



HM Treasury

Aligning the ring-fencing
and resolution regimes
Call for evidence - Response

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Call for evidence – Response



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Acronyms

HMT – HM Treasury

Bank – Bank of England

PRA – Prudential Regulation Authority

GFC – Global Financial Crisis

RFB – Ring-fenced bank

NRFB – Non-ring-fenced bank

OCIR – Operational continuity in resolution

Chapter 1

Overview

Background

1.1 On 7 March 2023, the government published a Call for Evidence on aligning the ring-fencing and resolution regimes.¹ This was the first stage in the government's response to the recommendations of the independent panel, chaired by Sir Keith Skeoch ('the Panel'), which undertook a statutory review of the ring-fencing regime and proprietary trading that concluded in March 2022.² As announced on 9 December 2022 as part of the Edinburgh Reforms, the government is also separately taking forward a series of near-term reforms to improve the existing ring-fencing regime and has published a consultation on draft secondary legislation.³

1.2 The Call for Evidence responded to the Panel's recommendation that HM Treasury (HMT) "review the practicalities of how to align the ring-fencing and resolution regimes". The Panel noted that both regimes are trying to tackle the same issue of "too big to fail" and judged that the resolution regime is now overtaking the ring-fencing regime as a more comprehensive and dynamic approach to this issue.

1.3 The Call for Evidence sought views from respondents to inform two judgements. Firstly, an assessment of the ongoing benefits that ring-fencing may provide to financial stability which are not found elsewhere in the regulatory framework. Secondly, and subject to that, what steps can be taken to better align the regimes without losing financial stability benefits or over-burdening firms with new, alternative, regulatory requirements.

1.4 The Call for Evidence also invited respondents to consider a spectrum of options for the longer-term future of ring-fencing. The Call for Evidence outlined at a high-level three main options: retaining the regime with no further changes, disapplying the regime and reforming the regime further. Disapplying the regime was one of the Panel's recommendations, suggesting that an effective way of aligning the two regimes may be to introduce a new power that would enable the authorities to remove banks from the ring-fencing regime when they are judged to be resolvable. The Panel was also clear that the government should ensure that aligning the ring-fencing and resolution regimes would not result in the weakening of wider powers,

¹ HM Treasury, [Aligning the ring-fencing and resolution regimes: Call for Evidence](#), March 2023.

² RFPT, [Ring-fencing and Proprietary Trading Independent Review: Final Report](#), March 2022.

³ HM Treasury, [A smarter ring-fencing regime: Consultation on near-term reforms](#), September 2023.

tools or policies that contribute to the maintenance of the UK's financial stability.

Overview of responses

1.5 The Call for Evidence closed on 7 May 2023. The government received 14 written responses. Responses were received from:

- UK deposit-takers (8 responses)
- industry representative bodies (3 responses)
- not-for-profit organisations (1 response)
- members of the public (1 response)
- other organisations (1 response)

1.6 Respondents provided a range of views on the benefits of the ring-fencing regime. Some respondents noted that ring-fencing supported the planning of resolution, the management of a firm's failure, notably by facilitating post-resolution restructuring, and the effective risk management and supervision of firms. Others felt that any such benefits would only apply to large, complex international firms, if they applied at all. Some respondents suggested that ring-fencing could make resolution and supervision processes more complex and less effective. Certain respondents considered that other regulatory developments such as enhancements to the banking capital framework and to deposit insurance provided greater financial stability safeguards than ring-fencing.

1.7 Many respondents voiced concerns about the operational costs of ring-fencing and noted the wider potential negative implications on banks' competitiveness, UK productivity and the real economy.

1.8 Respondents broadly agreed with the proposed criteria to assess potential long-term options for aligning the ring-fencing and resolution regimes: impact on financial stability, firms, UK competitiveness, growth and competition in the banking sector. Some respondents argued that the proposed criteria implied resolution and ring-fencing were substitutes, whereas they viewed the two regimes as complementary.

1.9 Respondents' views were mixed on the spectrum of options outlined in the Call for Evidence. Some argued ring-fencing should be disapplied as its costs outweigh its benefits to financial stability. While others argued that the regime is complementary to other regulatory frameworks and should be maintained. Some further outlined that while the regime should be maintained, it should be reformed over the medium-term while maintaining its benefits. Some respondents argued that if the Panel's recommendation to remove a bank deemed resolvable from the regime was taken forward, then this decision should be permanent and irreversible. Other respondents argued that all firms subject to the regime should be removed at the same time and

not on a case-by-case basis. Some respondents suggested allowing more financial interactions between a ring-fenced group's ring-fenced bank (RFB) and non-ring-fenced bank (NRFB) and reforming how capital requirements apply to ring-fenced groups. Respondents provided limited evidence on how these options may be operationalised.

1.10 Finally, some respondents commented on recent bank failures, specifically the resolution of Silicon Valley Bank UK (SVB UK) and the modifications made to the ring-fencing regime to facilitate SVB UK's acquisition by HSBC UK Bank plc on 13 March 2023. Some respondents argued these exemptions showed the limitations and excessive rigidity of the ring-fencing regime. Others argued that the resolution of SVB UK, and other recent bank failures, highlighted the importance of retaining ring-fencing to protect financial stability as relying solely on the resolution framework may not be prudent.

Response

1.11 Overall, the responses to the Call for Evidence provided limited evidence and a broad, mixed, range of views on: a) the ongoing benefits that ring-fencing provides to financial stability not found elsewhere in the regulatory framework; and b) the options for aligning the ring fencing and resolution regimes.

1.12 There was consensus among respondents that the Panel's proposal to disapply ring-fencing where banks are deemed resolvable is likely to be difficult to operationalise. As outlined in the Call for Evidence, resolvability assessments would require point-in time judgements that could vary over time, which means that firms may need to be brought in and out of the ring-fencing regime, which would likely be impractical and costly.

1.13 The government will continue to explore all of the options, including those put forward by respondents on how to reform the regime over the medium-to-long term, taking into account the lessons learned from recent bank resolutions as well as the short term reforms the government is already taking forward to improve the functioning of the existing regime.

1.14 Regarding respondents' comments on recent bank failures, the government is of the view that, in the case of SVB UK's acquisition by HSBC UK Bank plc, the resolution framework worked as intended. The Bank of England (the Bank), as the resolution authority, determined that use of the private sector purchaser tool produced the best outcome having regard to the special resolution objectives. This ensured SVB UK's customers were protected. This episode and the market stress that followed demonstrated the robustness of the UK regulatory framework and the resilience of its banking system, judged by the Bank as safe, sound, and well-capitalised.

1.15 The government also considers that the regulatory framework worked as intended by allowing certain modifications to be made to the ring-fencing regime, which were necessary to facilitate the sale of

SVB UK to HSBC UK Bank plc. These have been approved by Parliament, in line with the Banking Act 2009.

1.16 The government, working with the Bank and other relevant authorities, is reflecting on the lessons from recent events in the banking sector, and agrees with respondents that recent events should be taken into account in considering the case for further reform.

Chapter 2

Next steps

2.1 The Call for Evidence sought views on the ongoing financial stability benefits of the ring-fencing regime and how to better align the ring-fencing regime and resolution regimes. The responses have provided a broad range of views with varying degrees of evidence to support the arguments made.

2.2 The government will continue to work with the Bank and Prudential Regulation Authority (PRA), through the joint ring-fencing task force, to consider the benefits of ring-fencing that should be retained in the context of the other regulatory regimes that have been developed since the Global Financial Crisis (GFC). In doing so, it will take into account the recent events in the banking sector and the policy programmes underway at domestic and international level to consider the lessons learned for the resolution framework.

2.3 The government will set out publicly its policy response to the call for evidence and any proposals for further reform in the first half of 2024. Any proposals for further reform would be subject to consultation in the normal way.

Annex A

Future benefits of the ring-fencing regime

Question 1 - Do stakeholders consider that some, or all, of the identified benefits of ring-fencing to resolution materially assist in planning for resolution?

A.1 Most respondents noted that the ring-fencing and resolution regimes sit within a wider framework of prudential and conduct regulatory requirements, which can make it difficult to comment on the benefits of ring-fencing in isolation.

A.2 Some respondents argued that the primary objective of the ring-fencing regime is to insulate retail depositors from risks elsewhere in the financial system and that while ring-fencing may help with resolution planning, this is a secondary and indirect benefit.

A.3 Others suggested the costs of achieving and maintaining compliance with the ring-fencing regime outweighs any benefits to planning for resolution.

A.4 Some respondents argued that ring-fencing materially assists in the planning of resolution for complex banking groups that operate in multiple jurisdictions and have a UK retail-focused RFB. That said, as legal structures differ across banks, they noted that any such benefits are likely to vary by banks, even amongst the large and complex ones.

A.5 A number of respondents argued that the recent banking turmoil highlighted the importance of retaining the ring-fencing regime, as relying solely on the resolution regime may not be prudent. Other respondents suggested recent bank failures showed the limitations of ring-fencing, arguing the regime complicated the resolution of SVB UK because exemptions to ring-fencing requirements were required to facilitate SVB UK's sale to HSBC UK.

Question 2 - Do stakeholders consider that some, or all, of the identified benefits of ring-fencing to resolution materially increase the prospect of a firm failure being effectively managed?

A.6 A number of respondents considered that the benefits of ring-fencing to resolution do not materially increase the effective management of a firm failure compared to other regulatory regimes, such as recent enhancements to the capital and liquidity prudential framework and the introduction of recovery and resolution planning requirements.

A.7 Similarly, some respondents argued that the ring-fencing regime provides limited advantages to operational continuity. They outlined that the PRA's requirements relating to operational continuity in resolution (OCIR) are sufficient in this regard.

A.8 A number of respondents highlighted that ring-fencing helped to reduce the time and cost of post-resolution restructuring processes. Others disagreed, suggesting that the efficiency of post-resolution restructuring is not significantly dependent on ex-ante restructuring such as that provided by ring-fencing. They further argued that the effective management of a firm failure is mostly dependent on the firm having a credible resolution plan and operational continuity framework.

A.9 Some respondents did not consider that the ring-fencing regime acts as an insurance mechanism against the largely untested nature of the resolution regime. They argued that the ring-fencing regime does not fulfil this purpose and that resolution better supports the UK's financial stability and reduces the risks to UK public finances.

Question 3 - Do stakeholders consider that some, or all, of the identified benefits of ring-fencing to the supervisory regime materially reduce the risk of firm failure by facilitating more effective risk management and supervision?

A.10 Most respondents acknowledged that ring-fenced banking groups are subject to additional scrutiny, both externally, from supervisors, markets, and investors, and internally, through firms' own governance requirements. This is notably because RFBs and NRFBs are separate entities subject to individual requirements. But opinions differed as to whether further scrutiny reduces the risk of firm failure.

A.11 Some respondents considered that ring-fencing benefits the supervision of larger, more complex firms, by enabling a better understanding of business lines and legal entities. By contrast, other respondents suggested that having separate legal entities and governance arrangements between RFBs and NRFBs can complicate the effective risk management and supervision of banking groups as it may undermine firms and regulators' ability to oversee and manage risks appropriately at a group level.

A.12 Some respondents considered that other regulatory regimes introduced following the GFC have had a greater impact on reducing the risk of firm failure, relative to ring-fencing.

A.13 One respondent acknowledged that the ring-fencing regime's governance requirements, namely the appointment of non-executive directors for RFBs, have increased the organisational awareness of RFBs' matters. Other respondents argued those governance requirements are costly and unnecessarily constrain the composition of banks' boards.

Question 4 - Are there any further material benefits that ought to be taken into account when considering the long-term future of the ring-fencing regime?

A.14 One respondent noted that as a result of ring-fencing, many assets previously held by 'RFBs' have been moved into NRFBs, thereby reducing risks to UK depositors and public funds. Though, they noted that recent events have shown systemic risks can arise from banks other than RFBs or ring-fenced banking groups.

A.15 They also argued that ring-fencing has likely led to an increase in mortgage lending, which is likely to have contributed to the reduction in mortgage rates and spreads over recent years, thereby benefitting consumers. They noted that the increase in mortgage lending results from ring-fenced groups using retail deposits to fund this activity, as ring-fencing has prevented them from using retail funding to fund riskier banking activities such as investment banking.

A.16 The Call for Evidence also referenced the so called "ring-fencing bonus", defined by Warwick Business School researchers as ring-fenced banking groups' ability to borrow at lower rates in the overnight repo market due to the perception that these groups are safer. Some respondents did not recognise this phenomenon as they had not experienced it or, where their banking groups benefitted from cheaper wholesale funding, they thought it was attributable to other factors unrelated to ring-fencing such as the size of their group.

Annex B

The costs of the ring-fencing regime

Question 5 - Do stakeholders have any comments on the costs, including opportunity costs, associated with the ring-fencing regime once it has been modified by the implementation of the “near-term recommendations”?

B.1 Most respondents considered that the Panel’s recommendations, to be implemented through the ‘near-term’ ring-fencing reforms, should alleviate some of the issues and costs of the regime, without negatively impacting the UK’s financial stability. Respondents highlighted the importance of minimising the implementation and ongoing costs of these reforms to ensure that they are net beneficial.

B.2 There were suggestions that the proposed reforms should go further, for instance by easing the restrictions on intra-group services or exposures which, for example, currently prevent RFBs and NRFBs from relying on certain shared group services. Some respondents noted these restrictions create significant costs for ring-fenced banking groups, forcing them to duplicate certain internal systems, without material benefits to financial stability.

B.3 Some respondents also noted that once the near-term ring-fencing reforms are implemented, the ring-fencing regime may apply to a more limited number of banking groups. This is because certain banks may become exempt from the regime as a result of the Panel’s recommendation to remove retail focussed banks. Respondents argued this would potentially make the regime less worthwhile and increase market distortion.

B.4 Some respondents commented that the UK has one of the strictest structural separation regimes of any major jurisdictions, noting that the costs of the regime has diverted funds that banking groups could otherwise have invested in customer services and innovation. They argued that this has adversely impacted banks’ ability to grow and innovate.

B.5 One respondent suggested the ongoing high compliance costs of the regime largely resulted from the fact that strict requirements

were set out in legislation, rather than in regulators' rules. They recommended granting more flexibility to the PRA, by transferring the regime's legislative provisions into its rulebook. They thought this would reduce the compliance costs of ring-fencing, notably by allowing better and more proportionate assessments of regulatory breaches.

B.6 Additionally, some respondents considered that ring-fencing has negatively impacted the provision of finance to the real economy, by creating "trapped liquidity". They argued that RFBs have mainly used retail deposits to fund mortgage lending at the expense of other types of lending.

B.7 Other respondents argued that the regime has adversely affected competition and UK's competitiveness, making the UK less attractive to international banks seeking to expand their retail business.

Annex C

Long-term options for aligning the ring-fencing and resolution regimes

Question 6 - How appropriate are the proposed criteria, are there others that should also be taken in to account?

C.1 Most respondents broadly supported the proposed criteria for assessing the long-term options for aligning the ring-fencing and resolution regimes: impact on financial stability, firms, UK competitiveness and growth, and competition.

C.2 That said, some respondents did not believe these criteria gave sufficient consideration to the impact long-term options could have on customers - individuals and businesses, the complexity of the ring-fencing regime and the UK's competitiveness.

C.3 Respondents argued that, in assessing long-term options for ring-fencing, the government should ensure their implementation would not result in any new costs being passed onto customers, nor have any unintended consequences, and that the regime should be made simpler, rather than more complex to operate.

C.4 As part of the assessment of the impact on the UK's competitiveness, some respondents highlighted the need to consider whether certain options could increase reliance on foreign banks for the provision of critical economic functions. Such functions are defined by the PRA as including payment, settlement and clearing; retail banking; corporate banking; intra-financial system borrowing and lending; investment banking; custody services; life insurance; and general insurance. Respondents argued that where options may increase foreign banks' competitive advantage over UK ring-fenced banking groups, they could enable foreign banks with a UK presence to provide certain key banking services more cheaply, thereby creating some form of dependency on these foreign banks. This could in turn increase risks to the UK's financial stability, particularly as foreign banks may focus on their domestic markets in times of stress.

C.5 It was also suggested that the assessment of the long-term options should consider the risks posed by firms that remain close to but below the ring-fencing deposit threshold. This is currently set at

£25bn “core deposits” and the government is planning to increase it to £35bn as part of the near-term ring-fencing reforms. Respondents suggested that particular consideration should be given to the resolvability of these firms.

C.6 Lastly, some respondents argued that the criteria imply that the ring-fencing and resolution regimes are substitutes, rather than complementary. An additional criterion was proposed relating to the “reliability” or “predictability” of the ring-fencing regime. Respondents argued that in light of recent banking failures, it is preferable to have a regulatory regime that provides certainty and that the ring-fencing regime serves this purpose by adding an element of predictability to the overall regulatory framework.

C.7 Given many comments on the difficulty of disentangling the role of ring-fencing from that played by the wider regulatory landscape, some respondents suggested that there should be an assessment of the impact of all regulatory tools – not just ring-fencing in isolation. Similarly, a respondent argued that an updated “Cost Benefit Analysis” of ring-fencing should be carried out by the new independent “Cost Benefit Analysis Panels” being created under the Financial Services and Markets Act 2023.

Annex D

The spectrum of options

Question 7 - Considering the above criteria and the materiality of the regime's benefits and costs, do stakeholders have any initial overarching views on the long-term future of the ring-fencing regime?

D.1 Respondents provided a wide range of views on the options for the future of ring-fencing – from full retention to disapplication. Some argued that ring-fencing should be disapplied given its costs and the fact that other regulatory developments have been more beneficial in protecting financial stability. Others suggested that the priority should be to retain and reform the regime.

D.2 The respondents proposing to retain the regime without material long-term reforms noted that whilst ring-fencing does not fully protect the public from banking crises, it provides confidence to depositors that their deposits are protected from losses that may arise from investment banking activities. They argued ring-fencing also helps to impose different governance structures and organisational cultures for retail and investment banking arms, which are beneficial to financial stability. The respondents felt that their position was also justified by concerns, in light of recent bank turmoil, that the resolution regime may not always work as intended in practice.

D.3 The respondents in favour of retaining but reforming the regime over the medium to long term noted that ring-fencing is a key component of the UK's robust regulatory framework, but that the near-term reforms will go some way in removing the compliance burden for banks and improving the operation of the regime. It was suggested that future reforms could focus on allowing greater intragroup financial links without losing the benefits of the legal structure imposed by ring-fencing. Respondents also agreed that it is prudent for the government to periodically review the regime and to re-evaluate its costs and benefits as the wider regulatory and macro-financial environment develops.

D.4 Those who supported disapplication of the regime believed the compliance burden and cost of ring-fencing substantially outweighs its financial stability benefits – particularly given wider regulatory developments since the GFC, such as the resolution regime. They argued the identified benefits of ring-fencing could be retained by other regulatory measures imposed by regulators, based on evidence-

based evaluations of the risks posed by individual banks to financial stability. Some respondents expressed concerns that if a bank that is deemed resolvable is removed from ring-fencing, it would be operationally complex for them to be brought back in scope of the regime if their resolvability assessment changed.

Question 8 - Subject to Q6, how do stakeholders judge how different options may be best operationalised?

D.5 There was limited detail from many respondents on how different options should be operationalised.

D.6 A number of respondents suggested reconsidering ring-fencing and integrating specific requirements to protect retail banking activities as part of the resolution framework. They argued that this approach would create a unified and credible resolution regime that safeguards retail banking operations. They highlighted the need for transparency and confidence-building measures such as the public disclosure of resolution plans.

D.7 One respondent proposed that for firms to be exempt from ring-fencing requirements, they should obtain waivers granted by the relevant regulatory authority, based on an assessment of the firm's ability to demonstrate credible and feasible resolution plans.

D.8 Regarding the disapplication of the regime, some respondents argued that if the Panel's recommendation to remove a bank deemed resolvable from the regime was taken forward, then this decision should be permanent and irreversible. Other respondents argued that all firms subject to the regime should be removed at the same time and not on a case-by-case basis.

Question 9 - Assuming further reform of the regime was achievable without a material impact on financial stability, what reforms would stakeholders prioritise?

D.9 Some respondents advocated for increasing the ring-fencing deposit threshold beyond the £10bn increase to £35bn of sterling of deposits that the government is consulting on as part of the near-term ring-fencing reforms. Others strongly opposed this, arguing for maintaining the current threshold given more elevated risks in the financial system. Another respondent proposed the introduction of a qualitative – rather than quantitative – threshold to exempt certain banks from the ring-fencing regime.

D.10 Some respondents suggested permitting RFBs to provide a wider range of products and services, such as allowing them to deal in equity warrants, carbon credits, and more types of derivatives. Many respondents recommended relaxing restrictions on the use of shared services within banking groups under ring-fencing requirements. While another respondent proposed that the government assess the proportionality of the regime's governance requirements and how they could be improved.

D.11 Other respondents suggested that the regime's restrictions on intragroup exposures i.e., between a RFB and NRFB, be amended to, for example, allow for the sharing of liquidity subject to conditions such as the large exposure limit. They further argued that this would maintain the structural separation benefits of the regime and improve the competitiveness of ring-fenced banking groups, with limited increased risks to financial stability.

D.12 One respondent called for a review of the application of capital requirements on ring-fenced banking groups. They emphasised the need to ensure that the overall capital requirements for ring-fenced banking groups are not unduly burdensome compared to groups not subject to ring-fencing.

D.13 Another suggested introducing a power for the PRA to waive a breach of ring-fencing requirements, where appropriate, to somewhat soften the rigid approach of the current legislation to technical breaches that are not material in nature.

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