HM Treasury

# A smarter ring-fencing regime

## Consultation on near-term reforms - Response

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11 November 2024

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## Acronyms

HMT – HM Treasury

Bank – Bank of England

PRA – Prudential Regulation Authority

GFC – Global Financial Crisis

EEA – European Economic Area

RFB – Ring-fenced bank (the definition in legislation is ring-fenced body however for simplicity this term is used)

NRFB – Non-ring-fenced bank

RFI – Relevant Financial Institution

SME – Small and Medium-sized Enterprise

ICB – Independent Commission on Banking

FSBRA – Financial Services (Banking Reform) Act 2013

FSB – Financial Stability Board

BCBS – Basel Committee on Banking Supervision

G-SIB – Global Systemically Important Bank

G-SII – Global Systemically Important Insurer

UK CRR – UK Capital Requirements Regulation

AIF – Alternative Investment Fund

CIS – Collective Investment Scheme

# Introduction

## Background

1.1. Following the global financial crisis of 2007-08 (GFC), HM Treasury (HMT) 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."[1]

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.[2] 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.[3]

1.4. The Panel made seven recommendations related to the ring-fencing regime. Six of these recommendations were directed at HMT and proposed alterations to the regime that the Panel judged would improve the way it operates, benefitting both banks and their customers without undermining the UK's financial stability. One recommendation was directed at the Bank. Of the six recommendations directed at HMT, the Panel's intention was that five of these could be implemented through secondary legislation to improve the functioning of the existing regime. The Panel also recommended that HMT review how to align the ring-fencing and resolution regimes in the longer-term to ensure simpler and more coherent regulation in the future as both regimes seek to address the same issue of 'too-big-to-fail'.

[1] ICB Final Report Recommendations, September 2011

[2] 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 account-holders meets certain criteria.

[3] Ring-fencing and Proprietary Trading Independent Review Final Report, March 2022.

1.5. A joint HMT- Bank of England (BoE) task force was established to develop detailed proposals on how the recommendations made by the Skeoch review could be operationalised. On 28 September 2023, the previous government published a consultation on “A smarter ring-fencing regime” alongside a draft Statutory Instrument. This looked to take forward the majority of the Panel’s recommendations and also considered specific areas to go further.

1.6. Labour stated its support for the ongoing work following the Skeoch review in “Financing Growth: Labour’s Plan for Financial Services” (January 2024), with a view to limiting bureaucracy for banks while upholding the core purpose of the ring-fencing regime to protect financial stability.

1.7. On 14 October the government confirmed its intention to implement reforms to the ring-fencing regime by laying a Written Ministerial Statement in Parliament highlighting the most material proposed changes to the regime. This reflected the government’s assessment that implementing these reforms quickly and as expected gives industry important clarity and is consistent with its aim of supporting growth through predictable and proportionate regulation, which enhances international competitiveness and benefits economic growth.

## Overview of responses

1.8. The consultation closed on 26 November 2023. The government received 24 written responses. Responses were received from:

- UK deposit-takers (12 responses)
- industry representative bodies (5 responses)
- not-for-profit organisations (1 response)
- members of the public (1 response)
- other organisations (5 responses)

## Response

1.9. Overall, there was widespread support for the proposed reforms. However, a number of policy and legal issues were identified by respondents which the government has sought to address.

1.10. Details on how the government has responded can be found in subsequent chapters.

## Next steps

1.11. The government has today (11 November 2024) laid a statutory instrument in Parliament, which, subject to Parliamentary approval, will implement the smarter ring-fencing regime.

# Chapter 1
# Ring-fencing thresholds

## Deposit threshold

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

2.1. Some respondents supported the increase in the deposit threshold from £25bn to £35bn, with some arguing that it should be increased further. Respondents provided a range of suggestions for the threshold from £42bn to £100bn. One noted that £35bn threshold could still act as a disincentive to the growth of smaller UK banks and a bigger increase was needed to allow them to grow whilst still ensuring the largest banking groups were in scope of the ring-fencing regime.

2.2. Some respondents argued against any increase to the £25bn threshold. They argued that it would primarily benefit large, non-UK based international banking groups by enabling them to hold more retail deposits in their UK subsidiaries, and that these will be used for investment banking activities. They also argued that the proposed increase would not significantly improve competition or the competitiveness of smaller UK challenger banks, given their core deposits may be significantly below the current £25 billion threshold.

2.3. Lastly, several respondents suggested that the threshold should be revisited periodically or automatically change in relation to a set metric, such as annual deposit growth.

#### Government response

2.4. Having considered these arguments carefully, the government will increase the deposit threshold by £10bn. The government's view is that the broad, mixed range of views provided by respondents suggests that the proposed increase, which is informed by a range of economic indicators is appropriate and strikes the right balance between competition and financial stability considerations.

2.5. The reforms will encourage inward investment into the UK as new entrants to the UK banking market will have more room to grow, while improving outcomes for depositors.

## 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.**

2.6. There was support from a number of respondents for the proposal to use trading assets (excluding those acquired under article 6(2) EAPO) as the numerator for the secondary threshold calculation. Respondents noted that trading assets are a straightforward and clear metric which is easy to define (given they are related to accounting standards and can be determined based on consolidated financial statements).

2.7. Several respondents raised questions about the accuracy of trading assets as a measure, with one respondent noting it does not sufficiently target investment banking activities. One expressed concern that a trading asset portfolio may differ significantly over time, and suggested testing portfolios after 3 years.

2.8. One respondent proposed a threshold based on exposures to prohibited business resulting from dealing in investments or commodities as principal and RFI exposures. Another noted that if the government's policy view is that trading activities which are under 10% of a bank's tier 1 capital cannot pose undue risk to a bank's core activities, then this rule must remain consistent whether a banking group is ring-fenced or not.

### Government response

2.9. The government will maintain the proposal to use "trading assets" as the numerator for the secondary threshold calculation given respondents' views that it is a straightforward metric that is easy to define. The government assesses that this is a more practical way of measuring investment banking activities as it uses existing accounting concepts, with which banks should be familiar, rather than relying on the legislative definitions of "excluded activities".

2.10. HM Treasury, working with the PRA, has considered the proposals put forward by respondents, however it did not find these to be practical or

operable. The complexity for the regulatory authorities of designing, implementing, and supervising a secondary threshold that measures excluded and prohibited activities exactly as defined by the ring-fencing regime's legislation, or that utilises other existing regulatory frameworks, would be complex and likely lead to poor and inconsistent outcomes (please see further relevant detail in the government's response to question 7). This is contrary to the government's aim of streamlining regulation. The government will monitor the operation of the secondary threshold closely moving forward.

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

2.11. Most respondents agreed with the proposed calibration of 10% of tier 1 capital for the secondary threshold. One respondent highlighted that the benefit of this calibration is that it is easy to measure. Other respondents were supportive of the fact that the proposed calibration – an average over three years – enables banks to temporarily hold a certain volume of trading assets (for example, due to unforeseen circumstances) without formally breaching the threshold.

2.12. A few respondents disagreed with the 10% of tier 1 capital calibration, arguing that it should be set at 25% in line with the exposure limit in the large exposures regime, rather than the definition of what constitutes a single large exposure.

#### Government response

2.13. In line with the Panel's recommendation and with support from the majority of respondents, the government will set the calibration of the secondary threshold at 10% of tier 1 capital. This strikes the right balance between creating flexibility for banks with minimal investment banking activity to be exempt from the ring-fencing regime and maintaining the regime's financial stability benefits.

### 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?

2.14. Most respondents disagreed with the proposal that banks that are part of a G-SIB should not be exempt from the ring-fencing regime as a result of the secondary threshold. Some argued that banks that are part of a G-SIB should be able to utilise the secondary threshold because a G-SIB designation in isolation does not increase the risk posed to core deposits. One respondent instead suggested that the application of the secondary threshold should focus on the activities of a bank's UK resolution group.

2.15. Another respondent suggested that banks belonging to a G-SIB should be able to utilise the secondary threshold provided that they have (i) issued sufficient MREL to ensure that an orderly resolution can occur without

reliance on public funds, and (ii) that they have sufficient financial, managerial, and operational separation to enable a realistic resolution by UK authorities.

2.16. A respondent who agreed with the proposal, argued that G-SIBs have the scale to absorb the costs and governance requirements imposed by ring-fencing, and would retain a strong credit rating on either side of the ring-fence. In contrast, smaller ring-fenced institutions would not – worsening their cost of funding and ability to deliver on other regulatory requirements (e.g., bail-in requirements).

### Government response

2.17. The government will maintain 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.

2.18. This will 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 line with the government's commitment to upholding financial stability. G-SIBs are designated by the Financial Stability Board (FSB), in consultation with the Basel Committee on Banking Supervision (BCBS) and national authorities. The BCBS' methodology[4] for identifying G-SIBs recognizes that the size, complexity and interconnectedness of these institutions means any problems could have cross-border repercussions – requiring them to hold additional capital due to the additional systemic risks they pose. By maintaining this proposal, the government will ensure 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, in support of the regime's objectives.

**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?**

[4] SCO40 Global systemically important banks, November 2021

2.19. Respondents broadly supported the proposed approach to calculating tier 1 capital and trading assets. For some, that support was conditional on prudential requirements and financial reports being calculated on a consolidated basis.

2.20. Some respondents questioned the proposed approach, primarily due to the status and treatment of UK entities (e.g., branches) outside a UK ring-fenced group. Some suggested that under the proposed approach, trading assets and tier 1 capital used in the calculations may not be held in the same legal entity or resolution group.

### Government response

2.21. The government will maintain the proposal that both tier 1 capital and trading assets should be calculated on a consolidated basis.

2.22. However, following careful consideration of responses to this question, the government notes the initially proposed consolidation provisions for financial groups that contain entities other than banks may not achieve the intended outcome and has therefore introduced new provisions to accommodate different types of financial groups.

2.23. Additionally, the government has introduced new transition periods to allow a banking group sufficient time to comply with the ring-fencing regime. Firstly, where a UK bank is benefitting from the secondary threshold and is part of a banking group that is designated as a G-SIB, it will have four years to comply with the ring-fencing regime. Secondly, where a UK bank is benefitting from the secondary threshold and as a result of a merger or acquisition no longer satisfies the conditions of the secondary threshold, it will have four years to comply with the ring-fencing regime. These transition periods are consistent with those elsewhere in the regime.

## 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?**

2.24. Most respondents agreed with the proposal but noted that the £100,000 threshold does not represent a 'material change'. One respondent suggested that this threshold might enable the provision of small 'ancillary lines' (e.g., corporate credit cards) to RFIs that were not SMEs, while another argued the proposal would not have a material impact on operations or customer outcomes.

2.25. Respondents generally welcomed the proposal as a way to solve the compliance burden of reporting RFI notifications to the PRA for technical

breaches. However, some respondents suggested that – depending on how the proposal was implemented – the costs of complying with this new £100,000 limit may outweigh any gains. Other respondents suggested that the RFI definition be moved into the PRA rulebook.

2.26. Another respondent noted that the proposal required greater clarity as it currently operated on a "single name basis" and may permit RFBs to have multiple £100k exposures to a group of connected RFIs.

### Government response

2.27. The government will maintain the proposal to allow RFBs to incur exposures of up to £100,000 to a single RFI at any one time. Setting the threshold at up to £100,000 should capture most of RFBs' small breaches in relation to RFI exposures, reducing the significant compliance burden for RFBs, while ensuring that RFB's exposures to RFIs remain limited so as not to increase risks to firms.

2.28. The government will also clarify that, where an RFB's counterparty becomes an RFI, the twelve-month grace period in article 19B EAPO only applies where there is not another applicable exemption. The government notes respondents' proposal to move the RFI definition to the PRA rulebook. This would however require primary legislation, which is not currently planned.

**Question 7 –**

**(i) 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.**

2.29. Respondents broadly agreed that the benefits of introducing a de minimis for all excluded and prohibited activities, as defined by the ring-fencing regime, would be outweighed by the practical difficulties of implementation.

2.30. However, some respondents suggested a lack of consistency between exempting banks that undertake a minimal amount of trading activity while not permitting banks that remain subject to the regime the same flexibility. They argued that it would create a competitive disadvantage as banks that become exempt from the regime would be able to provide more types of products. Lastly, two respondents argued that a blanket de minimis would be beneficial, as it would allow some banks to provide a fuller suite of products to their customers.

### Government response

2.31. HM Treasury has extensively reviewed the options and practicalities of introducing a blanket de minimis, either through utilising existing regulatory

frameworks or designing a bespoke framework. Either option comes with significant drawbacks.

2.32. Utilising existing regulatory frameworks such as the large exposures regime would likely be simple to implement given firms could largely rely on existing reporting infrastructure, but would lead to a large degree of uncertainty, as the large exposures regime does not capture the market risk of trading assets and liabilities, nor does it capture commodities trading.

2.33. Designing and implementing a blanket de minimis that accounts for each excluded and prohibited activity would be operationally complex for firms to operate. As previously outlined, it is not feasible to measure, value, and aggregate all excluded and prohibited activities in a coherent and consistent way. This is because the two types of prohibited activities defined by legislation are inherently different: i.e., one excludes RFBs from undertaking certain types of activities while the other prohibits exposures to certain types of institutions.

2.34. Given the practical difficulties of implementing and supervising a blanket de minimis in a coherent and consistent way, the government will not introduce it at this stage.

# Chapter 2
# Architectural reforms

## Geographical restrictions

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

3.1. Respondents supported the proposal to remove geographic restrictions on where RFBs can operate. However, all noted a significant unintended consequence of expanding the geographic scope of "core deposits". If implemented, the proposal to include all core deposits held overseas, outside the UK or EEA, would require ring-fenced banking groups to undertake significant restructuring, and may also bring banking groups not currently subject to ring-fencing closer to the ring-fencing deposit threshold with little discernible benefit.

### Government response

3.2. In line with the Panel's recommendation, the government will remove the geographic restrictions on where RFBs can operate. RFBs will be able to operate branches and subsidiaries outside of the UK or EEA, subject to PRA rules. This should support UK banks in competing internationally and UK businesses operating abroad. RFBs will also be able to support clients in non-EEA jurisdictions and provide a broader range of services to UK-based clients.

3.3. The government recognises the unintended consequences of the proposed change to the geographic scope of core deposits identified by respondents. Therefore, it will limit the scope of core deposits to those held in UK accounts only.

## Mergers and 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?**

3.4. Respondents supported the proposed four-year transition period for complying with the ring-fencing regime for ring-fenced banking groups that acquire a bank not subject to the regime. Some argued that it should be expanded to cover other entities such as non-banks (i.e., wealth managers). Some respondents also suggested that the transition period should be further extended so that RFBs can acquire asset/liability portfolios.

## Government response

3.5. The government will introduce a four-year transition period as described above. In parallel, as there are no legislative restrictions on RFBs' ability to acquire certain types of non-banks, the PRA will update its ring-fencing supervisory statement[5] to clarify that RFBs can acquire businesses such as certain non-bank financial institutions.

3.6. The addition of a transition period for banks acquired before resolution should support financial stability by increasing the pool of potential acquirers for a distressed bank outside of resolution. It also removes a potential barrier for more general mergers and acquisitions (M&A) activity between RFBs and other banks in future.

3.7. The government will not at this stage introduce a transition period for RFBs when they acquire asset/liability portfolios. Ring-fenced groups can already purchase portfolios of assets/liabilities but need to ensure that these are ring-fencing compliant from the outset. HM Treasury is of the view that the risks of a transition period for sorting assets (temporarily allowing prohibited assets inside the RFB) would bring limited benefits relative to the associated prudential risks, as well as being very complex to implement and monitor (both for the PRA and banks).

[5] Supervisory Statement 8/16 Ring-fenced bodies (RFBs), December 2017.

# Chapter 3
# Permitted products and services

## Facilitating the provision of finance to SMEs

### C.1. 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?**

4.1. Respondents strongly supported the policy to enable RFBs to make equity investments into UK SMEs. However, nearly all respondents highlighted that the proposed SME definition is overly complex. It was widely suggested that a threshold of EUR 50m (or Sterling-denominated equivalent) be adopted based on the company's consolidated turnover, which is more closely aligned with the definition used by the Basel Committee.

4.2. Many respondents also raised the issue of SMEs 'outgrowing' the definition – at which point follow-up investment would be prohibited – or of the total value of investments exceeding the limit, which would create a cliff-edge which would require rapid divestment. Several respondents suggested increasing the threshold to 25% of tier 1 capital to align with the large exposures regime limit.

4.3. Other proposals were also argued as being too restrictive, including the requirement that an SME investment fund invest 70% of its capital in UK SMEs and the requirement for a fund to be an Alternative Investment Fund (AIF).

#### Government response

4.4. The government agrees with many of the issues identified by respondents and will make a series of changes. Firstly, the proposed definition of SME will be simplified and based on turnover only. Secondly, the government will clarify the proposed grandfathering provision so that where an RFB or SME fund's initial investment is in an UK SME and that SME grows, they will be able to make follow-on investments and not be forced to divest of their interest.

4.5. Thirdly, the government will lower the requirement for an SME investment undertaking to invest 70% of their investable capital in UK SMEs to 50%. Lastly, the requirement for an SME investment undertaking to be an AIF managed by an UK AIF Manager will be replaced with a requirement to be a "Collective Investment Scheme" or "investment company". These changes increase the options for RFBs when seeking to make investments, and should result in more material investment being made in the UK economy.

**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?**

4.6. Respondents agreed that the proposal would help to unlock equity financing in the UK. However, they also argued that any benefits may be partially offset by separate proposals being developed as part of the implementation of Basel 3.1.

### Government response

4.7. On 12 September 2024, the PRA published its near-final rules for the second part of its Basel package, which includes the capital requirements for firms' lending activity. While the rules remove the SME support factor, the PRA will offset this change in other parts of the capital framework ("Pillar 2"), thereby maintaining the effect of the SME support factor. This approach will help prevent increased costs for banks when lending to key sectors of the UK economy.

**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.**

4.8. See response to Question 10.

**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?**

4.9. Most respondents suggested that a benefit of the proposal would be to enable more SME equity investment by RFBs. One respondent noted how this would improve capital efficiency and make it easier to scale such investments. However, another noted that there was limited upside to the proposal (since it already invests in UK SMEs through other parts of its group).

4.10. One respondent noted that the fair value of equity investments may be subject to greater volatility, and (depending on the accounting treatment), impact a bank's regulatory capital. At the same time, they noted the proposal would align with other HMT efforts (e.g. the Mansion House Compact) to drive private capital investment into small businesses.

4.11. Lastly, a respondent highlighted that the benefits of the proposal are limited by the definition of an eligible fund as one that invests at least 70% of its capital in UK SMEs. One concern was that the proposal does not adequately explain whether the 30% of non-UK SME investments permitted is based on acquisition value or present value. A second issue raised was that private capital funds investing in UK SMEs may allocate funds on a diverse basis, including across jurisdictions, which could limit RFBs investment into many funds.

### Government response

4.12. See response to Question 10.

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

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

4.13. All respondents agreed with the proposal, noting that the risk from RFIs that qualify as SMEs is limited. However, most respondents argued that the exemption should not only include "investment firms" but also other types of RFI.

4.14. Respondents largely suggested that the SME RFI exception should be extended to include most or all types of RFI.

### Government response

4.15. The government broadly agrees with respondents and will expand the RFI SME exemption to include management companies, alternative investment fund managers (AIFMs), UCITS, AIFs, mixed financial holding companies, and financial holding companies. The government does not propose to include structured finance vehicles (SFVs) and credit institutions in the exemption. SFVs do not tend to report "turnover" due to the nature of their activities, meaning they may not be appropriately captured by this exemption.

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

4.17. The government also agrees that the proposed definition of SME is overly complex and will align the definition for the RFI SME exemption with the one used for equity investments.

# Other permitted products and activities

## C.3. 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?**

4.18. Respondents supported the objective of the proposed policy but provided a mixed range of views on whether it achieved the intended outcome. However, all respondents noted that the proposed requirement for an RFB to have a direct relationship with an importer or exporter of good or services would make the regime more restrictive than currently. Namely, it would prohibit RFBs from providing services to their customers that act as intermediaries in trade finance transactions.

### Government response

4.19. The government agrees that the proposed requirement for an RFB to have a direct relationship with either the supplier or receiver of goods or services is overly restrictive and will remove it.

4.20. The government will maintain the other proposals consulted on to clarify that, where an RFB intends to engage in trade finance activities, it should be able to enter into a wider range of arrangements. This includes standard forms of standby letters of credit, bills of exchange and promissory notes, and arrangements which take place under a master agreement such as debt factoring.

**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.**

4.21. See response to Question 15.

## C.4. 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"?**

4.22. All respondents agreed with the proposal, citing debt-for-equity swaps as an essential restructuring tool, and noting that this would provide additional flexibility. However, all respondents noted that the proposed requirement to always require a release of debt is too restrictive.

**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?**

4.23. Respondents did not agree that both requirements – a release of debt as well as the financial difficulties safeguard – were necessary.

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

4.24. Respondents did not consider a more specific financial difficulties test to be necessary.

**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)?**

4.25. Respondents agreed that there were such scenarios, including resetting loan covenants, extended a loan's term, and providing new lending.

**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)?**

4.26. One respondent outlined that it is unlikely for warrants or options to be structured in a way that is contingent on future debt releases because a release of debt usually takes place at the time of the debt restructuring. Another outlined that they have seen debt restructurings where the borrower has provided lenders with an option to acquire shares which is contingent on future events either taking, or not taking, place.

### Government response

4.27. The government agrees with respondents and will remove the release of debt requirement as it is overly restrictive and will not result in the desired policy outcome. This reform should lead to better outcomes for both RFBs and their customers, who will have more choice when considering debt restructurings.

**Question 22 – Are there are 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.**

4.28. Respondents outlined a number of scenarios where further flexibility in debt restructuring scenarios would be beneficial. For example, they argued that the proposed amendment prevents RFBs from acquiring an equity or related instrument issued by a new entity which has been established as part of a debt restructuring where this new entity may not, at the time of the provision of the loan, be a member of the debtor's original group. Furthermore, several respondents noted that the proposal prevents the RFB from participating in further equity issuance after the initial debt-for-equity swap has taken place, which could lead to the RFB's shareholding being diluted.

### Government response

4.29. The government agrees that further flexibility would be beneficial in some of the areas outlined by respondents. It will introduce provisions to permit RFBs to acquire shares in order to prevent their shareholding being diluted as well as where a new company is used in a debt-for-equity transaction.

## C.5. Servicing Central Banks

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

4.30. Respondents agreed with the proposal but noted that further institutions should be included on the list of entities that can be serviced by NRFBs. Respondents however provided limited evidence on which multilateral development banks should also be included in the proposed list.

### Government response

4.31. The government will permit NRFBs to service central banks outside of the UK. After consideration of respondents' views, the government has decided to include four more entities in the list of exemptions.[6]

4.32. The proposal will enable NRFBs to provide services to these entities, who are sometimes better suited to meet the needs of central banks, so can offer improved access to the products and services required by these groups.

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

4.33. See response to Question 39.

[6] The Bank for International Settlements, Bank of England Asset Purchase Facility Fund Limited, Covid Corporate Financing Facility Limited, and the UK Infrastructure Bank Limited.

## C.6. Inflation Swaps

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

4.34. Respondents agreed with the proposal to allow RFBs to provide inflation swap products to their clients. However, they noted that the proposed definition of inflation swap would only permit an RFB to offer fixed-floating rate inflation swaps derivatives. Some RFB customers may want to enter into floating-floating rate swaps as this product may better suited to their business's needs with regard to protecting against inflation risks.

#### Government response

4.35. The government proposes to permit RFBs to provide floating-floating rate inflation swaps as well as the initial proposal. However, there are increased liquidity risks if the tenor of an inflation swap is over 30 years. Therefore, the government proposes that the tenor of any inflation swap should be limited to 30 years.

4.36. This will enable banking customers to access certain types of inflation swaps from RFBs, meaning they will be able to access a wider range of products through their existing banking relationships. This will enable RFBs' customers to more easily hedge inflation risks, helping them to protect their business from inflation risks.

## C.7. Mortality risk and lifetime mortgages

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

4.37. Respondents broadly agreed with the proposal to allow RFBs to hedge mortality risk, but noted that to be able to provide lifetime mortgages, they also need to be able to hedge longevity risk.

#### Government response

4.38. The government will permit RFBs to hedge against longevity risk: i.e., the possibility a person lives longer than expected, so that they are able to provide lifetime mortgages. This should support competition in those markets and benefit customers through the impact on choice, pricing, and quality of product.

## C.8. 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?

4.39. Respondents agreed with the proposal but noted that the current provision will not allow a RFB to remedy a failure if it is identified post the

event. Additionally, respondents highlighted that RFBs on occasion make dealing errors.

### Government response

4.40. The government will permit RFBs to deal in investment as principal to: i) correct trading failures which have been identified after the event; and ii) correct trades which the RFB has made in error when dealing on behalf of a customer, (alongside the current proposed provision).

4.41. This will improve the functioning of the ring-fencing regime and efficiency of intermediating trades.

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

4.42. A small number of respondents answered this question. Respondents broadly agreed with the proposal.

## C.9. 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?**

4.43. Respondents agreed with the proposal.

### Government response

4.44. The government will implement the proposed change. This proposal should facilitate the launch of new products and services by RFBs, thereby improving the functioning of the ring-fencing regime.

**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?**

4.45. Respondents noted that a specific RFI exemption for the purposes of conducting test trades would be beneficial.

### Government response

4.46. The government will introduce a new exemption to allow RFBs to incur exposures to RFIs or the purposes of conducting test trades.

## C.10. 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?**

4.47. Respondents agreed with the proposal.

Government response

4.48. The government will implement the proposed change. 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.

## C.11. 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?

4.49. Respondents agreed with the proposal.

Government response

4.50. The government will implement the proposed change. This proposal should benefit RFB's customers, minors, and CIOs, without posing risks to financial stability. When a bank acts as a trustee, it is not itself taking on the risk in relation to trust assets. Instead, the trust beneficiary holds the risk of loss to trust assets from, for instance, investments underperforming.

### 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?

4.51. Respondents considered it necessary that further provision should be made for nominees. Additionally, one respondent argued that RFBs should be able to do so on behalf of Collective Investment Schemes.

Government response

4.52. The government will introduce a specific reference to Scottish nominees so that RFBs can act as trustee on behalf of these types of entities.

4.53. The government did not receive strong evidence that further changes are required.

## C.12. 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?

4.54. Respondents agreed with the proposal to permit RFBs to provide FX collar products to their customers. However, they noted that the proposed legislative drafting did not achieve the intended outcome.

Government response

4.55. The government will introduce a new legal provision that specifically describes FX collars and permits RFBs to provide them to their customers. This will allow RFBs to provide a fuller suite of derivative products to their customers, removing complexity and inefficiency for RFBs and their customers as RFBs will no longer need to involve NRFBs to enable their customers to hedge certain types of risk. This change does not pose material risks to financial stability. While RFBs will be exposed to new types of risks if they opt to take advantage of this new flexibility, the additional risk posed to RFBs will be mitigated by the existing limits in the ring-fencing regime on the position risk requirements attributable to their derivatives.

# Chapter 4
# Definitions and technical amendments

## D.1. 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?**

5.1. Respondents agreed with the proposal. .

### Government response

5.2. The government will implement the proposed change. This proposal should facilitate the use of sponsored SFVs by RFBs, thereby supporting RFBs' lending to the real economy.

## D.2. 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?**

5.3. Respondents welcomed the proposal. However, they noted that participants in a correspondent banking relationship may not always be "credit institutions" i.e., banks, and may be "payment service providers".

### Government response

5.4. The government agrees that participants in correspondent banking relationships may not always be "credit institutions". Therefore, it will amend the definition of correspondent banking to reflect market practices by replacing "credit institution" with "payment services provider" (which can include relevant non-UK firms). This clarification will better reflect market practices without materially increasing risks to financial stability.

## D.3. 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?**

5.5. Respondents agreed with this proposal but noted that the proposed legislative drafting did not fully achieve the intended outcome.

### Government response

5.6. The government will update the grace period so that an account holder would not need to be treated as an RFI for the full period of 12 months where this would complicate its transfer from an NRFB to RFB. This will relieve the administrative and compliance burden placed on NRFBs.

# Chapter 5
# Areas where the consultation sough further evidence

## E.1. 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?**

6.1. Respondents agreed that the NoD should be removed as its primary purpose of facilitating the effective separation of NRFBs has been achieved. Additionally, the requirement places NRFBs as at a disadvantage to other international banks that are not required to provide a NoD to prospective clients.

### Government response

6.2. The government agrees with respondents and will remove the NoD requirement. NRFBs will still be required to assess whether a prospective client satisfies the criteria to be banked by an NRFB.

## E.2. 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?**

6.3. Respondents agreed that this has not been an issue in practice.

**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?**

6.4. See response to Question 39.

### Government response

6.5. The government does not propose any changes.

## E.3. Conduit vehicles

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

6.6. Respondents broadly agreed with the description of the issue, but further noted that the current regime does not permit RFBs to acquire

instruments creating or acknowledging indebtedness issued by one of its own ‘D’ conduit vehicles.

### Government response

The government will permit RFBs to acquire financial instruments creating or acknowledging indebtedness issued by one of its own conduit vehicles. This reform will improve the operation of the regime without materially increasing the risks to financial stability.

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

6.7. See response to Question 41.

### Government response

6.8. The government will permit RFBs to acquire instruments creating or acknowledging indebtedness issued by one of its own ‘D’ conduit vehicles (as well as the investments that are currently permitted in article 7(2) EAPO).

## E.4. Related undertakings

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

6.9. Respondents agreed with the description of the issue and argued for the introduction of greater flexibility.

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

6.10. See response to Question 43.

### Government response

6.11. The government will permit RFBs to hedge the types of risks set out in article 6(2) of EAPO on behalf of its "participating interests” as well as those of certain entities within an RFB’s group. This will create more flexibility without materially increasing risks to financial stability as RFBs will not be exposed to new types of risks.

## E.5. 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?**

6.12. The majority of respondents noted that this has not been an issue in practice.

**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?**

6.13. See response to Question 45.

Government response

6.14. The government does not propose any changes.

## E.6 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?**

6.15. Respondents broadly agreed that the FSB's G-SII list is out of date and the ongoing reference to it in the legislation was unhelpful.

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

6.16. See response to Question 47.

Government response

6.17. The government will remove the reference to G-SIIs from the RFI definition and will keep under review whether a list will need to be introduced in the future. In practice this means that RFBs will be able to have exposures to insurers that are currently on the FSB's list.

6.18. This should not materially increase risks to financial stability as large insurers are no longer considered to be inherently systemically important and have less potential to give rise to material financial contagion.[7] Additionally, RFBs are prohibited from providing more complex, higher-risk products – limiting the riskiness of any exposures to insurers.

## E.7 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.**

6.19. Respondents provided a mixed range of views on whether RFBs should be able to provide structured FX products to their clients. Some noted that these types of products are complex and that they have not seen

[7] 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), 2022.

demand for these types of products. Others argued that current restrictions on the types of derivatives RFBs can provide to their clients are unduly restricted.

### Government response

6.20. The government has considered whether to permit RFBs to deal more complex, riskier types of derivatives (e.g., American and Bermudan type options) however does not believe that RFBs should be permitted to deal these due to the risks they carry. Therefore, the government will not introduce changes at this stage.

## E.8 Other areas

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

6.21. Respondents raised a broad range of further potential changes, the majority of which HM Treasury and had previously considered and not found to be compelling based on the evidence received. Other proposed changes have been taken forward as set out above.

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