



HM Treasury

# A smarter ring-fencing regime

## **Consultation on near-term reforms**

September 2023



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# Consultation and how to respond

The purpose of publishing this consultation document is to enable any interested parties or stakeholders to make representations on the government's proposed legislation to reform the ring-fencing regime.

This consultation is published on HM Treasury's website and will be open for 8 weeks. Responses are invited by **26 November 2023** and should be sent to [ringfencing\\_review@hmtreasury.gov.uk](mailto:ringfencing_review@hmtreasury.gov.uk). Responses may be shared with the Bank of England (the Bank), Prudential Regulation Authority (PRA), and Financial Conduct Authority (FCA).

Further information about responding to this consultation and the way in which personal data will be processed can be found in Chapter 6.

# Foreword

In launching the Edinburgh Reforms, the Chancellor set out a bold vision for an open, sustainable, and technologically advanced financial services sector that is globally competitive and acts in the interests of communities and citizens.

A central pillar of the Edinburgh Reforms was a commitment to a competitive marketplace promoting effective use of capital and, within this, a commitment to reforming the ring-fencing regime in response to the findings of the independent statutory review chaired by Sir Keith Skeoch (the Skeoch Review).

The Chancellor announced that the government would be taking forward a series of near-term measures proposed by the Skeoch Review to quickly improve the functionality of the existing ring-fencing regime, while moving some firms out of the regime. He also announced plans to consult on raising the deposit threshold above which firms would be required to enter the regime.

This consultation is the next stage towards delivering those commitments, inviting respondents to provide feedback directly on the draft secondary legislation that will implement the near-term reforms to the ring-fencing regime.

This is an ambitious and comprehensive package of reforms informed by the Skeoch Review's recommendations, stakeholder feedback, as well as the work of the joint Bank of England and HM Treasury ring-fencing Taskforce, established following publication of the Skeoch Review's report.

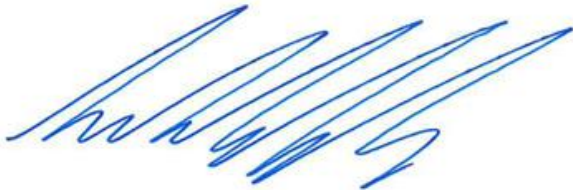
The near-term reforms represent an important milestone in supporting the necessary evolution of the ring-fencing regime, more than four years after the regime came into effect. The regulatory framework for banks has developed significantly since the inception of ring-fencing and has considerably strengthened the resilience of the UK banking sector.

The modified ring-fencing regime will be more adaptable, simpler and better placed to serve banks' customers, by reducing the rigidity of the existing regime and addressing unintended consequences. It will improve outcomes for banks and their customers, increase competition and improve the competitiveness of the UK banking sector. Several proposals are directly aimed at facilitating the provision of finance to UK small and medium enterprises, supporting their growth.

At the same time, the reformed regime will continue to maintain appropriate financial stability safeguards and minimise risks to the public finances. It will notably continue to provide protection to core retail banking services in large banks from risks that may arise from elsewhere in the financial system.

The near-term reforms do not unlearn the lessons of the past and are a sensible evolution of the ring-fencing regime supported by joint work between HM Treasury, the Bank of England and Prudential Regulation Authority. The reforms are in line with the government's commitment to robust regulatory standards that protect and maintain financial stability, a foundation of the UK's success as a global financial centre.

I warmly invite all interested stakeholders to use this consultation as an opportunity to share their views on the near-term ring-fencing reforms.

A handwritten signature in blue ink, appearing to read 'Andrew Griffith', is positioned above the printed name.

**Andrew Griffith MP**

**Economic Secretary to the Treasury**



# Chapter 1

## Introduction

### Background

1.1 Following the global financial crisis of 2007-08 (GFC), HM Treasury established the Independent Commission on Banking (ICB) to consider structural and wider reforms that would promote financial stability and competition within the UK banking market.

1.2 In 2011, the ICB published its final report and recommendations to the government. One of the most substantive recommendations was the establishment of a ring-fencing regime for large banks in the UK. The ICB envisaged that such a regime could “make it easier to sort out both ring-fenced banks and non-ring-fenced banks which get into trouble, without the provision of taxpayer-funded solvency support” and “insulate vital banking services on which households and SMEs depend from problems elsewhere in the financial system.”<sup>1</sup>

1.3 The regime was legislated for in the Financial Services (Banking Reform) Act 2013 (FSBRA) and came into full effect on 1 January 2019, with UK banks with more than £25 billion of “core deposits” required to legally separate their retail banking services.<sup>2</sup> In addition to providing the statutory footing for the regime, FSBRA also set out a requirement for the government to commission an independent review of the regime within two years of it coming into full effect. This review, undertaken by a panel of independent experts led by Sir Keith Skeoch (the Panel), launched in February 2021 and delivered its final report in March 2022.<sup>3</sup>

1.4 The Panel made seven recommendations related to the ring-fencing regime. Six of these recommendations (the near-term recommendations) proposed alterations to the regime that the Panel judged would improve the operation of the regime in a fashion that was beneficial to the banking industry and their customers, without undermining the UK’s financial stability, with five of these directed at HM Treasury and one at the Bank. The Panel’s intention was that the five directed at HM Treasury could be implemented through secondary legislation to quickly improve the functioning of the existing regime. In addition to the near-term recommendations, the Panel recommended that HM Treasury review how to align the ring-fencing and resolution regimes in the longer-term, to ensure a simpler and more coherent regulatory regime in the future as both regimes seek to address the same issue of “too-big-to-fail”.

1.5 On 9 December 2022, as part of the Edinburgh Reforms, the government announced its intention to consult on a series of near-term reforms to the ring-

<sup>1</sup> [ICB Final Report Recommendations](#), September 2011

<sup>2</sup> A core deposit is defined in article 2(2) of the Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014/1960 as a deposit held with a UK deposit-taker in a UK account or EEA account, except where one or more of the accountholders meets certain criteria.

<sup>3</sup> [Ring-fencing and Proprietary Trading Independent Review Final Report](#), March 2022.

fencing regime, broadly taking forward the Panel's recommendations.<sup>4</sup> The government announced that these reforms would:

- Take banking groups without major investment banking operations out of the regime. This would remove a barrier to growth for smaller banks and support domestic competition.
- Update the definition of a Relevant Financial Institution (RFI) to remove barriers that prevent some small businesses from accessing financial services.
- Remove blanket geographical restrictions on ring-fenced banks (RFBs), helping UK banks to compete internationally and supporting UK businesses operating abroad.
- Take forward technical amendments outlined in the Panel's recommendations to improve the functioning of the regime, removing unintended consequences, and providing benefits for the sector and the economy.
- Review and update the list of activities which RFBs are restricted from carrying out in order to assess whether certain activities could in the future be undertaken safely and improve the supply of financial services to consumers and businesses.
- Increase the deposit threshold – i.e., the point at which ring-fencing applies to banks – from £25 billion deposits to £35 billion deposits. This announcement went beyond the Panel's recommendations as the government considers that the appropriate deposit level has increased since it was first determined.

1.6 The proposals in this consultation include the policy proposals announced in December 2022, as well as new proposals to facilitate investment by RFBs in small and medium enterprises (SMEs). This includes permitting RFBs to make direct and indirect equity investments in UK SMEs.

1.7 Overall, the government believes that this is a significant package of reforms that will improve outcomes for banks and their customers as well as increase competition in, and the competitiveness of, the UK banking sector. The proposed changes represent a necessary evolution of the ring-fencing regime to make it more flexible and proportionate, whilst maintaining appropriate financial stability safeguards and minimising risks to public funds. They are in line with the government's commitment to robust regulatory standards, protecting and maintaining the UK's financial stability.

1.8 This consultation invites views from respondents on the draft secondary legislation to implement the near-term reforms.<sup>5</sup> The proposals have been informed by work undertaken by the Panel, stakeholder feedback, and the joint HM Treasury and Bank of England ring-fencing Taskforce (the Taskforce), established following publication of the Panel's report.

<sup>4</sup> HM Treasury, [Government response to the independent review on ring-fencing and proprietary trading](#), December 2022.

<sup>5</sup> HM Treasury, [Draft Statutory Instrument: The Financial Services and Markets Act 2000 \(Ring-fenced Bodies, Core Activities, Excluded Activities and Prohibitions\) \(Amendment\) Order 2023](#), September 2023.

1.9 In parallel, the PRA is consulting on changes to its rules that will integrate with the changes to legislation proposed in this consultation.<sup>6</sup> Additionally, the PRA is conducting its five-yearly review of the ring-fencing rules in its rulebook, which must be completed by end-2023.

1.10 Separately, and in response to the Panel's recommendation on the longer-term future of the ring-fencing regime, the government issued in March 2023 a Call for Evidence on aligning the ring-fencing and resolution regimes, which closed on 7 May 2023.

1.11 The Call for Evidence sought views on the ongoing financial stability benefits that ring-fencing provides that are not found elsewhere in the regulatory framework and the steps that could be taken to better align the ring-fencing and resolution regimes without increasing risks to financial stability. It also invited respondents to consider a wide range of options for the longer-term future of ring-fencing.

1.12 The government has alongside this consultation published its response to the Call for Evidence.<sup>7</sup>

## Consultation structure and next steps

1.13 This consultation is structured as follows:

- Chapter 2 provides a summary of the proposals in this consultation;
- Chapter 3 sets out the government's policy position, proposals and questions for respondents. The government is also seeking respondents' views on a number of areas where it did not have enough evidence at this stage to propose legislative changes;
- Chapter 4 outlines the government's preliminary considerations relating to the impact assessment and equalities impact of the near-term reforms;
- Chapter 5 summarises the list of questions on which this consultation seeks respondents' feedback;
- Chapter 6 provides further detail on the consultation process and how to respond to the consultation.

1.14 The government will consider respondents' feedback to this consultation, which will inform policy decisions as well as whether any changes or additions are made to the draft legislation on the proposed near-term ring-fencing reforms.

1.15 The government intends to lay secondary legislation implementing the near-term reforms in Parliament in early 2024, subject to Parliamentary time. The government expects the legislative changes to come into effect as soon as they have been approved by Parliament. Respondents should note that the draft secondary legislation attached to this consultation may be subject to change before it is laid before Parliament.

<sup>6</sup> Bank of England, [Ring-fenced bodies: establishment of third-country subsidiaries and branches](#), September 2023.

<sup>7</sup> HM Treasury, [Aligning the ring-fencing and resolution regimes: Call for evidence – Response](#), September 2023.

# Chapter 2:

## Summary of proposals

Proposal	Description
<b>A. Ring-fencing thresholds</b>	
<b>A.1 Deposit threshold</b>	Increase the ring-fencing deposit threshold from £25 billion to £35 billion of “core deposits”
<b>A.2 Secondary threshold</b>	Exempt from the ring-fencing regime retail-focused banks with trading assets of less than 10% of tier 1 capital, except where they are part of a Global Systemically Important Bank (G-SIB)
<b>A.3 De minimis threshold</b>	Allow RFBs to incur an exposure of up to £100,000 to a single RFI at any one time
<b>B. Architectural reforms</b>	
<b>B.1 Geographic restrictions</b>	Allow RFBs to establish operations outside of the UK or European Economic Area (EEA).
<b>B.2 Merger &amp; Acquisitions</b>	Introduce a four-year transition period for complying with the ring-fencing regime for ring-fenced banking groups that acquire a bank not subject to the ring-fencing regime
<b>C. Permitted products and services</b>	
<b>Facilitating the provision of finance to SMEs</b>	
<b>C.1 Equity investments</b>	Permit RFBs, subject to limits, to: <ul style="list-style-type: none"><li>• Make direct minority equity investments in UK SMEs</li><li>• Make investments in funds which invest predominantly in UK SMEs; and</li><li>• Acquire equity warrants when providing loans to UK SMEs</li></ul>
<b>C.2 Exposures to certain small financial institutions</b>	Permit RFBs to incur exposures to RFIs that qualify as SMEs

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## **Other products and services**

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### **C.3 Trade finance**

Permit RFBs to undertake a wider range of standard trade finance activities

### **C.4 Debt restructuring**

Broaden the scope of the existing exemption that permits RFBs to engage in “debt for equity swaps”

### **C.5 Servicing central banks**

Permit non-ring-fenced banks (NRFBs) to service central banks outside the UK

### **C.6 Inflation swaps**

Permit RFBs to offer inflation swap derivatives

### **C.7 Mortality risk and lifetime mortgages**

Permit RFBs to hedge mortality risk

### **C.8 Share dealing errors**

Permit RFBs to deal in investments as principal for the purpose of correcting the failure of a securities trade which is due to error

### **C.9 Test trades**

Permit RFBs to deal in investments as principal for the purpose of undertaking test trades

### **C.10 Divestments**

Permit RFBs to deal in investments as principal where they are divesting debentures

### **C.11 Trustee services**

Clarify that RFBs may incur exposures to RFIs when they act as a trustee for minors or charitable incorporated organisations

### **C.12 Derivatives**

Clarify that RFBs are permitted to offer certain collars

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## **D. Definitions and technical amendments**

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### **D.1 Structured finance vehicles (SFVs)**

Provide that an SFV qualifies as a sponsored SFV of an RFB where its assets were created or acquired by that RFB or another RFB in the same group

### **D.2 Correspondent banking definition**

Clarify that RFBs are permitted to incur exposures to RFIs where the exposure arises from correspondent banking arrangements, which involve more than two credit institutions

### **D.3 Grace period for NRFBs**

Introduce a twelve-month grace period for NRFBs to move customers that are no longer classified as an RFI to RFBs

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# Chapter 3:

## Policy position and proposed legislative changes

3.1 As outlined in Chapters 1 and 2, the government is seeking to implement a package of near-term ring-fencing reforms, broadly taking forward the Panel's recommendations and going beyond those in certain areas.

3.2 The government is seeking views on the policy proposals put forward in this consultation as well as the corresponding draft legislation given the technical nature of many of the proposed changes. The government's proposed changes aim to ensure that the regime is simpler to operate for banks within scope, leads to better outcomes for customers, and supports the growth of the UK economy, without materially increasing risks to financial stability.

3.3 HM Treasury must have regard to several statutory tests when amending the ring-fencing regime's secondary legislation. These vary in relation to the type of change being made. They may for instance require HM Treasury to be satisfied that new or expanded exemptions to particular restrictions in the regime's secondary legislation would not be likely to result in any significant adverse effect on the continuity of the provision in the UK of core retail banking services. HM Treasury has assessed the proposals in this consultation and the draft secondary legislation to implement them and concluded that they satisfy the relevant statutory tests.

3.4 This consultation proposes draft legislation to make changes relating to four broad categories: ring-fencing thresholds (**Section A**), architectural reforms (**Section B**), permitted products and services (**Section C**), and definitions and technical amendments (**Section D**). The government is also seeking further evidence from respondents on a few of the Panel's recommendations where it has found insufficient evidence to propose legislative changes at this stage (**Section E**).

### A. Ring-fencing thresholds

#### A.1. Deposit threshold

**Proposal A1 – Increase the ring-fencing deposit threshold from £25 billion to £35 billion of core deposits.**

→ Draft Statutory Instrument: see Article 2(5).

#### Background

3.5 The deposit threshold determines the point at which the ring-fencing regime applies to banking groups. It is currently set at £25 billion of core deposits, which broadly covers deposits from individuals and SMEs.

3.6 The original rationale for setting the deposit threshold at £25 billion was set out by HM Treasury as a risk-based judgment, informed by the recommendations from the ICB. A HM Treasury White Paper stated that the threshold “will need to adjust over time to reflect the evolution of banking practices and growth in the deposit base”.<sup>8</sup>

### Proposal

3.7 As announced on 9 December 2022, the government proposes to increase the deposit threshold by £10 billion, from £25 billion to £35 billion. This would mean in the future that banks with core deposits of less than £35 billion would not be subject to the ring-fencing regime.

3.8 Since the threshold was initially calibrated, the UK regulatory landscape has evolved, notably with the resolution regime and higher liquidity and capital requirements for banks. Given improvements in UK banks’ resilience, the government considers that the appropriate level for the deposit threshold – below which the costs of compliance with the ring-fencing regime would outweigh the financial stability benefits – has increased.

3.9 The proposed £10 billion increase is a decision informed by data-driven analysis as well as financial stability and competition considerations. It reflects changes in the wider macro-financial environment, including in the regulatory landscape and the growth in the deposit base. It would result in approximately 90% of banks’ UK retail deposits being covered by the ring-fencing deposit threshold, which is broadly in line with the proportion covered when the threshold was set originally.<sup>9</sup> The government and the Bank therefore consider that the proposed increase in the deposit threshold will not materially increase financial stability risks.

3.10 In practice, the higher deposit threshold is not expected to alter the scope of banks currently subject to the regime. However, it will remove a barrier to growth for firms currently below the £25 billion deposit threshold by allowing them to grow their deposit base further, up to £35 billion, before ring-fencing requirements would apply. This will support competition in the UK banking sector and benefit customers.

### Additional considerations

3.11 The proposed increase in the deposit threshold will take into account the separate proposal in this consultation (**Proposal B.1**) to remove the geographical restrictions that currently prevent RFBs from establishing operations outside of the UK or EEA. This means that core deposits held in any branches of an RFB, wherever they are located, including those located outside of the UK or EEA, will be included when a group is calculating its total core deposits.

3.12 In line with the original ICB recommendation, the government will continue to keep the deposit threshold under review in the future, taking into account future changes to the regulatory landscape and structural trends in the banking sector as appropriate.

<sup>8</sup> HM Treasury, [Banking reform: delivering stability and supporting a sustainable economy](#), para 2.85, June 2012.

<sup>9</sup> HM Treasury, [“Banking reform: delivering stability and supporting a sustainable economy”](#), para 2.85, June 2012.



## Question 1

**Do you agree with the proposal to increase the ring-fencing deposit threshold to £35 billion of core deposits?**

### A.2. Secondary threshold

**Proposal A2 – Exempt from the ring-fencing regime retail-focused banks with trading assets of less than 10% of tier 1 capital, except where they are part of a G-SIB.**

→ Draft Statutory Instrument: see Articles 2(4)(a)-(b) and (6).

#### Background

3.13 The Panel recommended exempting banking groups that have zero or low levels of “excluded activities” from the ring-fencing regime. The Panel defined these as certain measurable activities that the ring-fencing regime does not allow RFBs to undertake, namely dealing in investments as principal, commodities trading and having exposures to certain types of financial institutions known as RFIs. The Panel considered that the ring-fencing regime does not provide financial stability benefits for banks that undertake low levels of excluded activities.

3.14 The Panel proposed to introduce an additional threshold in the ring-fencing regime (a secondary threshold) set as a percentage of banks’ regulatory capital, whereby banks with a measure of excluded activities below that level would become exempt from the regime. The Panel suggested measuring excluded activities undertaken in a UK banking group, or the activities undertaken in the UK of a whole group, including branches, using an average of a three-year period and setting the threshold as 10% of tier 1 capital.

#### Proposal

##### Metrics

3.15 The government announced in December 2022 that, in line with the Panel’s recommendation, it would take banking groups without major investment banking operations out of the ring-fencing regime.

3.16 To implement this recommendation, the government proposes to use financial assets held for trading (trading assets) as a proxy for measuring banks’ investment banking operations. The government believes this is a more practical way of measuring investment banking activities as it uses existing accounting and regulatory concepts, with which banks should be familiar, rather than relying on the legislative definitions of “excluded activities”.

3.17 In general, under the ring-fencing regime, “excluded activities” relate to dealing in investments as principal and commodities trading; while “prohibited activities” relate to exposures to RFIs, payment services restrictions and other provisions. Together these can be referred to as “restricted activities”. The use of trading assets as a proxy for investment banking operations only covers excluded activities, i.e., it does not cover exposures to RFIs. The government believes that



measuring these types of exposures, alongside trading assets, would be impractical and deliver little benefit.

**3.18** Firms would be permitted to exclude from the calculation any trading assets that have been acquired under article 6(2) of the Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014/2080 (EAPO) (i.e., those that are used for a bank's own hedging purposes). This is to ensure that the proxy captures trading assets that best reflect those used for the purposes of investment banking-like activity.

### *Calibration*

**3.19** In line with the Panel's recommendation, the government proposes to calculate the secondary threshold as a ratio of trading assets over tier 1 capital and to set it at 10%:

$$\frac{\text{trading assets (excluding those acquired under article 6(2) EAPO)}}{\text{tier 1 capital}} = 10\%$$

Both trading assets and tier 1 capital will be measured as an average over a three-year period.

### *Approach to consolidation*

**3.20** Further in line with the Panel's recommendation, the scope of the proposed threshold will take into account all operations of a UK banking group (including overseas operations), and in the case of a foreign banking group headquartered abroad, all operations of its UK sub-group(s) (including overseas operations) and of any UK branches.

**3.21** This means that, where a UK bank is part of a UK headquartered banking group, both trading assets and tier 1 capital will be measured on a consolidated basis, at the highest UK consolidation level (i.e., across the UK consolidation group under UK Capital Requirements Regulation (UK CRR)).

**3.22** A foreign banking group may have multiple points of entry into the UK, via different subsidiaries of foreign companies in the group. Where this is the case, each UK sub-group should calculate its trading assets and tier 1 capital on a sub-consolidated basis, and the totals for each sub-group should be added together for the purposes of the secondary threshold.

**3.23** Where one of the UK sub-groups contains a bank, then UK CRR will likely already apply. Should a UK sub-group contain a different type of financial institution, such as an asset manager, then the proposed approach is to calculate trading assets and tier 1 capital on a sub-consolidated basis for that institution and its UK sub-group as if they were subject to UK CRR.

**3.24** Where trading assets are held by a UK branch of a foreign group company, and that branch is not part of the UK consolidated group, then those trading assets will be aggregated with the total consolidated trading assets of the UK group (or UK sub-groups, as the case may be). For example, if a foreign banking group had a UK branch and two subsidiaries in the UK, then tier 1 capital would be measured in each subsidiary and aggregated to calculate the total. Trading

assets would be measured in both subsidiaries as well as the branch, and then aggregated to calculate the total.

**3.25** The government is seeking respondents' views on whether this approach to consolidation would be workable in practice. In the case where a UK sub-group is not subject to UK CRR, an alternative approach might be to apply the prudential regulatory consolidation and capital rules to which that sub-group is subject.

**3.26** Annex A provides stylised examples of various banking group structures and illustrates how the secondary threshold would be calculated in each case.

### *Global Systemically Important Banks*

**3.27** Banks that are part of G-SIBs, as defined by the Financial Stability Board (FSB), would not be eligible to be exempt from the ring-fencing regime as a result of the secondary threshold. This is to ensure that banks that are part of very large and complex banking groups whose activities may pose systemic risks remain subject to the ring-fencing regime. In other words, and in line with one of the core objectives of the ring-fencing regime to insulate retail deposits from shocks elsewhere in the financial system, this ensures that UK retail deposits over £35bn cannot be used to fund a G-SIB's global investment banking activities or be put at greater risk by those wider group activities.

### *Expected outcomes*

**3.28** Overall, this proposal, together with the proposed increase to the "core deposit" threshold (**Proposal A1**), means that the ring-fencing regime would apply to banks which:

- hold more than £35 billion of "core deposits"; and
- hold UK trading assets amounting to more than 10% of tier 1 capital and/or are part of a G-SIB.

**3.29** This proposal should support domestic competition by removing ring-fencing requirements from retail-focused banks and removing a barrier to growth for smaller, growing banks. The government and the Bank consider that this proposal should not materially increase financial stability risks in relation to retail-focused banks.

### *Additional considerations*

**3.30** The government intends to keep the calibration of the secondary threshold under review, taking into account any future changes to the regulatory landscape and structural trends in the banking sector as appropriate.

## **Question 2**

**(i) Do you agree that the proposed numerator for the secondary threshold – trading assets excluding those acquired under article 6(2) EAPO – is an appropriate proxy for banks' dealing as principal and commodities trading activity as defined by the ring-fencing regime?**

**(ii) Do you agree that using trading assets would be a more practical way of measuring the secondary threshold, rather than relying on the definition of excluded activities set out in legislation?**

**(iii) Are there any alternative metrics that you think would be better for the purposes of the secondary threshold? If so, explain what they are and what greater benefits they would offer.**

### **Question 3**

**Do you agree with the proposed calibration – at 10% of tier 1 capital – for the secondary threshold?**

### **Question 4**

**Do you agree with the proposal that banks that are part of G-SIBs should not be exempt from the ring-fencing regime as a result of the secondary threshold?**

### **Question 5**

**(i) Do you agree with the proposed approach to calculating tier 1 capital and trading assets on a consolidated basis under the requirements in UK CRR, and where UK CRR does not apply to a particular UK sub-group, to approach the calculations as if the financial institutions in the sub-group and the sub-group itself were subject to UK CRR?**

**(ii) Are there any other alternative approaches to consolidation that you would consider more appropriate – for instance, in the case of a UK sub-group not subject to UK CRR, to apply consolidation requirements in accordance with the applicable regulatory framework?**

## **A.3. De minimis threshold**

**Proposal A3 – Allow RFBs to incur an exposure of up to £100,000 to a single RFI at any one time.**

→ *Draft Statutory Instrument: see Article 3(12).*

### **Background**

**3.31** The Panel recommended introducing a 'de minimis threshold', set in line with the secondary threshold (see **Proposal A2**), to allow RFBs to carry out some limited amount of restricted activities up to that threshold. Any restricted activities above the de minimis level would be required to be placed in the group's NRFB, where the group exceeds the deposit threshold.

**3.32** The Panel considered that a de minimis threshold would help to avoid cliff-edges that could arise from the introduction of the secondary threshold. By providing RFBs more flexibility in the activities they can undertake, it would also ensure that banks outside the ring-fencing regime do not have an unfair competitive advantage over RFBs operating within the ring-fencing regime.

### **Proposal**

**3.33** The government agrees with the principles behind the Panel's recommendation to introduce more flexibility into the ring-fencing regime and to reduce the compliance burden for firms by allowing RFBs to undertake some limited levels of restricted activities.

3.34 However, the government considers that the Panel's recommendation would likely be very difficult to implement in practice. Restricted activities cover a wide range of activities which cannot be measured in a consistent and practical way, and therefore would be difficult to aggregate.

3.35 Instead, the government proposes to introduce a specific de minimis threshold to allow RFBs to incur a limited amount of exposures to RFIs. RFI exposures is an area where RFBs face a significant compliance burden and where the government considers that more flexibility is needed.

3.36 The ring-fencing regime currently prohibits RFBs from having any exposures to RFIs, such as other banks, certain insurers, or investment firms (subject to certain exemptions). This is to reduce financial interconnectedness and RFBs' exposure to shocks in the wider financial system that would undermine the objectives of the ring-fence.

3.37 That said, firms reported to the Panel the disproportionate compliance and administrative burden in relation to small breaches, for example where an RFB inadvertently incurs an exposure e.g., credit card, to an RFI. The vast majority of breaches to the ring-fencing regime reported to the PRA have been in relation to RFI exposures, often these have been of immaterial value. Such small breaches are unlikely to pose any significant risks to the safety and soundness of RFBs, but they are required to report them in any case.

3.38 The government therefore proposes to allow RFBs to incur aggregate exposures of up to £100,000 to any individual RFI, given the generally low value of reported breaches. This could include multiple exposures to a single RFI provided that the total amount of exposure was not more than £100,000 at any one time. Setting the threshold at £100,000 should capture most of RFBs' small breaches in relation to RFI exposures, reducing the compliance and monitoring burden for firms, while ensuring that RFBs' exposures to RFIs remain limited so as not to increase risks to firms or depositors.

#### Additional considerations

3.39 The proposed de minimis threshold for RFI exposures should be read in conjunction with **Proposal C2** in this consultation to allow RFBs to incur exposures to an RFI where the RFI is an SME.

3.40 In addition to the de minimis threshold for RFI exposures, the government proposes to permit RFBs to undertake more types of activities, as set out in **Section C**.

#### Question 6

**(i) Do you agree with the proposal to allow RFBs to incur exposures of up to £100,000 to a single RFI at any one time?**

**(ii) Do you agree that this proposal would alleviate the compliance burden of the ring-fencing regime on firms?**

#### Question 7

**Do you agree that the Panel's de minimis threshold recommendation would not be easy to implement in practice? If you do not, please explain your rationale and any alternative options along with their benefits.**

## B. Architectural Reforms

### B.1. Geographical restrictions

#### **Proposal B1 – Allow RFBs to establish operations outside of the UK or EEA.**

→ Draft Statutory Instrument: see Article 2(2)(a)-(b); Article 2(3)(a)(i); Article 2(3)(b); Article 2(7); Article 3(13).

#### Background

3.41 The Panel recommended removing the geographic prohibition in the ring-fencing legislation that currently prevents RFBs from operating a subsidiary or branch outside of the UK or EEA.

3.42 The Panel noted that this restriction has limited RFBs' ability to service customers that are based outside the UK or EEA. The Panel also suggested that the prohibition has become redundant given that the UK has left the EU.

3.43 At the time the ring-fencing regime was introduced, the government acknowledged that this restriction could be eased in the future provided that cross-border resolution agreements with non-EEA countries' authorities were considered satisfactory by the Bank, as UK resolution authority.<sup>10</sup> Furthermore, the resolution framework for banks has evolved since then and RFBs must already consider their overseas activities (including those outside the EEA) when developing resolution plans.

#### Proposal

3.44 As announced in December 2022, and in line with the Panel's recommendation, the government proposes to remove these geographical restrictions on RFBs.

3.45 RFBs will be able to operate branches and subsidiaries outside of the UK or EEA, subject to PRA rules and/or requirements. This should support UK banks in competing internationally and UK businesses operating abroad. RFBs will be able to support clients in non-EEA jurisdictions and provide a broader range of services to UK-based clients.

3.46 The government considers that the Bank and PRA are best placed to judge risks associated with RFBs' overseas subsidiaries and branches, and that they can implement relevant safeguards in accordance with their statutory objectives. In particular, the PRA has the power to implement additional rules or requirements that it deems necessary to manage any risks to an RFB arising from its overseas operations.

#### Additional considerations

3.47 Alongside this consultation, the PRA is consulting on rules for RFBs' non-UK operations to further mitigate any risks that may arise from such activities.

3.48 Respondents should also note that when calculating the deposit threshold for determining whether a bank should become subject to the ring-fencing regime (see **Proposal A1**), deposits held in EEA branches of RFBs count toward

<sup>10</sup> HM Treasury, "[Banking reform: delivering stability and supporting a sustainable economy](#)", page 19, June 2012.

this threshold. In light of the removal of the non-EEA restriction, the method for calculating total core deposits should therefore apply globally to deposits held in any RFB branch.

### Question 8

**Do you agree with the proposal to allow RFBs to establish operations outside of the UK or EEA?**

## B.2. Mergers & acquisitions

**Proposal B2 – Introduce a four-year transition period for complying with the ring-fencing regime for ring-fenced banking groups that acquire a bank not subject to the ring-fencing regime.**

→ *Draft Statutory Instrument: see Article 2(4)(c).*

### Background

3.49 The Panel recommended introducing transitional periods for complying with ring-fencing rules for mergers and acquisitions (M&A) of banks outside of a resolution scenario.

3.50 The Panel highlighted what it believed to be a discrepancy in the current ring-fencing legislation regarding the use of transitional periods:

- if a bank crosses the core deposit threshold and becomes subject to the ring-fencing regime, it is allowed a four-year transition period to comply with the ring-fencing requirements;
- there is also a four-year transition period to comply with the regime for banking groups that, through M&A, cross the core deposit threshold;
- however, there is no transition period in the scenario where a ring-fenced banking group merges with or acquires a bank that is not subject to the ring-fencing regime, unless the acquired bank entered resolution at the time of the acquisition.

3.51 The panel noted that the lack of a transition period in this last scenario could impede M&A during the regular course of business or where a purchaser is sought to rescue a distressed bank before it enters resolution.

### Proposal

3.52 The government proposes that where a ring-fenced group acquires the shares of a banking group that is not subject to ring-fencing, a four-year transition period should be introduced to allow the expanded banking group time to comply with the ring-fencing regime. This should apply in all M&A scenarios, whether the acquired bank has entered resolution or not.

3.53 Providing such a transition period for banks acquired before resolution is necessary to facilitate the purchase of distressed banks by other banks and is consistent with the transition period that already applies where a bank is acquired after having entered resolution. The proposal should support financial stability as the pool of potential acquirers for a distressed bank, prior to resolution,

would increase if banking groups subject to ring-fencing could act as acquirers. It should also more generally facilitate RFBs' M&A with other banks, which should benefit the banking sector.

**3.54** Given the wide range of potential M&A transaction structures, the government proposes that the transition period applies where a bank which is not subject to ring-fencing is acquired by:

- an RFB or its subsidiaries;
- an NRFB or its subsidiaries; or
- a ring-fenced group's parent holding company.

**3.55** The government considers that the PRA should be best placed to supervise any risks arising from future bank M&A and has sufficient powers to impose controls relating to the acquisition (which may include indicating which side of the business (RFB or NRFB) should make the acquisition), if required. The PRA is already required to authorise change in control requests. In line with its safety and soundness objective, it may also consider at the same time any additional exercise of PRA powers that may be needed as a result of the change in control.

### Additional considerations

**3.56** On 13 March 2023, the RFB HSBC Bank UK plc (HSBC UK) acquired Silicon Valley Bank (SVB) UK. SVB UK had previously entered resolution, following the failure of its parent company.

**3.57** The government introduced statutory instruments on 13 March and 10 May 2023 which modified specific ring-fencing requirements in relation to the acquisition of Silicon Valley Bank UK Limited (SVB UK) by HSBC UK.<sup>11</sup> The modifications included allowing SVB UK to remain permanently exempt from the ring-fencing regime, subject to certain conditions, which goes beyond the four-year transition period that applied to SVB UK under the existing ring-fencing legislation. The two instruments have been approved by Parliament and were necessary to facilitate the sale of SVB UK to HSBC UK, and thereby to protect depositors, the UK's financial stability, and the public finances.

**3.58** Those modifications to the ring-fencing requirements are entirely separate from the proposals in this consultation and only apply in relation to HSBC UK's acquisition of SVB UK.

### Question 9

**Do you agree with the proposal to introduce a four-year transition period for complying with the ring-fencing regime where ring-fenced banking groups acquire another bank that is not subject to ring-fencing?**

<sup>11</sup> SVB UK was subsequently renamed HSBC Innovation Bank Limited.



## C. Permitted products and services

3.59 In December 2022, the government announced its intention, in line with the Panel's recommendations, to review and update the list of activities which RFBs are restricted from carrying out. The government said it would assess whether certain activities could be undertaken safely by RFBs in order to improve the supply of financial services to consumers and businesses.

3.60 The Panel identified a number of excluded activities where it considered that the restrictions in place can cause complexity and result in undesirable outcomes for customers. The government has made proposals regarding those activities, alongside several others identified as part of its review of excluded activities.

### Facilitating the provision of finance to SMEs

#### C.1. Equity investments

##### **Proposal C1 – Permit RFBs, subject to limits, to:**

- **make direct minority equity investments in UK SMEs;**
- **make investments in funds which invest predominantly in UK SMEs; and**
- **acquire equity warrants when providing loans to UK SMEs.**

→ *Draft Statutory Instrument: see Article 3(7) and Article 3(9)(d).*

#### Background

3.61 Equity financing enables companies to raise money through the sale of shares, either to its existing shareholders or to new investors. Estimates from the British Business Bank (BBB) suggest that the level of equity invested into the UK's smaller businesses in 2022 was £16.7bn.<sup>12</sup>

3.62 A key government priority is to support the growth of UK SMEs by facilitating the provision of finance to these firms. Established in 2014, the BBB aims to make finance markets for smaller businesses work more effectively, allowing those businesses to prosper, grow and build UK economic activity. The stock of finance supported through the BBB's core finance programmes was £12.2bn at the end of March 2022.

3.63 The government has also worked to close the finance gap for SMEs seeking to scale up. Following the Patient Capital Review in 2017, it established British Patient Capital (BPC) as a commercial subsidiary of the BBB to invest in late-stage venture and growth capital, with a 10-year mandate and initial government funding of £2.5bn. In June 2023, the Chancellor announced the Mansion House package to reform the pensions market with the aim of boosting returns and improving outcomes for pension fund holders whilst increasing funding liquidity for high-growth companies.

3.64 Current restrictions in the ring-fencing legislation can prevent RFBs from taking direct equity stakes in other companies, including SMEs, and from investing into funds that invest into such companies. The Panel identified this as an area for review, in particular RFBs' ability to invest in funds such as the

<sup>12</sup> BBB, [Small Business Equity Tracker 2023](#), June 2023.



Business Growth Fund (BGF) or Big Society Capital (BSC). These are two UK-based funds that notably invest equity in UK SMEs. In the case of the BGF, which is wholly owned by the UK's five largest banking groups, four of which are subject to the ring-fencing regime, current restrictions mean that only the NRFBs of these groups, rather than the RFBs, can own shares in the BGF.

**3.65** However, RFBs typically own the commercial banking relationships with SMEs, lending to them and holding their deposits, which may mean that RFBs would be well placed, and better placed than NRFBs, to invest in SMEs, either directly or indirectly via funds that invest in those firms.

## Proposal

**3.66** The government proposes to facilitate the provision of equity investments to SMEs by permitting RFBs to:

- make direct minority equity investments in UK SMEs, as defined by the UK CRR.<sup>13</sup> RFBs would be able to maintain their stake in the firm if it grew beyond being an SME, provided it met the SME definition at the point of investment;
- make investments into certain types of funds that invest predominantly in UK SMEs. This would be defined as funds (excluding funds of funds) which are alternative investment funds (AIFs) with a UK manager, which invest at least 70% of their capital in UK SMEs. This proposal is intended to only permit long-term capital-like investments by RFBs into UK SMEs, indirectly through investment funds, and will not permit RFBs to provide commercial loans or other banking services to those funds; and
- acquire equity warrants when providing loans to UK SMEs (i.e., outside of “debt for equity swap” scenarios as currently permitted). This will enable lenders to take warrants over shares in a borrower where this is agreed by the parties as part of a commercial loan transaction.

**3.67** The government proposes to cap the aggregate of these three types of activities to 10% of the RFB's consolidated tier 1 capital (consolidated at the highest UK group level).

**3.68** These proposals aim to support the growth of UK SMEs, through long-term investments either directly or indirectly via funds, which in turn should benefit the wider UK economy, innovation, and employment, in line with the government's wider economic priorities. In particular, the proposal relating to equity warrants is intended to incentivise RFBs to provide loans to SMEs to support their growth, as equity warrants provide a means by which RFB can benefit from a firm's growth in value.

**3.69** While equity investments may be considered relatively risky activities, the government and the Bank are of the view that permitting RFBs to make a limited amount of investments in SMEs, as well as funds that invest in UK SMEs, is

<sup>13</sup> Regulation (EU) No 2013/575 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (retained EU law) (Article 4(1)(128D)).

unlikely to materially increase risks to firms' safety and soundness and financial stability. The 10% of tier 1 capital cap on the level of those activities that RFBs can undertake would in any case limit the risks that may arise from those activities, which would also be mitigated by the relatively high capital requirements that apply to such investments. Given these protections, the government considers that the potential benefits to the economy and SMEs of permitting RFBs to undertake those activities outweighs the relatively limited risks they could pose to stability.

**3.70** The government acknowledges that other factors could restrict the provision of equity financing by RFBs, including the relatively high capital requirements that apply to these types of exposures. The government is therefore seeking respondents' feedback on the extent to which they consider that the proposals in this consultation could help to unlock financing to UK SMEs.

#### **Question 10**

**Do you agree with the proposal to permit RFBs to (i) make direct minority equity investments in UK SMEs, (ii) make investments in funds that invest predominantly in UK SMEs and (iii) acquire equity warrants in UK SME borrowers, up to 10% of tier 1 capital?**

#### **Question 11**

**To what extent do you think this proposal would help to unlock equity financing in the UK and address UK SMEs' financing needs? If responding as a ring-fenced group, would you undertake this type of activity?**

#### **Question 12**

**Is the UK CRR definition of SME viable as a size limit for equity investments, both directly and indirectly through funds? If you believe it is not, please suggest an alternative definition. The government is open to considering alternative definitions that may better reflect current market practices and investment strategies, provided that this supports the overall policy objective.**

#### **Question 13**

**On the proposal to permit investments in funds that invest predominantly in UK SMEs:**

**(i) what do you perceive as the risks and benefits of this proposal?**

**(ii) if responding as a ring-fenced group, can you provide further information on the type of funds you may consider investing in?**

**(iii) would you consider establishing a fund that meets the conditions set out in the draft secondary legislation?**

**(iv) do you consider that the proposed types of permitted funds capture those which are currently operating in UK SME markets?**

## C.2. Exposures to certain small financial institutions

### **Proposal C2 – Permit RFBs to have exposures to RFIs that qualify as SMEs.**

→ Draft Statutory Instrument: see Article 2(3)(a)(ii) and Article 3(3).

#### Background

3.71 RFBs are currently prohibited from having exposures to RFIs, subject to limited exceptions. RFIs generally include banks (apart from other RFBs), investment firms, structured finance vehicles, globally systemic insurers, funds (undertakings for collective investment in transferable securities and alternative investment funds), management companies and certain fund managers, and financial holding companies. This prohibition aims to reduce financial interconnectedness and RFBs' exposure to shocks in the wider financial system that would undermine the objectives of the ring-fencing regime.

3.72 The Panel noted that the constraints related to RFIs were the most cited issue by industry, suggesting that the list of institutions captured by the RFI definition was too broad, including firms such as high street independent financial advisors and mortgage brokers, that would not be considered high risk.

3.73 As a result, certain of these smaller low-risk RFIs may find it difficult to access banking services, including current accounts, overdrafts, loans and credit cards, as they cannot be served by RFBs. The Panel noted that NRFBs are not generally well-placed to provide services to small RFIs as their product offerings are suited to larger businesses.

#### Proposal

3.74 As announced in December 2022 and in line with the Panel's recommendation, the government proposes to update the definition of RFIs. This will enable RFBs to incur exposures to RFIs that are investment firms and meet the definition of an SME under the UK CRR. This should capture RFIs which have:

- an annual turnover not exceeding €50 million; and/or
- a balance sheet total not exceeding €42 million; and
- fewer than 250 employees.

3.75 Where an enterprise exceeds these thresholds, the government proposes that this should not result in the loss of the status of RFI SME unless the thresholds are exceeded over two consecutive accounting periods.

3.76 Similarly, the government proposes that the deposits of an RFI SME should not be considered "core deposits" and could be held by both RFBs and NRFBs.

3.77 This proposal should remove a barrier preventing some small businesses such as high street financial advisers from accessing financial services, by allowing them to be served by RFBs as well as NRFBs and removing a disproportionate compliance burden on banks.

#### Additional considerations

3.78 This proposal should be read in conjunction with the other proposal in this consultation to allow RFBs to incur de minimis exposures up to £100,000 to any single RFI (see **Proposal A3**).

### Question 14

**Do you agree with the proposal to permit RFBs to have exposures to RFIs that qualify as SMEs?**

## Other permitted products and activities

### C.3. Trade Finance

**Proposal C3 – Permit RFBs to undertake a wider range of standard trade finance activities.**

→ *Draft Statutory Instrument: see Article 3(10).*

#### Background

3.79 The ring-fencing legislation currently provides an exemption that allows RFBs to incur exposures to RFIs to support trade finance activity. However, some market standard trade finance products such as standby letters of credit (SBLCs) and bills of exchange do not always fall within scope of the current exemption. As a result, there is a degree of legal uncertainty as to the type of trade finance products RFBs are permitted to facilitate. This was one of the areas identified by the Panel for review.

#### Proposal

3.80 The government proposes to clarify that, where an RFB intends to engage in trade finance activities, it should be able to enter into a wider range of market standard arrangements. This includes SBLCs, bills of exchange and promissory notes, and arrangements which take place under a master agreement such as debt factoring.

3.81 In principle, an RFB should have a direct relationship with the customer involved in a trade finance transaction, whether that customer is an importer or exporter (or a buyer or seller, if the transaction is domestic). The objective of the proposed change is to widen the existing exemption so that it better reflects market practices.

3.82 The government is of the view that such clarification is in line with the original policy intent behind the exemption and should benefit RFBs and their customers.

### Question 15

**Do you agree with the proposal to clarify that RFBs can have exposures to RFIs where those are incurred to support standard trade finance activities?**

### Question 16

**Do you consider that there are any standard trade finance activities which should be permitted, but would not be permitted under the new exemption? If so, please explain why.**

## C.4. Debt restructuring

### **Proposal C4 – Broaden the scope of the existing exemption that permits RFBs to engage in “debt for equity swaps”.**

→ *Draft Statutory Instrument: see Article 3(6)(b)-(c).*

#### Background

**3.83** The current ring-fencing legislation allows RFBs to engage in “debt for equity swaps” – i.e., RFBs can accept equity in a company in return for releasing the company from a debt it owes to the RFB. This enables RFBs to restructure debt owed by its borrowers, to manage counterparty credit risk and increase the likelihood of recovering money where a borrower gets into financial difficulty.

**3.84** The Panel noted that the exemption may be too narrowly drawn as the need for an equity stake to be in direct exchange for a debt write-off means that RFBs are sometimes unable to support more complex restructurings. For example, the current exemption does not allow an equity stake in a company to be taken in return for further loan facilities being granted as part of a wider restructuring.

#### Proposal

**3.85** As announced in December 2022, and in line with the Panel’s recommendation, the government proposes to widen and clarify the scope of the exemption relating to “debt for equity swaps” to provide greater flexibility to RFBs and businesses to restructure loans when in financial difficulty. In particular, the government proposes that:

- an RFB should be able to exercise options or warrants which were issued by a borrower in return for a release of debt, such that equity in the borrower may subsequently be issued to the RFB without another release of debt being needed in return;
- a borrower should be able to issue options or warrants to an RFB as part of a restructuring of debt, but otherwise than in return for a release of debt, where those options or warrants are exercisable in return for a release of debt;
- a borrower should be able to issue equity, debentures, options or warrants to an RFB as part of a wider debt restructuring, other than directly in return for a release of debt (e.g., in exchange for the provision of further loan facilities, or amendments to the terms of an existing loan) provided that there is a release of debt as part of the overall restructuring; and
- in each case, the purpose of the restructuring would need to be to mitigate the financial difficulties of the borrower.

**3.86** This proposal should support the ability of RFBs to restructure borrowers’ debt to recover monies from struggling debtors, as originally intended by the ring-fencing legislation. The government intends to make clear that the exemption should only apply where the borrower is in financial difficulties, so as to maintain the objectives of the exemption.

## Additional considerations

3.87 Where an RFB acquires equity in a UK SME by exercising warrants issued under this provision, this will not count towards the limit outlined in **Proposal C1**.

### **Question 17**

**Do you agree with the proposal to broaden the scope of the exemption that permits RFBs to engage in “debt for equity swaps”?**

### **Question 18**

**Do you consider it necessary for there to be a requirement for a release of debt as well as a financial difficulties safeguard?**

### **Question 19**

**Do you consider that a more specific test than “financial difficulties” would be helpful?**

### **Question 20**

**Are there any circumstances in which shares or other instruments would be issued as part of a debt restructuring, where no release of debt takes place (e.g., where shares are issued in consideration for other amendments to the loan terms)?**

### **Question 21**

**Are there any transaction structures which have been provided for in the new exemption, which you consider unlikely to arise in practice (e.g., where warrants or options are issued which are exercisable on a release of debt)?**

### **Question 22**

**Are there any other standard ways of structuring a “debt for equity swap” which are not captured in this proposal? If so, please explain what they are and provide evidence as to why they should be captured by the exemption.**

## **C.5. Servicing central banks**

### **Proposal C5 – Permit NRFBs to service central banks outside of the UK.**

→ *Draft Statutory Instrument: see Article 2(3)(a)(iii)-(iv).*

### Background

3.88 The Panel recommended that NRFBs should be allowed to service central banks outside of the UK.

3.89 Prior to the UK leaving the European Union (EU), the central bank of an EEA State other than the UK, or the European Central Bank (ECB) were allowed to place deposits at a NRFB. During the process of onshoring EU legislation, this provision was removed. The consequence is that EEA central banks and the ECB can only be serviced by an RFB and cannot place deposits with an NRFB. As a

result, they are often unable to access certain products or services that RFBs are restricted from providing under the ring-fencing regime.

### Proposal

**3.90** In line with the Panel's recommendation, the government proposes to permit NRFBs to hold the deposits of, and provide services to, any central bank outside of the UK. This aims to address an unintended consequence caused by the onshoring of EU legislation, and as such, should not pose risks to financial stability.

**3.91** The proposal will enable NRFBs to provide services to these entities which are better suited to their needs and ensure that central banks are able to access the products and services they require more easily.

### Question 23

**Do you agree with the proposal to permit NRFBs to service central banks outside of the UK?**

### Question 24

**Are there any other multilateral and/or multinational organisations that should be included? If so, please provide further detail.**

## C.6. Inflation swaps

### Proposal C6 – Permit RFBs to offer inflation swap derivatives.

→ *Draft Statutory Instrument: see Article 3(8)(a)(iii) and (b).*

### Background

**3.92** An RFB is not permitted to deal in derivatives unless an exemption applies, for instance in relation to currency swaps and interest rate swaps. The Panel noted that the regime does not provide an exemption for inflation swaps which are often used in project finance transactions.

**3.93** Project finance is a commercial financing arrangement whereby the capital output of a project – usually infrastructure or public services – is used to meet debt obligations to creditors while also acting as security for the loan. Project finance transactions can be highly exposed to inflation risk, since the contractual agreements involved in the financing of large projects are often linked to an inflation index. As such, these transactions typically use inflation swaps for long-term hedging purposes. As an RFB cannot trade such swaps, it would have to ask the NRFB in its group to enter into the trade with the client. The Panel considered that this creates friction for the banks and their customers and identified this as an area for review.

### Proposal

**3.94** In line with the Panel's suggestion, the government proposes to allow RFBs to offer inflation swap derivatives to customers who wish to hedge against inflation risk. This will allow RFBs to offer a broader range of products, benefitting their customers.



### Question 25

**Do you agree with the proposal to permit RFBs to offer inflation swap derivatives?**

## C.7. Mortality risk and lifetime mortgages

### **Proposal C7 – Permit RFBs to hedge mortality risk.**

→ *Draft Statutory Instrument: see Article 3(2)(b); Article 3(6)(a) and Article 3(9)(b).*

#### Background

3.95 The ring-fencing legislation currently prohibits an RFB from hedging mortality risk. Mortality risk is the risk that a bank takes if a customer dies sooner than expected, which reduces the future payments of interest on the loan and so impacts the bank's anticipated future source of revenue.

3.96 Mortality risk usually applies in the context of equity release products such as lifetime mortgages. An equity release is a financial product which enables a homeowner to take cash out of their home without having to move, and most commonly this is done via a lifetime mortgage.

3.97 The Panel noted that it is not commercially viable for RFBs to provide this product since they cannot appropriately manage the mortality risk associated with it. The other main risks associated with lifetime mortgages are interest rate risk, residential property prices, and liquidity risk, which RFBs are permitted to manage.

#### Proposal

3.98 As announced in December 2022 and in line with the Panel's suggestion, the government proposes to allow RFBs to hedge mortality risk.

3.99 This would enable RFBs to offer products such as lifetime mortgages or equity release products to their customers. This should support competition in those markets and benefit customers through the impact on choice, pricing, and quality of product.

### Question 26

**Do you agree with the proposal to permit RFBs to hedge mortality risk?**

## C.8. Share dealing errors

### **Proposal C8 – Permit RFBs to deal in investments as principal for the purpose of correcting the failure of a securities trade which is due to error.**

→ *Draft Statutory Instrument: see Article 3(6)(e).*

#### Background

3.100 An RFB is permitted to deal in investments as agent, meaning that it is allowed to buy and sell securities when it acts as a broker on behalf of its customers. While acting as a broker, sometimes systems and processing errors



can risk the failure of a customer's security trade to be executed, in which case an RFB may wish to step in on behalf of its client and complete the trade. However, to do so an RFB would need to deal as principal, not agent.

**3.101** The Panel highlighted that current exemptions do not allow RFBs to deal as principal for the purpose of correcting a failure of a securities trade due to an error on behalf of one of the participants to a transaction.

**3.102** This results in inflexibility for RFBs and poor outcomes for their customers, whereby it is not possible to correct inadvertent systems and processing errors which cause them to fail.

### Proposal

**3.103** The government proposes to allow RFBs to deal in investments as principal for the purpose of correcting the failure of a securities trade which is due to error.

**3.104** Where an RFB intends to rescue a customer trade which would otherwise fail due to an inadvertent systems or operating error, it will be able to execute the trade as principal. The security would have to be allocated to the relevant customer as soon as practicable following acquisition.

**3.105** This should improve the functioning of the ring-fencing regime and efficiency of intermediating trades.

### Question 27

**Do you agree with the proposal to permit RFBs to deal as principal for the purpose of correcting the failure of a securities trade which is due to error?**

### Question 28

**Do you agree with the proposal that a security should be allocated as soon as practicable following acquisition?**

## C.9. Test trades

**Proposal C9 – Permit RFBs to deal in investments as principal for the purpose of undertaking test trades.**

→ *Draft Statutory Instrument: see Article 3(6)(e).*

### Background

**3.106** The Panel noted that the ring-fencing legislation prevents RFBs from dealing in investments as principal, including for the purpose of testing new products or services. The Panel identified this as an area for review.

**3.107** Where an RFB plans to launch a new product, service, or enhance an existing platform for customers, it may want to undertake live test trades to ensure a product is working as intended, as well as assess and mitigate potential operational issues associated with the product or service.

**3.108** Since test trades involve dealing in investments as principal, RFBs are prevented from undertaking such tests, even for a nominal amount such as £1.

Conversely, NRFBs are permitted to undertake test trades for new products and services since they are not subject to the same restrictions.

## Proposal

**3.109** The government proposes to allow RFBs to deal as principal for the purpose of undertaking test trades. The new exception should apply to the following securities:

- shares;
- instruments creating or acknowledging indebtedness;
- government and public securities; and
- units in a collective investment scheme.

**3.110** An RFB will be permitted to deal as principal in the lowest possible denomination for the purposes of conducting a test trade. Where it is not possible to trade one security, an RFB should trade the lowest possible amount of that security. For example, it may only be possible to buy a minimum number of units in a certain fund, or a broker may only permit a minimum number of equities.

**3.111** Any purchased security must be sold as soon as practicable, and this will be permitted as an exception to the prohibition on dealing as principal.

**3.112** RFBs will not be required to monitor the amount of aggregate test trades as this would place an undue burden on RFBs.

**3.113** Where an RFB or member of its group intends to launch a new service or product, it will be able to conduct test trades, if and only if the purpose of the trade is to test the relevant service or product.

**3.114** This proposal should facilitate the launch of new services of products and services by RFBs, thereby improving the functioning of the ring-fencing regime.

### Question 29

**Do you agree with the proposal to permit RFBs to deal in investments as principal for the purpose of undertaking test trades?**

### Question 30

**Are counterparties during test trades sometimes RFIs? If so, would a new RFI exemption need to be introduced for the purposes of conducting test trades? Or would the proposed £100,000 RFI exposure de minimis be sufficient?**

## C.10. Divestments

**Proposal C10– Permit RFBs to deal in investments as principal where they are divesting debentures.**

→ *Draft Statutory Instrument: see Article 3(6)(d).*

## Background

3.115 The Panel noted that although the ring-fencing regime provides for several exceptional situations in which an RFB is allowed to acquire shares and debentures (a financial instrument that operates like a bond), an RFB can be more limited in its capacity to sell or divest them.

3.116 The regime currently does not allow an RFB to divest itself of a debenture acquired from an issuer where it relates to loans, credit, or guarantee. In such circumstances, the debenture and associated loan must be held to maturity.

3.117 This has the unintended consequence of limiting an RFB's ability to divest itself of both the loan and associated debenture in a portfolio sale i.e., when they are being sold together.

3.118 This can lead to situations where an RFB has to hold an investment for the long-term, regardless of market developments and whether that investment continues to meet the RFB's changing risk appetite.

## Proposal

3.119 The government proposes that RFBs should be able to deal in investments as principal where they are divesting i.e., selling a debenture where the loan, credit, or guarantee and the debenture are being sold together.

3.120 This will remove unnecessary frictions currently being caused by the regime, allowing RFBs to better manage their investments in line with their risk appetite, and respond to market conditions.

### Question 31

**Do you agree with the proposal to permit RFBs to deal in investments as principal when they are divesting debentures in the circumstances outlined above?**

## C.11. Trustee services

**Proposal C11 – Clarify that RFBs may incur exposures to RFIs when they act as a trustee for minors or charitable incorporated organisations.**

→ *Draft Statutory Instrument: see Article 3(11).*

## Background

3.121 RFBs are permitted to deal in investments as principal when acting as trustee for or on behalf of any individual, minor, charity or Charitable Incorporated Organisation (CIO).<sup>14</sup> However, the Panel highlighted that the legislation only permits RFBs to incur exposures to RFIs when acting as trustee for or on behalf of any individual or charity.<sup>15</sup>

<sup>14</sup> Article 6(7) EAPO.

<sup>15</sup> Article 19(7) EAPO.

## Proposal

3.122 The government proposes to clarify that RFBs may incur exposures to RFIs when acting as trustee on behalf of minors and CIOs, aligning the RFI exemption with the dealing as principal exemption.

3.123 The government considers that this proposal should benefit RFBs' customers, minors, and CIOs, without posing risks to financial stability. When a bank acts as trustee, it is not itself taking on risk in relation to trust assets. Instead, the trust beneficiary holds the risk of loss to trust assets from, for instance, investments underperforming.

## Additional considerations

3.124 The Panel also suggested that RFBs should be able to act as trustee on behalf of other types of entities such as companies. However, there is currently insufficient evidence to justify extending the current exceptions in the existing ring-fencing legislation to include companies. Additionally, the government is not aware of this being an issue in practice for banks that are subject to the ring-fencing regime and is therefore not seeking to broaden the existing exemption.

3.125 Lastly, the Panel noted that the current exemptions do not reference nominees in Scotland. The government is aware of the Trusts and Succession (Scotland) Bill currently before the Scottish Parliament and seeks respondents' views as to whether further provision should be made for nominees in Scotland.

### Question 32

**Do you agree with the proposal to clarify that RFBs may incur exposures to RFIs where they act as trustees for minors or CIOs?**

### Question 33

**Do you consider that further provision needs to be made for nominees in the exemptions that allow RFBs to deal in investments as principal and incur RFI exposures when acting as trustee?**

## C.12. Derivatives

### **Proposal C12 – Clarify that RFBs are permitted to offer certain collars.**

→ *Draft Statutory Instrument: see Article 3(8)(a)(ii).*

## Background

3.126 Evidence collected by the Panel indicated that some RFBs considered that the current restrictions on the types of derivatives they can deal in as principal are too narrow and do not allow them to provide all the types of derivative products their customers require. Some RFBs argue that this results in additional complexity and inefficiency for them and their customers, whereby RFBs must involve NRFBs to enable their customers to hedge certain types of risk. This appears to be particularly an issue for financial products relating to foreign exchange (FX) and interest rate risk.

## Proposal

3.127 The government has assessed the various types and tenors of derivatives that RFBs are and are not permitted to provide under the existing ring-fencing legislation and is of the view that the current restrictions remain broadly appropriate. Any material easing of restrictions on derivatives could significantly increase risks to RFBs.

3.128 However, the government has identified one type of FX derivative product, “FX collars”, where it proposes to clarify the existing ring-fencing legislation.

3.129 An FX collar is a forward hedging strategy that uses options and can be referred to by different names (e.g., Cap and Floor, Range Forward, Corridor). If the collar were viewed as two separate transactions (as it has two ‘legs’), rather than being seen as a single ‘agreement,’ then one, strict, interpretation of the existing ring-fencing legislation may result in the view that it is not permitted for RFBs to offer these products.

3.130 The government proposes to put beyond doubt in the legislation that RFBs are permitted to offer FX collar products, regardless of whether they are viewed as single agreements. The government considers that this clarification should not increase risks to financial stability, while ensuring that RFBs are permitted to offer a wider range of derivative products to their clients.

## Additional considerations

3.131 The government is separately seeking more evidence from stakeholders on restrictions currently applying to the offering of structured FX derivative products by RFBs (see **Issue 7**).

### Question 34

**Do you agree with the proposal to clarify that RFBs may offer certain collar products? Do you agree that the proposed legislative change will achieve this?**

## D. Definitions and technical amendments

3.132 In December 2022, the government announced its intention to take forward technical amendments identified by the Panel to improve the functioning of the regime. This section sets out the government’s proposals in this area. Most of the proposals relate to proposed clarifications to the definition of an RFI and associated rules and aim to address unintended consequences in the existing ring-fencing legislation.

### D.1. Structured finance vehicles

**Proposal D1 – Provide that a structured finance vehicle (SFV) qualifies as a sponsored SFV of an RFB where its assets were created or acquired by that RFB or another RFB in the same group.**

→ *Draft Statutory Instrument: see Article 3(4) and Article 3(5).*

## Background

3.133 Under the ring-fencing legislation, RFBs are prevented from incurring exposures to an SFV, which are a type of RFI. This is to limit RFBs' exposures to risks from the wider financial sector that may arise from SFVs whose purpose is to receive and hold financial assets from a range of market participants.

3.134 There are, however, exemptions for SFVs which are sponsored by an RFB, where the SFV only holds assets originating from the RFB. RFBs typically use sponsored SFVs to fund certain types of lending products.

3.135 The Panel highlighted that the current definition of sponsored SFVs and rules relating to the exemptions are potentially unclear and complex. The Panel identified a potential unintended consequence of the existing legislation as the exemption of sponsored SFVs applies in respect of assets originated by the RFB or its subsidiaries, but not by another ring-fenced body in the same group. Additionally, there is a perceived lack of clarity as to whether an RFB is entitled to make use of the sponsored SFV exemptions to securitise assets where the RFB has acquired these assets from a third party.

## Proposal

3.136 The government proposes to clarify that an SFV will qualify as a sponsored SFV where the SFV's assets were created or acquired by the RFB or its subsidiaries or by another ring-fenced body in the same group.

3.137 In addition, the government proposes to clarify that it would treat assets which the RFB acquired in the same way as assets it originated itself, since any acquisition of assets would be subject to the ring-fencing requirements.

3.138 This proposal should facilitate the use of sponsored SFVs by RFBs, thereby supporting RFB's lending to the real economy.

### Question 35

**Do you agree with the proposal to provide that an SFV qualifies as a sponsored SFV of an RFB where its assets were created or acquired by that RFB or by another RFB in the same group?**

## D.2. Correspondent banking definition

**Proposal D2 – Clarify that RFBs are permitted to incur exposures to RFIs where the exposure arises from correspondent banking arrangements, which involve more than two credit institutions.**

→ *Draft Statutory Instrument: see Article 3(2)(a).*

## Background

3.139 RFBs are not permitted to incur exposures to RFIs, but there is an exemption for exposures arising from the provision of money transmission, including correspondent banking.

3.140 Correspondent banking is currently defined in legislation as an arrangement between two credit institutions pursuant to which one such entity provides payment services to the clients of the other entity, on its behalf.

3.141 The Panel highlighted a number of concerns raised by stakeholders about the definition. These were that correspondent banking arrangements may involve more than two credit institutions, the entities involved may not always be “credit institutions,” the services are not always provided directly to the client, and the services do not always constitute money transmission.

### Proposal

3.142 The government proposes to amend the definition of “correspondent banking” to clarify that relationships and transactions can involve more than two credit institutions.

3.143 This change in definition should enable RFBs to incur exposures to RFIs for the purposes of correspondent banking, as intended by the original legislation.

3.144 The government is not proposing any further changes to the definition of correspondent banking for the following reasons:

- the Basel Committee on Payment and Market Infrastructures defined correspondent banking in general terms as an arrangement under which one bank holds deposits owned by other banks and provides payment and other services to those other banks.<sup>16</sup> Deposits are therefore necessary in order to provide banking and/or payment services as part of a correspondent banking arrangement and it is not clear what types of financial institutions, other than credit institutions, may be included in such arrangements;
- while the government agrees that correspondent banking can cover a wide range of services beyond payment services, for the purposes of the ring-fencing legislation, it is limited to payment services. This is to maintain financial stability by limiting the types of exposure RFBs may have to other financial institutions.

### Question 36

**Do you agree with the proposal to clarify that RFBs are permitted to incur exposures to RFIs where the exposure arises from correspondent banking arrangements, which involve more than two credit institutions?**

## D.3. Grace period for NRFBs

**Proposal D3 – Introduce a twelve-month grace period for NRFBs to move customers that are no longer classified as an RFI to RFBs.**

→ *Draft Statutory Instrument: see Article 2(3)(c).*

### Background

3.145 The Panel recommended introducing a grace period for NRFBs to move customers that are no longer classified as an RFI to an RFB. They considered that the absence of such a grace period creates a disproportionate monitoring and

<sup>16</sup> BIS, [Committee on Payments and Market Infrastructures](#), July 2016.

compliance process for NRFBs, potentially resulting in poor outcomes for customers.

**3.146** An RFI customer of an NRFB may cease to be an RFI, for instance, if a fintech business no longer wishes to provide investment activities and surrenders its licences to provide these services, or if an independent financial adviser business is restructured and no longer constitutes an investment firm. In that case, any deposits the former RFI customer holds with the NRFB would, unless another exemption applies, become “core deposits” for the purposes of the ring-fencing regime and would need to be held by an RFB.

**3.147** The current absence of a grace period means that the banking group would be immediately in breach of the ring-fencing regime at the point at which the customer ceases to be an RFI, unless another exemption applies. By contrast, where a customer of an RFB becomes an RFI, the RFB has twelve months to transfer the deposits to an NRFB.

**3.148** The current position can result in poor outcomes for customers as the NRFB may request information from a customer on a continuous basis to determine whether it is an RFI. There is also a concern that this might result in the loss of banking services for customers, as an NRFB may decide to immediately “de-bank” the customer so as not to be in breach of the regime, rather than move its deposits to an RFB.

### Proposal

**3.149** In line with the Panel’s recommendation, the government proposes to introduce a twelve-month grace period for NRFBs to move to their RFB customers that are no longer classified as an RFI and do not qualify under another exemption. As a result, an NRFB will not be required to report the reclassification of the RFI to the PRA.

**3.150** The introduction of a grace period should reduce the compliance burden without increasing risks to financial stability. This will allow NRFBs to assess the RFI status of customers on a regular but less intensive basis.

**3.151** The consequences of the NRFB failing to transfer the customer to the RFB within the grace period should be the same as the consequences for breaching the regime as it stands. This means that the bank should have to report the breach to the PRA, who would then be responsible for enforcement.

### **Question 37**

**Do you agree with the proposal to introduce a twelve-month grace period for NRFBs to move customers to RFBs that are no longer classified as an RFI?**

## **E. Areas where the government is seeking further evidence**

**3.152** The Panel made a number of recommendations where the government has found insufficient evidence to propose additional legislative changes. Therefore, respondents are invited to provide evidence on the areas outlined



below to support consideration of potential further legislative changes that would be taken forward with the proposals outlined earlier in the consultation.

## E.1. Notice of determination for onboarding

### **Issue 1 – The government is seeking views on whether to remove or keep the notice of determination requirement for onboarding NRFB customers.**

#### Background

3.153 The Panel recommended that the “notice of declaration” requirement for onboarding NRFB customers should be removed. It should be noted that this requirement was removed by the 2016 amendments to the Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014/1960 (CAO) and replaced with a “notice of determination” (NoD), which is the term this consultation uses. The effect of the NoD was that the NRFB must assess whether a potential client meets the criteria to bank with it, not the potential client.

3.154 If an NRFB wishes to take on a new customer, it is required to first collect a set of information from that customer. The NRFB must then provide the customer with a NoD notifying them that they meet the qualifying conditions to be banked by the NRFB and why the NRFB has made that decision. Within fourteen days of receipt of the notice of declaration, the customer can submit reasons why it believes the NRFB’s decision is a mistake.

3.155 The Panel noted that the primary purpose of the NoD was to facilitate the effective separation of RFBs and NRFBs by 2019, given the large volume of customers that needed to be moved. Now that separation has been completed, the Panel considered that this requirement was redundant.

3.156 The Panel further outlined that the requirement for NRFBs to issue a NoD to new clients can appear to unnecessarily lengthen the onboarding process and negatively affect new clients’ experiences.

#### Issue

3.157 While the government agrees that the NoD requirement was originally introduced to facilitate the separation between RFBs and NRFBs, it considers there may be some merit in maintaining the NoD.

3.158 If the NoD were removed in all circumstances, an NRFB would still need to assess whether a potential client meets the requirements to place its deposits in an NRFB. Therefore, it is unclear to what extent the NoD requirement creates a material additional burden on NRFBs. It may also be desirable to ensure that clients are informed which side of the ring-fence they are being banked.

3.159 Retaining the NoD requirement may also help to ensure customers have the opportunity to protest any decision by an NRFB to onboard them or not. In particular, the NoD may help to ensure that clients who may not be sophisticated enough to be banked by an NRFB are adequately protected and can argue that they should be banked by an RFB.

3.160 A number of industry participants have previously claimed that the fourteen-day period given to customers to agree or disagree with a determination made by an NRFB introduces a delay into the onboarding process which cannot be shortened. The government is unclear as to the reasons for this.

3.161 The government is therefore seeking views at this stage on the issue to gather further information before making a policy decision on whether or not to remove the NoD requirements.

### **Question 38**

**Do you consider that the NoD requirement should be removed for onboarding NRFB customers, and if so, why?**

## **E.2. Status of trustees and insolvency practitioners**

**Issue 2 – The government is seeking views on whether the status of trustees and insolvency practitioners under the ring-fencing regime needs to be clarified.**

### **Background**

3.162 The Panel recommended clarifying that insolvency practitioners and trustees could be served by RFBs or NRFBs, or both depending on the circumstances.

3.163 Under the ring-fencing regime, deposit accounts of individuals – other than those for high-net-worth individuals – are generally required to be placed in an RFB. Insolvency practitioners are individuals and trustees can be individuals, and as such likely to be required to bank at an RFB, but they are also relatively sophisticated clients, who may require access to banking services that RFBs cannot provide. Therefore, it is potentially unclear whether they can also be banked by an NRFB.

3.164 The Panel noted that for insolvency practitioners, when a company (or in exceptional cases a wealthy individual or partnership) that banks with an NRFB becomes insolvent, the insolvency practitioners usually need to operate accounts with the NRFB too. This can lead to them requiring separate accounts with an RFB and NRFB in respect of the same insolvency arrangement.

3.165 The Panel also noted that for trustees, that are most often individuals, sometimes acting as trustees for relatively large and sophisticated trusts such as pension schemes, it is unclear if they qualify to be banked by NRFBs.

### **Issue**

3.166 The government is unclear as to why this is an issue in practice. Where a trustee or insolvency practitioner opens an account on behalf of the trust or insolvent company (or wealthy individual or partnership), it is expected that the test should apply to that trust or company (or other relevant person) rather than the individual circumstances of the trustees or insolvency practitioner. The government is therefore seeking views on whether the status of trustees and insolvency practitioners in the ring-fencing regime needs to be further clarified.

### Question 39

**Do you agree with the description of the issue relating to the status of trustees and insolvency practitioners?**

### Question 40

**Please provide an assessment of how significant an issue this is for you. Do you face issues providing or accessing banking services on either side of the ring-fence?**

## E.3. Conduit vehicles

**Issue 3 – The government is seeking views on whether the definition of “conduit vehicles” in the ring-fencing legislation should be amended.**

### Background

3.167 The Panel suggested that the definition of “conduit vehicles” in the ring-fencing legislation may need to be clarified. Conduit vehicles are special purpose vehicles established or operated for the benefit of a third-party to acquire, hold, and manage assets, or make loans or provide financial products.

3.168 The ring-fencing legislation permits an RFB to incur an exposure to an RFI in respect of two types of conduit lending arrangements: (i) so-called “A” conduit vehicles (ACVs) where conduit lending is established by or operated for the benefit of a third-party that is not the RFB; and (ii) so-called “D” conduit vehicles (DCVs) where the conduit lending is established by or operated for the benefit of the RFB.

3.169 However, there are differences in how the two types of conduit lending arrangements are treated regarding general exemptions to excluded activities, and exemptions related to securitisation and covered bonds. The Panel noted that the justification for these distinctions was not immediately apparent.

### Issue

3.170 The government is of the view that the way the exemptions in the ring-fencing legislation apply with respect to each type of conduit lending arrangement is consistent with the policy intention: i.e., where it reduces the risk to the RFB rather than increases an RFB’s exposure to a third party.

3.171 ACVs are those which have been set up by an RFB’s non-RFI client to hold assets acquired from the client which act as security for a loan from the RFB. Provided the conditions in article 17(1)(a) and (b) EAPO are met, the RFB can have an exposure to an ACV.

3.172 Although an ACV is an RFI, it has been established by a non-RFI client, solely to make enforcement of the security for the RFB’s loan simpler in the event of default. The provisions prevent discrimination between different forms of secured lending according to their legal form.

3.173 As the purpose of the exposure to an ACV is merely to facilitate the perfection of the security for the loan, the exposure is targeted at mitigating default risk. Given that the exposure is permitted only to mitigate default risk, it is logical that ACVs are not included within the exemptions in articles 6(1) and 7(1)

EAPO but that DCVs be included. That is, a “D” conduit vehicle is a member of the RFB’s group, whereas the “A” conduit vehicle is a third-party legal entity.

3.174 The government is therefore seeking further views on the justification and any potential issues arising from this distinction between the two types of conduit lending arrangements.

#### **Question 41**

**Do you agree with the description of the issue relating to the definition of “conduit vehicles”?**

#### **Question 42**

**Is there any further evidence or reason for why this definition should be amended? If so, what changes would you propose making?**

## **E.4. Related undertakings**

**Issue 4 – The government is seeking views on whether the definition of “related undertakings” in the ring-fencing legislation should be amended.**

### **Background**

3.175 An RFB is allowed to undertake certain activities that are otherwise prohibited when it does so for the benefit of a subsidiary undertaking or “related undertaking” (i.e., a subsidiary undertaking of a parent undertaking that is subject to the group ring-fencing rules).

3.176 The Panel considered that the current definition does not allow such activities to be undertaken for an entity in which an RFB has a “participating interest”, which the Panel suggests normally means a stake equalling between 20-50% of a company’s equity.

3.177 The Panel suggests that it is potentially confusing to not permit RFBs to undertake activities in respect of those companies that it can undertake for its subsidiaries and related undertakings.

### **Issue**

3.178 The government has not seen sufficient evidence at this stage that the definition of “related undertakings” is inconsistent or confusing and needs to be changed. The current legislation draws a distinction between an RFB conducting activities for entities within the group, and an RFB undertaking activities for the benefit of others (e.g., clients and joint venture partners) over which it has far less control.

3.179 The government is therefore seeking further evidence on why amending this definition is necessary.

### **Question 43**

**Do you agree with the description of the issue relating to the definition of “related undertakings”?**

### **Question 44**

**Is there any further evidence or reason for why this definition should be amended? If so, what changes would you propose making?**

## **E.5. Qualifying organisations and groups for NRFBs**

**Issue 5 – The government is seeking views on whether the definition of “qualifying organisations” and a member of a “qualifying group” for NRFBs regarding charitable trusts, companies, and associations in the ring-fencing legislation should be amended.**

### **Background**

3.180 The Panel suggested that the definitions of “qualifying organisations” and “qualifying groups” for NRFBs in the ring-fencing legislation may need to be amended – particularly in the case of charitable trusts, companies, and associations.

3.181 According to the Panel, in many circumstances, charitable trusts, companies, or associations cannot be banked by an NRFB when they have been established by a group that is eligible to be banked with the NRFB. This then leads to such entities being ‘orphaned’ from the rest of their group who are banking with the NRFB. The Panel also suggested that organisations should be able to satisfy the tests to be banked by an NRFB on a prospective basis.

### **Issue**

3.182 Due to the unreliability of financial projections, the government is not seeking to make any amendments here. Additionally, the government is unclear as to how this issue materialises in practice, and therefore seeks further evidence on the case for amending the definitions.

### **Question 45**

**Do you agree with the description of the issue relating to the definition of qualifying organisations and groups?**

### **Question 46**

**Under what circumstances have you found, if any, that charitable trusts, companies, and associations established by a “qualifying group” cannot be banked by an NRFB?**

## **E.6 Global Systemically Important Insurer**

**Issue 6 – The government is seeking views on whether the reference to Globally Systemically Important Insurer in the definition of an RFI in the ring-fencing legislation should be amended.**

## Background

3.183 The definition of an RFI in the ring-fencing legislation includes Global Systemically Important Insurers (G-SIIs). This means that RFBs cannot have exposures to insurers that are designated as a G-SII. The purpose of the prohibition was to limit the risks of financial contagion from the insurers to RFBs.

3.184 The list of G-SIIs was maintained by the Financial Stability Board (FSB) but updating this list has been subsequently discontinued. The FSB may decide to restart maintenance of this list in 2025 when it conducts a review of its practices.<sup>17</sup>

## Issue

3.185 Given the ongoing uncertainty around whether the FSB's list of G-SIIs will be maintained, the government is seeking respondents' views on whether the reference to G-SIIs in the RFI definition should be amended.

3.186 For example, the definition of RFIs could refer to a new definition for large insurers, that would not rely on the FSB's G-SII list. Any new definition of large insurers would aim to achieve a similar outcome to the original ring-fencing legislation and provide certainty for RFBs and large insurers.

### Question 47

**Should an alternative definition of large insurers be introduced to replace the current reference to the FSB's G-SII list in the RFI definition?**

### Question 48

**Is the current reference to G-SII in the RFI definition still appropriate and should it therefore be retained?**

## E.7 Structured FX products

**Issue 7 – The government is seeking views on how the current ring-fencing legislation restricts RFBs from providing structured FX derivative products.**

## Background

3.187 Some RFBs argued that they should be permitted to provide structured FX derivative products to their clients. Structured FX products cover a broad range of financial instruments whose performance or value is linked to that of an underlying asset, product, or index.

## Issue

3.188 The government is seeking more detailed evidence from stakeholders on how the current regime prohibits them from providing particular structured FX derivative products.

<sup>17</sup> FSB, [The FSB endorses an improved framework for the assessment and mitigation of systemic risk in the insurance sector and discontinues annual identification of global systemically important insurers \(G-SIIs\)](#), December 2022.

### **Question 49**

**Do you consider that RFBs are unduly restricted under the existing legislation from providing structured FX products to their clients? If so, please provide detailed evidence on the relevant types of structured products and corresponding financial instruments, and how they are currently prohibited.**

## **E.8 Other areas**

3.189 There are a limited number of additional areas in the ring-fencing regime that the Panel recommended for review where the government is not considering making legislative amendments. These are technical definitions relating to the status of ownership interests in Limited Liability Partnerships (LLPs) and Collective Investment Schemes (CISs), the “default risk” exemption, when an exposure is “incurred”, the concept of account holder, the definition of “liquid assets,” and emission allowances. However, if stakeholders wish to provide evidence to justify a legislative change the government would welcome this.

### **Question 50**

**Are there other areas where you consider technical changes to the ring-fencing legislation regime are needed?**

# Chapter 4 Preliminary considerations for the Impact Assessment and Equalities Impact

## Impact Assessment

4.1 The proposals in this consultation aim to facilitate competition and competitiveness in the banking sector, benefitting banks and their customers, and remove unnecessary administrative burdens while maintaining appropriate financial stability safeguards.

4.2 The government is required to undertake an impact assessment of the proposed near-term reforms, considering the package of reforms as a whole, as well as individual proposals. The assessment will be published alongside the final secondary legislation that will give effect to the near-term reforms.

4.3 The impact assessment will notably cover the impact on:

- competition in the UK banking sector (both for assets and liabilities);
- the competitiveness of the UK banking sector;
- customers – both individuals and businesses; and
- the UK's financial stability.

4.4 The government will use evidence already gathered by the Panel which provided an overview of some of the expected benefits that would arise from implementing its recommendations. The Panel judged that its package of recommendations could be implemented without increasing risks to financial stability. It considered that the main benefits of the recommendations would be “to provide more flexibility to the authorities and banks so that they can adapt to customer needs using a forward looking, judgment-based approach, taking account of the associated risks as they evolve in a changing financial sector and economy.”<sup>18</sup>

4.5 The impact assessment will also include an assessment of the costs of implementing the reforms and will consider any potential unintended consequences and associated costs that any of the proposed reforms could have.

4.6 The government welcomes views from stakeholders on the potential costs and benefits of implementing the proposed near-term reforms to inform its impact assessment.

<sup>18</sup> RFPT, [Ring-fencing and Proprietary Trading Independent Review Final Report](#), March 2022.



### **Question 51**

**What do you expect the impacts to be of the proposed near-term reforms, in particular on:**

- (i) competition in the banking sector;**
- (ii) the competitiveness of banks;**
- (iii) customers (individuals and businesses); and**
- (iv) the UK's financial stability.**

### **Question 52**

**Do you expect any of the proposals in this consultation to lead to potential unintended consequences, including any associated costs, if implemented? If so, please provide detail.**

### **Question 53**

**For banks subject to ring-fencing, what do you expect the cost and benefits of implementing the proposed near-term reforms to be? Where possible please provide numerical values in pound sterling.**

## **Equalities Impact**

4.7 When developing its policy proposals, the government is required to comply with the Public Sector Equality Duty (PSED) in s.149 of the Equality Act 2010. The PSED requires the government to have due regard to the need to:

- eliminate discrimination;
- advance equality of opportunity; and
- foster good relations (between people who share a protected characteristic and people who do not share it).

4.8 The government will undertake a full assessment to fulfil its obligations under the PSED. Its preliminary view is that the proposals will not have an impact on those sharing protected characteristics.

### **Question 54**

**Do you agree with the provisional assessment that the government's proposed reforms will not have an impact on those sharing particular protected characteristics?**

### **Question 55**

**If you disagree, do you have any further data you can provide on the potential impacts on persons sharing any of the protected characteristics?**

# Chapter 5: Summary of questions

## Deposit threshold

**Question 1** – Do you agree with the proposal to increase the ring-fencing deposit threshold to £35 billion of core deposits?

## Secondary threshold

**Question 2** –

(i) Do you agree that the proposed numerator for the secondary threshold – trading assets excluding those acquired under article 6(2) EAPO – is an appropriate proxy for banks' dealing as principal and commodities trading activity as defined by the ring-fencing regime?

(ii) Do you agree that using trading assets would be a more practical way of measuring the secondary threshold, rather than relying on the definition of excluded activities set out in legislation?

(iii) Are there any alternative metrics that you think would be better for the purposes of the secondary threshold? If so, explain what they are and what greater benefits they would offer.

**Question 3** – Do you agree with the proposed calibration – at 10% of tier 1 capital – for the secondary threshold?

**Question 4** – Do you agree with the proposal that banks that are part of G-SIBs should not be exempt from the ring-fencing regime as a result of the secondary threshold?

**Question 5** –

(i) Do you agree with the proposed approach to calculating tier 1 capital and trading assets on a consolidated basis under the requirements in UK CRR, and where UK CRR does not apply to a particular UK sub-group, to approach the calculations as if the financial institutions in the sub-group and the sub-group itself were subject to UK CRR?

(ii) Are there any other alternative approaches to consolidation that you would consider more appropriate – for instance, in the case of a UK sub-group not subject to UK CRR, to apply consolidation requirements in accordance with the applicable regulatory framework?

## De minimis threshold

### Question 6 –

(i) Do you agree with the proposal to allow RFBs to incur exposures of up to £100,000 to a single RFI at any one time?

(ii) Do you agree that this proposal would alleviate the compliance burden of the ring-fencing regime on firms?

**Question 7** – Do you agree that the Panel's de minimis threshold recommendation would not be easy to implement in practice? If you do not, please explain your rationale and any alternative options along with their benefits.

## Geographical restrictions

**Question 8** – Do you agree with the proposal to allow RFBs to establish operations outside of the UK or EEA?

## Mergers & acquisitions

**Question 9** – Do you agree with the proposal to introduce a four-year transition period for complying with the ring-fencing regime where ring-fenced banking groups acquire another bank that is not subject to ring-fencing?

## Equity investments

**Question 10** – Do you agree with the proposal to permit RFBs to (i) make direct minority equity investments in UK SMEs, (ii) make investments in funds that invest predominantly in UK SMEs and (iii) acquire equity warrants in UK SME borrowers, up to 10% of tier 1 capital?

**Question 11** – To what extent do you think this proposal would help to unlock equity financing in the UK and address UK SMEs' financing needs? If responding as a ring-fenced group, would you undertake this type of activity?

**Question 12** – Is the UK CRR definition of SME viable as a size limit for equity investments, both directly and indirectly through funds? If you believe it is not, please suggest an alternative definition. The government is open to considering alternative definitions that may better reflect current market practices and investment strategies, provided that this supports the overall policy objective.

**Question 13** – On the proposal to permit investments in funds that invest predominantly in UK SMEs:

(i) what do you perceive as the risks and benefits of this proposal?

(ii) if responding as a ring-fenced group, can you provide further information on the type of funds you may consider investing in?

(iii) would you consider establishing a fund that meets the conditions set out in the draft secondary legislation?

(iv) do you consider that the proposed types of permitted funds capture those which are currently operating in UK SME markets?

## Exposures to small financial institutions

**Question 14** – Do you agree with the proposal to permit RFBs to have exposures to RFIs that qualify as SMEs?

## Trade finance

**Question 15** – Do you agree with the proposal to clarify that RFBs can have exposures to RFIs where those are incurred to support standard trade finance activities?

**Question 16** – Do you consider that there are any standard trade finance activities which should be permitted, but would not be permitted under the new exemption? If so, please explain why.

## Debt restructuring

**Question 17** – Do you agree with the proposal to broaden the scope of the exemption that permits RFBs to engage in “debt for equity swaps”?

**Question 18** – Do you consider it necessary for there to be a requirement for a release of debt as well as a financial difficulties safeguard?

**Question 19** – Do you consider that a more specific test than “financial difficulties” would be helpful?

**Question 20** – Are there any circumstances in which shares or other instruments would be issued as part of a debt restructuring, where no release of debt takes place (e.g., where shares are issued in consideration for other amendments to the loan terms)?

**Question 21** – Are there any transaction structures which have been provided for in the new exemption, which you consider unlikely to arise in practice (e.g., where warrants or options are issued which are exercisable on a release of debt)?

**Question 22** – Are there any other standard ways of structuring a debt for equity swap which are not captured in this proposal? If so, please explain what they are and provide evidence as to why they should be captured by the exemption.

## Servicing central banks

**Question 23** – Do you agree with the proposal to permit NRFBs to service central banks outside of the UK?

**Question 24** – Are there any other multilateral and/or multinational organisations that should be included? If so, please provide further detail.

## Inflation swaps

**Question 25** – Do you agree with the proposal to permit RFBs to offer inflation swap derivatives?

## **Mortality risk and lifetime mortgages**

**Question 26** – Do you agree with the proposal to permit RFBs to hedge mortality risk?

## **Share dealing errors**

**Question 27** – Do you agree with the proposal to permit RFBs to deal as principal for the purpose of correcting the failure of a securities trade which is due to error?

**Question 28** – Do you agree with the proposal that a security should be allocated as soon as practicable following acquisition?

## **Test trades**

**Question 29** – Do you agree with the proposal to permit RFBs to deal in investments as principal for the purpose of undertaking test trades?

**Question 30** – Are counterparties during test trades sometimes RFIs? If so, would a new RFI exemption need to be introduced for the purposes of conducting test trades? Or would the proposed £100,000 RFI exposure de minimis be sufficient?

## **Divestments**

**Question 31** – Do you agree with the proposal to permit RFBs to deal in investments as principal when they are divesting debentures in the circumstances outlined above?

## **Trustee services**

**Question 32** – Do you agree with the proposal to clarify that RFBs may incur exposures to RFIs where they act as trustees for minors or CIOs?

**Question 33** – Do you consider that further provision needs to be made for nominees in the exemptions that allow RFBs to deal in investments as principal and incur RFI exposures when acting as trustee?

## **Derivatives**

**Question 34** – Do you agree with the proposal to clarify that RFBs may offer certain collar products? Do you agree that the proposed legislative change will achieve this?

## **Structured finance vehicles**

**Question 35** – Do you agree with the proposal to provide that an SFV qualifies as a sponsored SFV of an RFB where its assets were created or acquired by that RFB or by another RFB in the same group?

## **Correspondent banking definition**

**Question 36** – Do you agree with the proposal to clarify that RFBs are permitted to incur exposures to RFIs where the exposure arises from correspondent banking arrangements, which involve more than two credit institutions?

## **Grace period for NRFBs**

**Question 37** – Do you agree with the proposal to introduce a twelve-month grace period for NRFBs to move customers to RFBs that are no longer classified as an RFI?

### **Notice of determination for onboarding**

**Question 38** – Do you consider that the NoD requirement should be removed for onboarding NRFB customers, and if so, why?

### **Status of trustees and insolvency practitioners**

**Question 39** – Do you agree with the description of the issue relating to the status of trustees and insolvency practitioners?

**Question 40** – Please provide an assessment of how significant an issue this is for you. Do you face issues providing or accessing banking services on either side of the ring-fence?

### **Conduit vehicles**

**Question 41** – Do you agree with the description of the issue relating to the definition of “conduit vehicles”?

**Question 42** – Is there any further evidence or reason for why this definition should be amended? If so, what changes would you propose making?

### **Related undertakings**

**Question 43** – Do you agree with the description of the issue relating to the definition of “related undertakings”?

**Question 44** – Is there any further evidence or reason for why this definition should be amended? If so, what changes would you propose making?

### **Qualifying organisations and groups for NRFBs**

**Question 45** – Do you agree with the description of the issue relating to the definition of qualifying organisations and groups?

**Question 46** – Under what circumstances have you found, if any, that charitable trusts, companies, and associations established by a “qualifying group” cannot be banked by an NRFB?

### **Global Systemically Important Insurer**

**Question 47** – Should an alternative definition of large insurers be introduced to replace the current reference to the FSB’s G-SII list in the RFI definition?

**Question 48** – Is the current reference to G-SII in the RFI definition still appropriate and should it therefore be retained?

## Structured FX products

**Question 49** – Do you consider that RFBs are unduly restricted under the existing legislation from providing structured FX products to their clients? If so, please provide detailed evidence on the relevant types of structured products and corresponding financial instruments, and how they are currently prohibited.

## Other areas

**Question 50** – Are there other areas where you consider technical changes to the ring-fencing legislation regime are needed?

## Impact assessment

**Question 51** – What do you expect the impacts to be of the proposed near-term reforms, in particular on:

- (i) competition in the banking sector;
- (ii) the competitiveness of banks;
- (iii) customers (individuals and businesses); and
- (iv) the UK's financial stability.

**Question 52** – Do you expect any of the proposals in this consultation to lead to potential unintended consequences, including any associated costs, if implemented? If so, please provide detail.

**Question 53** – For banks subject to ring-fencing, what do you expect the cost and benefits of implementing the proposed near-term reforms to be? Where possible please provide numerical values in pound sterling.

## Equalities impact

**Question 54** – Do you agree with the provisional assessment that the government's proposed reforms will not have an impact on those sharing particular protected characteristics?

**Question 55** – If you disagree, do you have any further data you can provide on the potential impacts on persons sharing any of the protected characteristics?

# Chapter 6 Responding to this consultation

6.1 This consultation will close on **26 November 2023**. The government is inviting stakeholders to provide responses to the questions set out in this document and to share any other views on the proposals being put forward. The government encourages responses from stakeholders who only wish to respond to a subset of the questions.

6.2 The government cannot guarantee that responses submitted after 26 November 2023 will be considered.

6.3 Please send responses to [ringfencing\\_review@hmtreasury.gov.uk](mailto:ringfencing_review@hmtreasury.gov.uk) or post to:

**Financial Stability Group**  
**HM Treasury**  
**Horse Guards Road**  
**London**  
**SW1A 2HQ**

6.4 When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make clear who the organisation represents and, where applicable, how the views of members were assembled.

## Processing of Personal Data

6.5 This section sets out how we will use your personal data and explains your relevant rights under the UK General Data Protection Regulation (UK GDPR). For the purposes of the UK GDPR, HM Treasury is the data controller for any personal data you provide in response to this consultation.

### Data subjects

6.6 The personal data we will collect relates to individuals responding to this consultation. These responses will come from a wide group of stakeholders with knowledge of a particular issue.

### The personal data we collect

6.7 The personal data will be collected through email submissions and are likely to include respondents' names, email addresses, their job titles, and employers as well as their opinions.

### How we will use the personal data

6.8 This personal data will only be processed for the purpose of obtaining opinions about government policies, proposals, or an issue of public interest. Processing of this personal data is necessary to help us understand who has responded to this consultation and, in some cases, contact certain respondents to



discuss their response. HM Treasury will not include any personal data when publishing its response to this consultation.

## Lawful basis for processing the personal data

6.9 The lawful basis we are relying on to process the personal data is Article 6(1)(e) of the UK GDPR; the processing is necessary for the performance of a task we are carrying out in the public interest. This task is consulting on the development of departmental policies or proposals to help us to develop good effective policies.

## Who will have access to the personal data

6.10 The personal data will only be made available to those with a legitimate need to see it as part of consultation process. We sometimes conduct consultations in partnership with other agencies and government departments and, when we do this, it will be apparent from the consultation itself. For these joint consultations, personal data received in responses will be shared with these partner organisations in order for them to also understand who responded to the consultation.

6.11 In this case, your full responses may be shared with the Bank, the PRA, and the FCA in order for them to be able to review the evidence.

6.12 As the personal data is stored on our IT infrastructure, it will be accessible to our IT service providers. They will only process this personal data for our purposes and in fulfilment with the contractual obligations they have with us.

## How long we hold the personal data for

6.13 We will retain the personal data until the consultation process has been completed and the policy is implemented. After this, we will only retain personal data if it is embedded in a response, but we will not use it for any unrelated purposes.

## Your data protection rights

6.14 You have the right to:

- request information about how we process your personal data and request a copy of it;
- object to the processing of your personal data;
- request that any inaccuracies in your personal data are rectified without delay;
- request that your personal data are erased if there is no longer a justification for them to be processed; and
- complain to the Information Commissioner's Office if you are unhappy with the way in which we have processed your personal data.

## How to submit a Data Subject Access Request (DSAR)

6.15 To request access to personal data that HM Treasury holds about you, contact:

**The Information Rights Unit**

**HM Treasury**

**1 Horse Guards Road**

**London**

**SW1A 2HQ**

**[dsar@hmtreasury.gov.uk](mailto:dsar@hmtreasury.gov.uk)**

## Complaints

6.16 If you have concerns about our use of your personal data, please contact the Treasury's Data Protection Officer (DPO) in the first instance at [privacy@hmtreasury.gov.uk](mailto:privacy@hmtreasury.gov.uk).

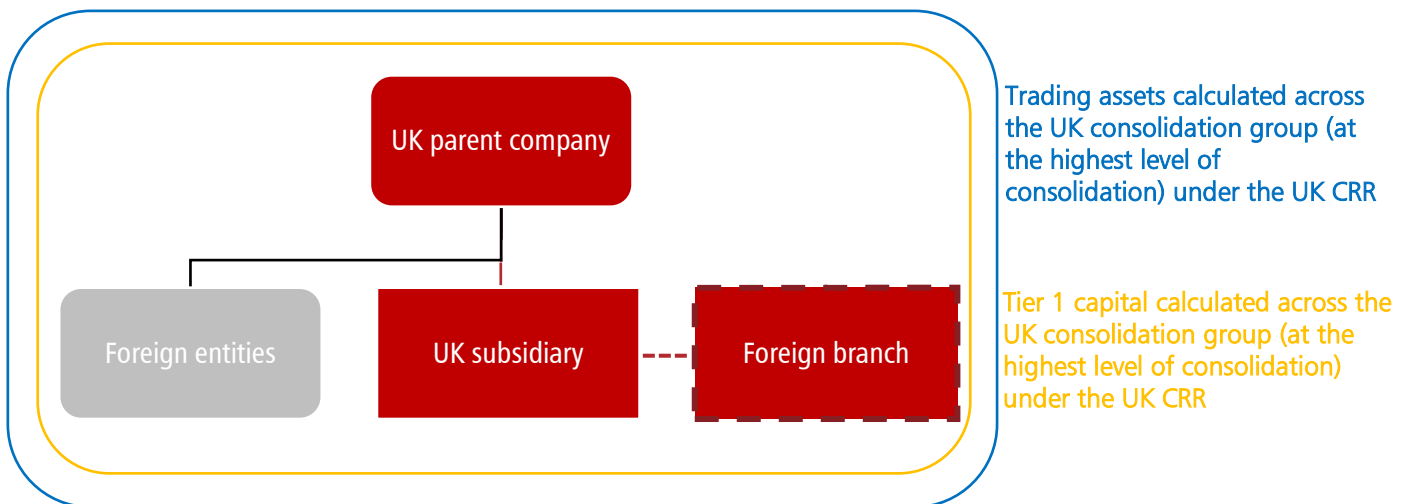
6.17 If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner at [casework@ico.org.uk](mailto:casework@ico.org.uk) or via this website: <https://ico.org.uk/make-a-complaint>.

# Annex A

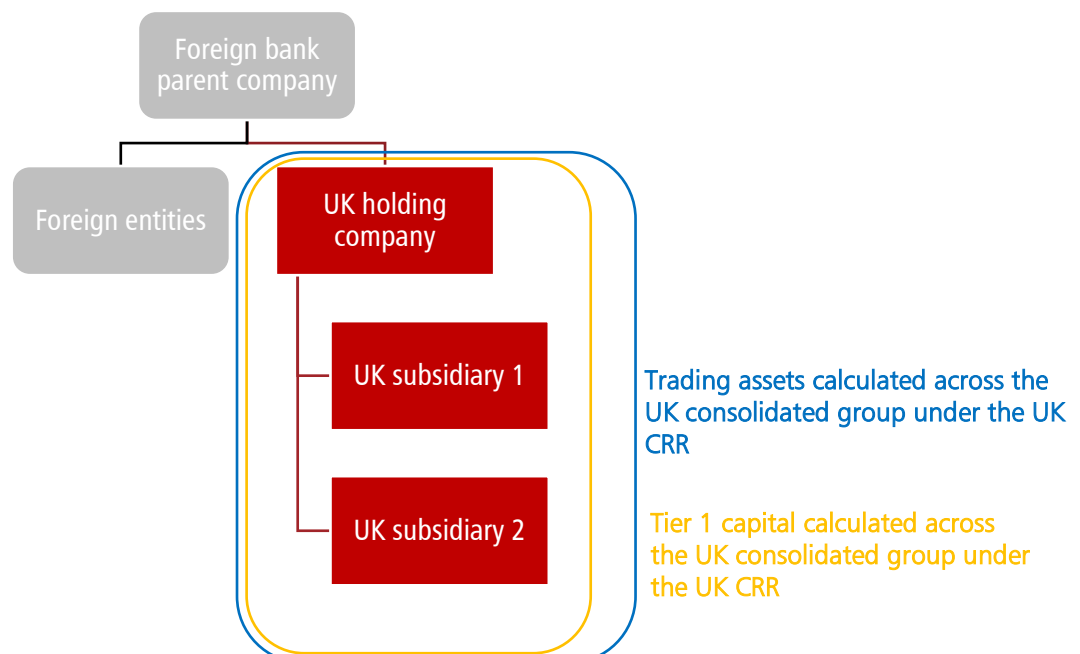
## Illustration of the secondary ring-fencing threshold calculation in a selection of stylised examples

Note: the subsidiaries and branches in the examples are assumed to be credit institutions, subject to UK CRR, unless otherwise specified.

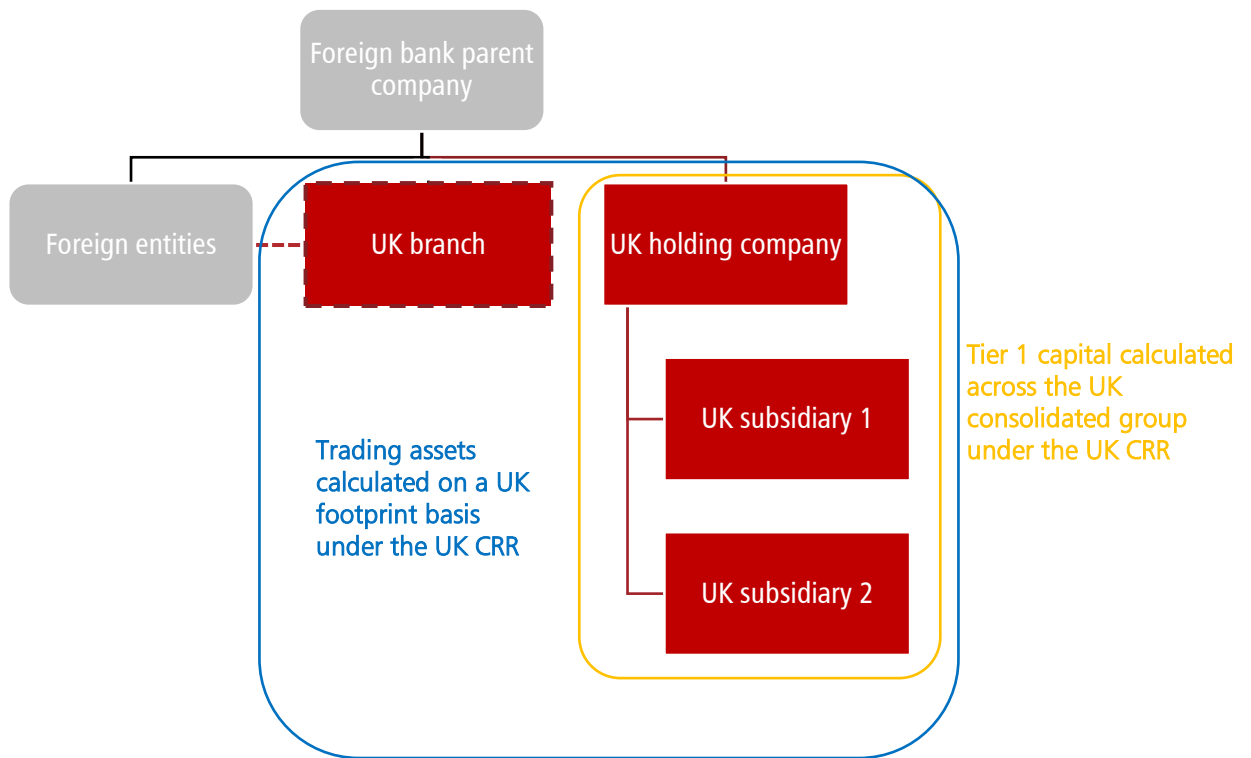
### Example 1 – UK banking group with an international footprint



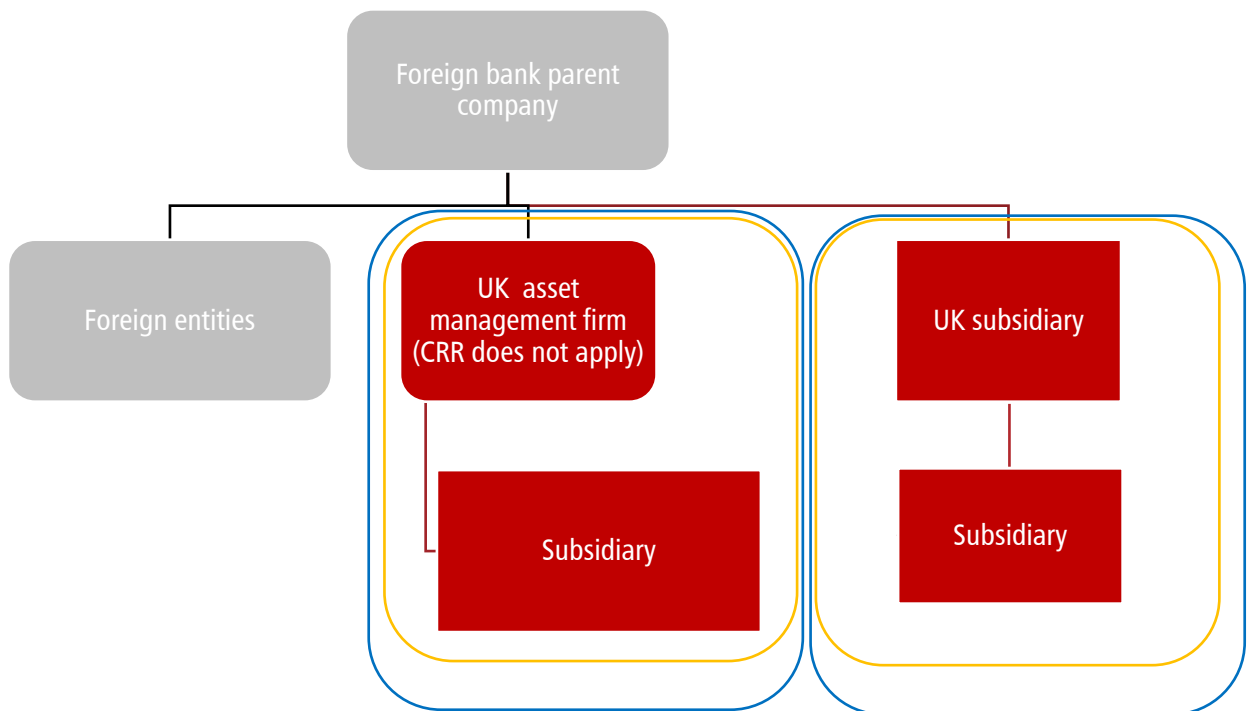
### Example 2 (a) – Foreign banking group with one point of entry in the UK



Example 2 (b) – Foreign banking group with a UK branch and UK subsidiaries



Example 2 (c) – Foreign banking group with multiple points of entry in the UK, where one of the UK subsidiaries is not subject to CRR



Trading assets calculated as the sum of the consolidated total for each UK sub-group, under the UK CRR where applicable or 'as if the UK CRR applied'

Tier 1 capital calculated as the sum of the consolidated total for each UK sub-group, under the UK CRR or 'as if the UK CRR applied'

# Annex B

## Glossary of terms

- ACV** – “A” conduit vehicles
- AIF** – Alternative Investment Fund
- BBB** – British Business Bank
- BGF** – Business Growth Fund
- BPC** – British Patient Capital
- BSC** – Big Society Capital
- CAO** – Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014/1960
- CIO** – Charitable Incorporated Organisation
- CIS** – Collective Investment Schemes
- DCV** – “D” conduit vehicles
- DPO** – Data Protection Officer
- DSAR** – Data Subject Access Request
- EAPO** – Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions Order) 2014/2080
- ECB** – European Central Bank
- EEA** – European Economic Area
- EU** – European Union
- FCA** – Financial Conduct Authority
- FSB** – Financial Stability Board
- FSBRA** – Financial Services (Banking Reform) Act 2013
- FX** – Foreign exchange
- GFC** – Global Financial Crisis
- G-SIB** – Global Systemically Important Bank
- G-SII** – Global Systemically Important Insurer
- ICB** – Independent Commission on Banking
- LLP** – Limited Liability Partnership
- M&A** – Mergers and Acquisitions
- NoD** – Notice of Determination
- NRFB** – Non-Ring-Fenced Bank
- PRA** – Prudential Regulation Authority

**PSED** - Public Sector Equality Duty

**RFB** – Ring-fenced banks

**SBLC** – Standby letter of credit

**SFV** – Structured finance vehicle

**SME** – Small and medium enterprise

**The Bank** – Bank of England

**The Panel** – independent panel, chaired by Sir Keith Skeoch, that undertook a statutory review of the ring-fencing regime and proprietary trading.

**The Taskforce** – joint HM Treasury and Bank of England ring-fencing Taskforce.

**UK CRR** – Regulation (EU) No 2013/575 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (retained EU law).

**UK GDPR** – UK General Data Protection Regulation

### **HM Treasury contacts**

This document can be downloaded from [www.gov.uk](http://www.gov.uk)

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

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Tel: 020 7270 5000

Email: [public.enquiries@hmtreasury.gov.uk](mailto:public.enquiries@hmtreasury.gov.uk)