EXPLANATORY MEMORANDUM TO

THE ENTERPRISE ACT 2002 (SPECIFICATION OF ADDITIONAL SECTION 58 CONSIDERATION) ORDER 2008

2008 No. 2645

1. This Explanatory Memorandum has been prepared by the Department for Business Enterprise and Regulatory Reform and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 This Order specifies maintaining the stability of the UK financial system as a public interest consideration under Section 58 of the Enterprise Act 2002 ("the Act") enabling the Secretary of State to intervene on this basis in a relevant merger as defined in section 23 Enterprise Act 2002.

2.2 This Order is being proposed in light of the extraordinary stress in the financial markets and, specifically in the case of the proposed Lloyds TSB Group plc/HBOS plc merger, to provide for careful and urgent consideration of financial stability as part of the overall public interest assessment relating to the proposed transaction. The timing is urgent as the Secretary of State is unable to make decisions on the proposed Lloyds TSB/HBOS merger until Parliamentary approval is received for the Order. The urgency is essential in order to give both certainty to the market on the regulatory framework and certainty for the proposed Lloyds/HBOS merger.

3. Matters of Special Interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Background

4.1 Section 23 of the Act provides that a "relevant merger situation" arises for the purposes of the Act where two or more enterprises cease to be distinct and where either the UK annual turnover of the enterprise being acquired is in excess of £70 million or the combined enterprises would, as a result of the merger, have a market share for the supply of particular goods or services that is in excess of 25% of the UK market or of the market in a substantial part of the UK.

4.2 Under Section 42 of the Act, the Secretary of State may intervene in a relevant merger where he believes that a public interest consideration specified in Section 58 of the Act is or may be relevant to a consideration of the merger. Where such an intervention is made, the Office of Fair Trading (or in the case of a media merger, Ofcom) must provide a report to the Secretary of State, within such time as he may specify, in accordance with Section 44 of the Act. The Secretary of State must then take decisions in accordance with Section 45 of the Act on whether to refer the case to the Competition Commission or to clear the merger.

4.3 Where the Secretary of State intervenes on the basis of a new public interest consideration he believes should be specified in Section 58 of the Act but which has not yet been finalised, he is required to take the necessary action to finalise the proposed new public interest consideration as soon as practicable.

4.4 Section 58(3) of the Act provides that the Secretary of State may add new public interest considerations by Order. Section 124(7) provides that the Order is to be made and then laid before Parliament where it needs to be approved, by resolution of each House, within 28 days

4.5 The new public interest consideration does not apply to concentrations with a European dimension and therefore the ECMR does not apply. The new consideration will be available for use only in respect of relevant UK merger situations that fall within the jurisdiction of the UK competition authorities, as is the case with the proposed Lloyds TSB/HBOS merger.

5 Extent

5.1 This instrument applies to all of the United Kingdom.

6 European Convention on Human Rights

6.1 I am satisfied that this Order is compatible the European Convention on Human Rights.

7 Policy Background

7.1 Advice from the Tripartite authorities (HM Treasury, Bank of England, Financial Services Authority) stressed the importance of significant weight being given to financial stability issues alongside competition questions in the assessment of the proposed merger between Lloyds TSB and HBOS. The Secretary of State also considers that the proposed merger may raise public interest considerations of the highest order on grounds that maintaining financial stability within the UK should be a public interest consideration. The Order will enable the Secretary of State to consider public interest issues alongside competition issues in making his final decisions on this proposed merger.

7.2 As provided for in the Act, the Secretary of State has already issued an intervention notice on the basis of the new public interest consideration in anticipation of making the necessary order and finalising the new consideration. This was considered necessary in view of the urgent need to intervene in respect of the proposed merger between Lloyds TSB and HBOS and to give wider market clarity about the regulatory process.

7.3 The Enterprise Act 2002 provides for the regulatory consideration of all mergers and acquisitions by the competition authorities on the basis of a merger's effects on competition in the relevant market. The Act also provides that the Secretary of State may intervene in any merger he considers raises concerns relevant to a public interest consideration that has been specified in the Act or that he believes should be so specified. Presently, there are two public interest considerations specified in the

Enterprise Act – national security and plurality, quality and standards in the media. This order will introduce a third consideration of maintaining the stability of the UK financial system Since the coming into force of the Enterprise Act 2002, the power to intervene in mergers on public interest grounds has been used seven times: five times on national security grounds in respect of mergers in the defence sector, once on media plurality grounds and now once on the basis of this new consideration.

7.4 The financial services sector is vital to the rest of the economy. It matches the resources of savers to the needs of borrowers; provides firms and individuals with the means to make and receive payments; and provides channels for the distribution and diversification of risk. Financial instability in the financial services sector can disrupt these functions and have a damaging effect on the wider economy. In particular, the failure of a bank, building society or other deposit-taking firm would leave customers – individuals or businesses – unable to access savings, to raise finance or to meet obligations. A single bank failure has the potential to spread to other parts of the financial system through consequent effects on consumer confidence, through the inter-bank lending market, or through other channels. This, in turn, can have knock-on negative effects for the wider economy. For these reasons, the failure of a bank can involve greater and more widespread costs to the economy than that of a similar size business in a different sector. Creating this new public interest consideration will enable the interest of maintaining the stability of the UK financial system to be taken into account when considering and taking decisions about relevant UK merger situations.

8. Impact Assessment

8.1 An Impact Assessment has been prepared for this Order and is attached to this Explanatory Memorandum.

9. Contact

9.1 Paul Bannister at the Department for Business Enterprise and Regulatory Reform, telephone 0207 215 5009 or e mail paul.bannister@berr.gsi.gov.uk can answer any queries regarding this instrument.

Summary: Intervention & Options

Department /Agency: 1. Department for Business Enterprise & Regulatory Reform	Title: 2. Impact Assessment of an order to specify the financial stability of the UK as a public interest consideration on which the Secretary of State may	
Stage:	**Version:** 1	**Date: 3 October 2008**
Related Publications: None		

Contact for enquiries: paul.bannister@berr.gsi.gov.uk **Telephone: 020 7215 5009**

What is the problem under consideration? Why is government intervention necessary?

In the light of extraordinary stress in the worldwide financial markets and specifically, in the case of the proposed Lloyds TSB Group merger with HBOS plc and the systemic importance of HBOS to the UK banking system, the Secretary of State considered that there is a need to act quickly as there is a serious threat to the stability of the UK financial system.

Financial instability has a damaging effect on the wider economy. The failure of a bank can involve greater and more widespread costs to the economy than that of a non-financial firm of a similar size, as it has the potential to spread to other parts of the financial system through the effect on consumer confidence (contagion), through the inter-bank lending market, or through other channels. This, in turn, can exert a negative externality on the wider economy.

Having received advice from the Tripartite Authorities (HM Treasury, Bank of England and the Financial Services Authority), the Secretary of State believes mergers in the banking sector are capable of giving rise to concerns relevant to the financial stability of the UK.

Advice from the Tripartite Authorities also stressed the importance that significant weight should be given to the financial stability issues alongside competition questions in the assessment of the proposed Lloyds TSB Group merger with HBOS plc. There was also a need to give clarity to the market on the regulatory framework and some certainty for the proposed merger.

The Chancellor, the FSA and the Bank of England all endorsed that merger as important to ensure the financial stability in the UK in the interest of consumers and the wider economy. It would not have been possible for that deal to be completed without the Government issuing an intervention notice and so it was important that this action was taken immediately.

What are the policy objectives and the intended effects?

The Financial Services sector and the banking sector in particular, are vital to the rest of the economy. It matches the resources of savers to the needs of borrowers, provides firms and individuals with the means to make and receive payments, and provides channels for the distribution and diversification of risk. Financial instability in the financial services sector can disrupt these functions and have a damaging effect on the wider economy. In particular, the failure of a bank, building society or other deposit-taking firm would leave individuals and businesses unable to access savings, raise finance or meet day to day financial obligations.

Creating this new public interest consideration will enable the interest of maintaining the stability of the UK financial system to be taken into account when considering and taking decisions about relevant UK merger situations. This should alleviate the potential consequences of increased financial instability set out above.

What policy options have been considered? Please justify any preferred option.

The following options have been considered:

- Do nothing
- A private-sector merger, achieved through an Order under the Enterprise Act identifying 'stability of the UK financial system' as an additional public interest consideration

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The power to intervene in mergers on the basis of a public interest consideration specified under Section 58 of the Enterprise Act 2002 will be available unless and until the consideration concerned is removed from the statute.

Ministerial Sign-off For final proposal/Implementation Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:

Shiriti Vadera

.... Date: 6th October 2008

Summary: Analysis & Evidence

Policy Option: Do nothing	Description: Order to specify the financial stability of the UK as a public interest consideration on which the Secretary of State may intervene in mergers

COSTS	**ANNUAL COSTS**		Description and scale of **key monetised costs** by 'main affected groups'	
	One-off (Transition)	**Yrs**	Taking no action is likely to have significant impact on shareholders and some depositors of financial institutions that may fail as a result of increased financial stability. Parties in the wider economy may be affected via the transmission of these risks through the financial system and beyond.	
	£ N/A			
	Average Annual Cost (excluding one-off)			
	£ N/A		**Total Cost** (PV)	**£ TBC**
	Other **key non-monetised costs** by 'main affected groups'			

BENEFITS	**ANNUAL BENEFITS**		Description and scale of **key monetised benefits** by 'main affected groups'	
	One-off	**Yrs**	There are likely to be negligible benefits to a situation in which no action is taken, as this could lead to increased instability of the UK financial system.	
	£ N/A			
	Average Annual Benefit (excluding one-off)			
	£ N/A		***Total Benefit** (PV)	**£ 0**
	Other **key non-monetised benefits** by 'main affected groups'			

Key Assumptions/Sensitivities/Risks

Price Base Year 07/08	Time Period Years 0	**Net Benefit Range** (NPV) **£ TBC***	**NET BENEFIT** (NPV Best estimate) **£ TBC***

What is the geographic coverage of the policy/option?			United Kingdom	
On what date will the policy be implemented?			October 2008	
Which organisation(s) will enforce the policy?			BERR	
What is the total annual cost of enforcement for these organisations?			[£ Negligible]	
Does enforcement comply with Hampton principles?			[?]	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ None	
Will the proposal have a significant impact on competition?			Yes	
Annual cost (£-£) per organisation (excluding one-off)	Micro **£0**	Small **£0**	Medium **£0**	Large **£0**
Are any of these organisations exempt?	N/A	N/A	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)					(Increase - Decrease)
Increase of	£ N/A	Decrease	£ N/A	**Net**	**£** N/A

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Summary: Analysis & Evidence

Policy Option: Make an order for public intervention	Description: Order to specify the financial stability of the UK as a public interest consideration on which the Secretary of State may intervene in mergers

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'	
One-off (Transition)	**Yrs**	The measure has no general impact on costs to business. Introducing the possibility of making such interventions and making decisions on the basis of the new public interest consideration is a factor that business will need to take into account when contemplating a merger.	
£ N/A			
Average Annual Cost (excluding one-off)			
£ N/A		**Total Cost** (PV)	**£ TBC**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'	
One-off	**Yrs**	The benefits of increased financial stability of the UK through having the power to intervene in mergers on the basis of a public interest consideration. At the present time, it is not possible to provide an assessment of the precise economic benefits that may arise from making such an intervention.	
£ N/A			
Average Annual Benefit (excluding one-off)			
£ N/A		***Total Benefit** (PV)	**£ TBC**

Other **key non-monetised benefits** by 'main affected groups'

Benefits of regulatory certainty for financial services industry at large.

Key Assumptions/Sensitivities/Risks

Specifying this new public interest consideration will enable public interest interventions to be made so that the effects of mergers on the financial stability of the UK can be taken into account in taking merger decisions. Whether or not it is appropriate to use the power in respect of a particular merger will depend on the circumstances of the case.

Price Base Year 07/08	Time Period Years 0	**Net Benefit Range** (NPV) **£ TBC***	**NET BENEFIT** (NPV Best estimate) **£ TBC***

What is the geographic coverage of the policy/option?	United Kingdom			
On what date will the policy be implemented?	October 2008			
Which organisation(s) will enforce the policy?	BERR			
What is the total annual cost of enforcement for these organisations?	[£ Negligible]			
Does enforcement comply with Hampton principles?	[?]			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ 0			
What is the value of changes in greenhouse gas emissions?	£ None			
Will the proposal have a significant impact on competition?	Yes			
Annual cost (£-£) per organisation (excluding one-off)	Micro **£0**	Small **£0**	Medium **£0**	Large **£0**
Are any of these organisations exempt?	N/A	N/A	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)					(Increase - Decrease)
Increase of	£ N/A	Decrease	£ N/A	**Net**	**£** N/A

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base (for summary sheets)

IMPACT ASSESSMENT

The Enterprise Act 2002 (Specification of Additional Public Interest Consideration) Order 2008

INTRODUCTION

The financial services sector makes a vital contribution to the rest of the economy by: matching the resources of savers to the needs of borrowers; providing firms and individuals with the means to make and receive payments; and providing channels for the distribution and diversification of risk. The contribution of financial service has increased from 6.2 per cent of UK GDP in 1997 to 9.4 per cent in 2006.

The financial stability of UK economy is therefore clearly a matter of public interest. Further, private sector mergers, especially between financial institutions, can be an important tool for maintaining that stability. It is therefore important that any benefits of a merger to the financial stability of the UK are considered alongside the effects of that merger on competition. Adding "the stability of the UK financial sector" to the list of public interest considerations will allow both factors to be considered in cases where I issue an intervention notice.

This Impact Assessment is structured as follows:

- Section 1 - background and rationale for government action.
- Section 2 - brief review of the cost and benefits analysis
- Section 3 - Specific Impact Tests with special attention paid to the impact on Competition and Small Firms.
- Section 4 - assessment of the affected groups and sectors.
- Section 5 - Summary and Recommendation.

Background and Rationale for new public interest consideration

In light of the current extraordinary stress in the global financial markets there has been a marked increase in the risk of bank defaults which in turn threaten the stability of the UK financial services sector. Should stability of the UK financial services sector be undermined the effects are likely to be long lasting.

The financial services sector is vital to the rest of the economy. It matches the resources of savers to the needs of borrowers; provides firms and individuals with the means to make and receive payments; and provides channels for the distribution and diversification of risk. Financial instability in the financial services sector can disrupt these functions and have a damaging effect on the wider economy. In particular, the failure of a bank, building society or other deposit-taking firm would leave customers

– individuals or businesses – unable to access savings, to raise finance or to meet obligations. A single bank failure has the potential to spread to other parts of the financial system through consequent effects on consumer confidence, through the inter-bank lending market, or through other channels. This, in turn, can have knock-on negative effects for the wider economy.

For these reasons, the failure of a bank can involve greater and more widespread costs to the economy than that of a similar size business in a different sector. In instances where a banking failure can be prevented through a soundly structured merger, the economic harm caused by any lessening of competition resulting from the merger could be substantially less than the economic harm caused should the merger not go ahead and a bank failure allowed to occur.

Creating this new public interest consideration will enable the interest of maintaining the stability of the UK financial system to be taken into account when considering and taking decisions about relevant UK merger situations.

CONSULTATION

Within Government

In laying this order, BERR has received representations from HM Treasury, which itself received advice from the Financial Services Authority and the Bank of England.

Wider Consultation

None

OPTIONS REVIEW (Including Benefits and Costs)

The actual economic benefits and costs of this additional power to intervene in mergers will depend upon the specific impact on the particular circumstances of those cases in respect of which the power is used. However, the analysis below outlines the potential costs and benefits in broad terms.

Option 1 - Do nothing

Benefits

There are no tangible benefits to not implementing the public interest order.

Costs

There would be no way for the Secretary of State for BERR to intervene in a merger to ensure that financial stability implications were considered alongside competition issues. A merger can make a significant contribution to ensuring the financial stability of the UK economy. In the case of such a merger, if competition issues were considered in isolation and this delayed or prevented the merger this would damage the stability of the financial services sector which is worth 9.4% of the UK economy (2006). In particular, if the absence of the merger caused the failure of the bank this would prevent individuals and businesses from accessing savings, raising finance or meeting obligations. The resultant effect on consumer confidence and the inter-bank lending market, particularly during current financial conditions, would mean that in some cases such a failure would have significant effect on the rest of the financial sector. Either there would be significant economic costs as a result, or the Government would be required to intervene. The latter could involve a need for taxpayer funding.

Option 2 – implement additional public interest consideration, as proposed

Benefits
This option allows the Secretary of State to consider the implications of a proposed merger for both competition and financial stability, in those cases where he or she chooses to intervene. This will ensure that the overall public interest is served in the consideration of that merger. In cases where a merger is considered essential for maintaining financial stability and where this outweighs any competition concerns, the benefits could include: preventing the failure of a financial institution, protecting depositors and maintaining market confidence (particularly important during the current market stresses). Further, if a private sector solution could not be found and a financial institution was at risk it may be necessary for the Government to intervene in a way which incurs taxpayer expense.

Costs
There are no direct economic costs of implementing a public interest order and the measure has no general impact on costs to business.

The Secretary of State may, as a result of this power, allow a merger to proceed which would have been prevented purely on competition grounds or prevent a merger which would have been allowed purely on competition grounds. However, he will only do so when it serves the overall public interest.

SPECIFIC IMPACT TESTS

Competition Assessment

According to the OFT's guidelines "*Completing competition assessments in impact assessments*", the purpose of conducting an impact assessment from a competition law viewpoint is to consider whether the proposed regulation prevents, restricts or distorts competition (OFT876, page 7). Whilst adopting a power to intervene in mergers on the basis of their impact on the public interest as it relates to the financial stability of the UK does not necessarily directly prevent, restrict or distort competition, exercising the power under that order could potentially have an impact on competition in financial services in some cases. However, this power does provide for non-competition impacts to be taken into account when taking decisions about certain mergers, such that competition is no longer the only relevant consideration.

Small Firms Impact Tests

Smaller firms – who by definition have smaller capital bases – are disproportionately vulnerable to adverse changes in the availability of liquidity in the marketplace. The protection that this new consideration would offer to small firms against systemic instability adds to the protection that the competition regime would otherwise provide.

AFFECTED SECTORS AND GROUPS

The consideration could apply to any merger. It is our expectation that this would primarily apply to the financial services sector, however – including banks, building societies and mutuals, and other financial service providers – where the performance and viability of firms in the sector has a direct impact on financial stability more widely.

SUMMARY AND RECOMMENDATION

The addition of a new public interest consideration of financial stability to the existing considerations under the Enterprise Act 2002 allows the SoS to act to protect the UK economy from the damaging effects of financial instability.

For an intervention to be undertaken in the public interest, the SoS would have to be convinced that the benefits of acting in the public interest outweighed the opposing case for allowing the competition regime to run its course, based on assessments from the Office for Fair Trading, the Financial Services Authority and the Bank of England. The Government remains committed to supporting competition as a fundamental characteristic of dynamic, solvent financial markets. By taking this step Government is moving to ensure that conditions in these markets are sufficiently stable to enable these forces to operate.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

Annexes

No Annexes are attached to this Impact Assessment