

# New UK coalition sets out proposals for banking reform

The Conservative and Liberal Democrat parties have published the agreements reached between the two political parties on a range of issues, including banking reform. These agreements will form the policy basis of the new Liberal Conservative coalition government formed following the May UK general election, in which no single party obtained enough seats in Parliament to command a majority. The agreements involve compromises for both parties from the positions taken in their election manifestos on banking reform, in particular for the Conservatives on the restructuring of the Financial Services Authority (FSA) and for the Liberal Democrats on the separation of retail and investment banking.

The published document sets out a statement by the two parties of the issues that needed to be resolved between them in order for them to work together in the new coalition government. The parties have said that it will be followed in due course by a final Coalition Agreement, covering the full range of policy and including foreign, defence and domestic policy issues.

On banking reform the parties have agreed on the following points.

## Structure of supervision

It now looks as if the FSA will survive in something like its current form. The two parties have agreed to bring forward proposals to give the Bank of England 'control of macro-prudential regulation and oversight of micro-prudential regulation'. This looks quite different from the Conservatives' manifesto pledge to abolish the tripartite system of financial regulation, put the Bank of England in charge of prudential supervision and create a new consumer protection agency to replace the FSA. The question will be the extent to which the Bank takes an intrusive role as part of the micro-prudential supervisory process and the extent of the macro-prudential regulatory powers granted to the Bank. However, any rule making powers will be limited by the increasing move to a 'single EU rule-book' where most prudential rules are set at the EU level, with fewer national options and discretions, especially after the EU transforms the existing advisory committees into new European level authorities with quasi-rule making powers.

## Banking levy

The parties have agreed that a banking levy will be introduced, although there will need to be a detailed agreement between them on implementation. The Conservatives had said in their manifesto that they were prepared to act "unilaterally, if necessary" on a banking levy while the Liberal Democrats had said that they wanted to introduce a banking levy to charge banks for the financial support they have received, until 'such time as they can be split up'. It now looks as if the parties are now committed to going ahead with a levy (probably to contribute to general government revenues, rather than a specific fund), even if no EU or international deal can be reached.

The structure of any levy will raise a range of issues for the sector. In particular, the imposition by different jurisdictions of bank levies raises difficult questions of allocating the levy between relevant jurisdictions and a clear risk of double taxation.

## Key Issues

UK Conservatives and Liberal Democrat parties reach agreement on banking reform policies

Bank of England to be given control of macro-prudential regulation and oversight of banking regulation, but FSA likely to survive

Plans for a unilateral bank levy to be developed

Independent commission to report on separation of retail and investment banking (initial report within one year)

Proposals for 'robust action to tackle unacceptable bonuses' in the financial services sector

Plans to consider a major loan guarantee scheme and the use of net lending targets for the nationalised banks to encourage SME lending

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The extent of these issues will depend on the precise form which the levies take, but it is likely that existing double taxation treaties would not be apt to cover taxes which are based on a bank's assets or liabilities (such as the levy discussed by the International Monetary Fund in its report to the G-20), as opposed to its income or profits. These issues may become more significant if some countries seek to impose levies by reference to worldwide consolidated measures (as the US has proposed), while other countries also impose levies on businesses within their jurisdiction. However, the impact will also clearly depend on the scope and scale of the levy as well as the way in which it is calculated.

### Separation of retail and investment banking

The parties have clearly had to compromise on this issue. They propose to establish an independent commission 'to investigate the complex issue of separating retail and investment banking in a sustainable way', setting a one year deadline for the initial report. The Conservatives' policy had been to focus on reaching international agreement (somewhat along the lines of the proposed 'Volcker rule') on preventing retail banks from 'engaging in activities, such as large-scale proprietary trading, that put the stability of the system at risk', while the Liberal Democrats were committed to establishing 'a clear separation between low-risk retail banking and high-risk investment banking'. The policy decision has been deferred for a short period, but will doubtless be one of the more contentious issues, not just for UK headquartered banks but also for non-UK banks operating here, if their local operations could be affected.

### Bonuses

The parties plan to bring forward detailed proposals for 'robust action to tackle unacceptable bonuses' in the financial services sector. The Conservatives had planned to give new powers to the Bank of England to 'crack down on risky bonus arrangements' while the Liberal Democrats had pledged to 'ensure that the bonus system can never again encourage banks to behave in a way that puts the financial system at risk or offers rewards for failure'. The precise form of the coalition's plans remains open, in particular as to the extent to which it is intended to go significantly beyond the international framework recommended by the Financial Stability Board. The Financial Services Act 2010 already imposed new obligations on the FSA to make rules on firms' remuneration policy and empowered HM Treasury to make regulations on increased transparency for remuneration.

### SME lending and competition

There are pledges by the two parties to develop proposals to ensure the flow of credit to small and medium sized enterprises (SMEs), in particular including consideration of both a major loan guarantee scheme and the use of net lending targets for the nationalised banks. They also plan to bring forward detailed proposals to foster diversity, promote mutuals and create a more competitive banking industry. This may involve looking at the Liberal Democrat's promise to encourage regional and local banks and 'to seek to' turn the nationalised Northern Rock into a building society. They may also look again at the promises both parties made on disclosure and bank charges (the Conservatives to introduce more transparency on credit card charges and the Liberal Democrats to ban unfair transaction charges and to cap interest rates charged to consumers).

### Euro

The parties have also agreed to rule out joining the European Single Currency during the duration of their agreement.

However, many other policies from the manifestos are not reflected in the jointly agreed document, such as the Conservatives' policies for a free national advice service funded by the industry and to offer a people's bonus on the privatisation of the state's stakes in banks or the Liberal Democrats' policies to pursue international agreement on a financial transaction tax. Some of these may, of course, be revived at a later stage, if the parties reach further agreement.

The parties' agreed policy document and election manifestos can be found at:

[www.conservatives.com/](http://www.conservatives.com/)  
[www.libdems.org.uk/](http://www.libdems.org.uk/)

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