The RFSF will set up a working group, which will engage with banks, mutuals, consumer groups, employees and trades unions and report to the Chancellor in time for the Pre-Budget Report.**

[19] A summary of responses to the consultation which sets out next steps on these proposals will shortly be available at www.hm-treasury.gov.uk/consult_mortgage_regulation.htm