RFPT | Ring-fencing and Proprietary Trading Independent Review

CALL FOR EVIDENCE

April 2021

This publication is available at: https://rfpt.independent-review.uk

Any enquiries regarding this publication should be sent to feedback@rfptreview.org.uk

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Foreword

When the Treasury asked me to chair the statutory independent reviews on ring-fencing and proprietary trading, I reflected on the last decade and the transformation we have seen in the financial sector since the 2007-08 financial crisis. A big part of this shift has been the large scale of reforms in the regulation of the sector. Although the damage inflicted in 2008 may have been diluted in our memories with the passage of time, it is important that we do not forget the very real consequences it had on the economy, the taxpayer, and people's jobs.

The sector as a whole, and banks in particular, are more resilient than they were before the financial crisis. While this has reduced the risk to the financial system, there is no room for complacency. The ring-fencing regime and rules applied to proprietary trading were bold strides taken by the UK, and it is important that reform continues to build on the hard work of the UK authorities and industry over the past decade.

"Although the damage inflicted in 2008 may have been diluted in our memories with the passage of time, it is important that we do not forget the very real consequences it had on the economy, the taxpayer, and people's jobs."

At the same time, changes to the environment in which the UK financial sector now operates need to be considered. The sector is still finding its feet outside of the European Union, dealing with the economic impacts of the Covid-19 pandemic, and incorporating technology that continues to bring new and innovative challengers to the market.

This review therefore presents a unique opportunity to consider whether the ring-fencing regime and the rules applied to proprietary trading have met the original intentions of the legislation based on the recommendations of the Independent Commission on Banking (ICB) and the Parliamentary Commission on Banking Standards (PCBS), and whether they strike the right balance for today's world.

Approaches to regulating the financial sector also continue to evolve as circumstances change, memories fade, understanding improves, and cultures adapt. In hindsight we can look back at cycles of increasing regulation and deregulation and learn from what they got right, and crucially what they got wrong. A review like this is an opportunity to further future-proof the system and where appropriate, recommend changes on the basis of new information and evidence that we have developed with the benefit of time and experience.

In that spirit, I am pleased to launch this call for evidence in order to focus on the observed impacts and any unintended consequences of the ring-fencing regime and rules applied to proprietary trading compared to their original objectives.

An important part of this review will be the impact on the customer. The financial sector sits at the centre of people's every-day lives, whether you're a small business owner, a large corporation, or an individual current account holder. Customers are not best served by banks that fail, or by banks that cannot provide them with the service that they need. Having a strong, innovative sector with robust competition is the best way of ensuring that customers have access to the products and services that serve their needs.

That is why this call for evidence will put a particular focus on understanding the impacts on, and outcomes for customers and will aim to gather views from as many voices as possible. We would therefore urge potential respondents to frame their responses with customers in mind.

"…this call for evidence will put a particular focus on understanding the impacts on, and outcomes for customers and will aim to gather views from as many voices as possible."

Finally, it is worth noting that there are many views on the costs and benefits of financial sector regulation in the UK, in particular when it comes to ring-fencing. My challenge to respondents is this – if you believe that the ring-fencing regime and/or rules applied to proprietary trading have positively or negatively impacted on the areas outlined in this document, then please take this opportunity to provide us with the evidence to support your position.

We recognise that this is a tall order given the relatively short time period during which the ring-fencing regime has been in place, and the material impacts that other events such as Covid-19 have had over the same period. However, this review will be evidence-led, and any conclusions or recommendations made by the Review Panel will need to be grounded in hard evidence.

The Review Panel and I look forward to engaging with as wide a range of interested parties as possible on this fascinating and crucially important issue in the months to come. I sincerely thank you in advance for the valuable contributions that I hope you will make to this review.

Keith Skeoch

Keith Skeoch

Chair, RFPT Independent Review

Chapter 1
Background

Origins of this review

1.1 The Financial Services (Banking Reform) Act (FSBRA) 2013 required the Treasury to appoint an independent panel to review the operation of the legislation relating to ring-fencing, and separately to appoint a panel to review banks' proprietary trading activities following a statutory report completed by the Prudential Regulation Authority (PRA) in September 2020. [1]

1.2 The Treasury appointed Keith Skeoch to chair the panel of both reviews (the 'Review Panel') along with panel members John Flint, Patrick Honohan, Betsy Nelson, Preben Prebensen, and Linda Yueh.

1.3 The terms of reference (ToRs) for the reviews were published on 2 February 2021 on the government's website. The Review Panel aims to finalise its written reports to the Treasury within one year of the beginning of the reviews. [2]

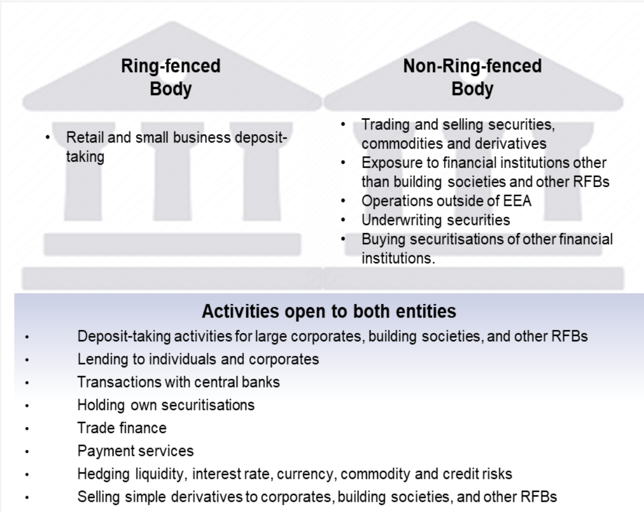
Summary of the ring-fencing regime

1.4 The UK ring-fencing regime came into effect on 1 January 2019. It applies to all banking groups operating in the UK with more than £25 billion of core deposits. In practice that currently consists of the following banking groups: Barclays, HSBC, Lloyds Banking Group, NatWest Group, Santander UK, TSB, and Virgin Money UK. [3]

1.5 The ring-fencing regime was established by the FSBRA 2013 and was supplemented by secondary legislation, as well as more detailed PRA rules. This is summarised in **Table A1.A** in Annex A.

1.6 Ring-fencing is designed to separate the activities of a banking group between a ring-fenced body (RFB) which undertakes core services such as deposit taking, from a non-ring-fenced body (NRFB) which undertakes other activities such as investment banking. The core services are 'ring-fenced' from these other excluded activities so that in the event of a failure of the NRFB, the provision of core services can continue. The activities are illustrated in **Figure 1.A**. [4]

Figure 1.A: Division of activities within banking groups



Source: Bank of England Quarterly Bulletin, Q4 2016

[1] https://www.bankofengland.co.uk/prudential-regulation/publication/2020/proprietary-trading-review
[2] https://www.gov.uk/government/publications/members-of-the-ring-fencing-and-proprietary-trading-independent-review-panel-announced
[3] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/authorisations/which-firms-does-the-pra-regulate/2020/ring-fenced-bodies-list-1-january-2020.pdf
[4] https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2016/ring-fencing-what-is-it-and-how-will-it-affect-banks

Summary of rules and powers applied to proprietary trading

1.7 The FSBRA 2013 defines proprietary trading as taking place "where the person trades in commodities or financial instruments as principal." [5] The PRA further notes that "it requires the use of a firm's own capital, or liquidity, or both. The profits or losses of the activity accrue to the firm, rather than to its clients. […] The key features of classic proprietary trading are that it is short-term and that it is conducted for profit." [6] These activities can give rise to risks to the safety and soundness of firms and by extension, financial stability and the wider economy.

1.8 In addition to proprietary trading being an excluded activity for RFBs under the ring-fencing regime, the PRA addresses the risk associated with proprietary trading through a number of its wider powers and supervisory tools. These include:

- The **PRA's statutory Threshold Conditions** which set out the minimum requirements that firms must meet in order to carry out regulated activities;
- The **Senior Managers and Certification Regime (SMCR)** which requires pre-approval from the PRA and the Financial Conduct Authority (FCA) for individuals who perform key roles at regulated firms;
- **Remuneration policy** to align rewards of individuals with prudential objectives; and
- The **PRA's Fundamental Rules** which are high-level rules that firms must comply with.

"The key features of classic proprietary trading are that it is short-term and that it is conducted for profit [using a firm's own capital]."

1.9 Furthermore, the PRA's risk assessment framework considers the operational mitigation, financial mitigation, and structural mitigation undertaken by a firm, as well as the potential impacts on wider financial stability. Taking each in turn:

- **Operational mitigation** for the purposes of proprietary trading risks focuses on governance, risk management, and controls within a firm.
- **Financial mitigation** takes account of the financial resources (capital) held against the risks to which a firm is exposed, including proprietary trading risks.
- **Structural mitigation** focuses on planning for the risks that could materialise, and includes recovery planning, resolution planning, and wind-down plans. Specifically for proprietary trading risks, the ability to wind down a trading book is an important element for wider recovery and resolution planning.

1.10 The PRA ensures compliance with the above areas through the use of supervisory powers that allow for direct intervention to impose requirements, or through enforcement powers such as fines or public censure.

[5] https://www.legislation.gov.uk/ukpga/2013/33/section/11
[6] https://www.bankofengland.co.uk/prudential-regulation/publication/2020/proprietary-trading-review

Chapter 2
Call for evidence

Overview

2.1 The objective of this call for evidence is to inform the Review Panel's assessment of the impacts of the ring-fencing regime and rules applied to proprietary trading.

2.2 It is a unique opportunity to assess the observed impacts of the regulatory regimes, intended or otherwise, for financial stability, competition, competitiveness, and the balance between these in light of developments in the UK financial sector and wider economy.

2.3 The Review Panel is keen to receive responses from a broad range of stakeholders and would encourage potential respondents who may not have evidence for all the areas covered, to consider submitting responses to the relevant subset of questions that they have an interest or expertise in.

2.4 Some additional guidance is provided in Annex A, which sets out potential considerations for respondents, and interpretations of some terms and concepts used.

2.5 Please note the importance of **providing evidence** to support your response to each question, which could take the form of quantitative, qualitative or case study examples.

"…opportunity to assess the observed impacts […] intended or otherwise, for financial stability, competition, competitiveness, and the balance between these…".

2.6 In line with the ToRs set by the Treasury, the Review Panel has been given a broad remit to make recommendations as it sees fit following its assessment of the ring-fencing regime and rules applied to proprietary trading. In addition to the call for evidence questions, **the Review Panel would welcome respondents' views on the areas that they would like to see the Review Panel focus on when considering recommendations**, along with any supporting evidence.

How to respond

2.7 Responses should be sent by email to feedback@rfptreview.org.uk. If a postal response is necessary, contact the RFPT Review secretariat at the above email address to arrange this. This is due to ongoing restrictions relating to the Covid-19 pandemic.

2.8 The closing date for responses is **13th June 2021.**

2.9 All written responses relating directly to this call for evidence provided to the RFPT Review will be made public. If you would like any of the information provided in your response to be treated confidentially, please state this clearly in a covering note or email, identifying the relevant information and explaining why it is confidential.

2.10 For further information regarding data privacy, please refer to our separate Data Privacy Notice on https://rfpt.independent-review.uk.

Call for evidence questions

Impact on financial stability

Q1. *Does the ring-fencing regime in your view achieve its aim of supporting UK financial stability, and if so how?*

Q2. *Do you think that the ring-fencing regime has contributed to reducing risks to UK public finances, and if so, how best can this be observed?*

Q3. *What role does the ring-fencing regime play in supporting financial stability in the context of wider changes to banking regulation since the 2007-08 financial crisis?*

Q4. *Do you think there are any negative consequences of ring-fencing for financial stability?*

Impact on customers, competition and competitiveness

Q5. *Do you think that ring-fencing has had an impact on outcomes for customers or firms in the mortgage market?*

Q6. *Do you think that ring-fencing has had an impact on outcomes for customers or firms in other retail banking markets (apart from mortgages)?*

Q7. *Do you think that ring-fencing has had an impact on outcomes for customers or firms in investment or wholesale banking markets?*

Q8. *Do you think ring-fencing has had an impact on the competitiveness of UK-based investment or wholesale banks relative to foreign investment or wholesale banks?*

Q9. *In your view, has ring-fencing had an impact on the provision of productive finance to businesses, including small and medium sized enterprises (SMEs)?*

Operation of the ring-fencing regime

Q10. *Do you think that the ring-fencing regime requires clarifications or amendments?*

Q11. *Do you think that the scope of the ring-fencing regime has been appropriately defined in terms of prohibited activities, thresholds at which firms come into scope, and geographical activities?*

Q12. *Do you think that the rules on RFB governance ensure the independence of RFB boards?*

Adequacy and impact of rules applied to proprietary trading

Q13. *Are PRA rules and powers relating to proprietary trading adequate and proportionate to manage the level of activity and associated risks?*

Q14. *Have PRA rules and powers relating to proprietary trading impacted on the services that banks provide their customers?*

Other impacts of ring-fencing and rules applied to proprietary trading

Q15. *Has ring-fencing or PRA rules and powers relating to proprietary trading impacted on market liquidity and the functioning of financial markets more broadly?*

Q16. *Have changes in the UK financial sector or wider economy, such as those discussed in this document, impacted on the operation of the ring-fencing regime or rules applied to proprietary trading?*

Q17. *Are there other unintended consequences arising from the ring-fencing regime or rules applied to proprietary trading that you would like to raise?*

Chapter 3
Context for the call for evidence

Origins of ring-fencing in the post-crisis response

3.1 The 2007-08 financial crisis caused financial markets to seize up and pushed the global economy into a recession. The UK government provided the financial sector with over £1 trillion in guarantees and further distributions of £137 billion.[1] The Office for Budget Responsibility's latest estimate puts the implied cost at £37 billion.[2]

3.2 The crisis revealed the need for fundamental changes to how banks are regulated. In June 2010, the UK government set up the ICB to consider both structural and related non-structural reforms to the UK banking sector in order to promote financial stability and competition.

3.3 In its report published in September 2011, the ICB recommended that UK banks should be required to separate or 'ring-fence' the provision of core services from other activities within their groups.

3.4 The intention behind ring-fencing was to build greater resilience against future financial crises and remove risks to public finances. It would achieve this by making it "easier and less costly to resolve banks that get into trouble", help to "insulate retail banking from external financial shocks", and assist "the monitoring of banking activities by both market participants and the authorities."[3]

"…the UK government set up the ICB to consider both structural and related non-structural reforms to the UK banking sector…".

3.5 While the ICB did not recommend an outright ban of proprietary trading outside of RFBs, the Parliamentary Commission on Banking Standards did recommend enhanced monitoring by the PRA of banks' trading activities and risk exposures of banks' trading books.[4] The PRA's approach to managing these risks is summarised in Chapter 1.

3.6 Ring-fencing was only one element of reforms designed to increase the stability of the UK financial system. Paragraphs 3.7 to 3.14 provide the main backdrop for this review in terms of the key reforms that were designed to increase banks' resilience and limit the impact on UK public finances, alongside ring-fencing. **Figure 3.A** outlines the wider picture of post-crisis regulatory reform.

3.7 In 2007-08, UK authorities did not have sufficient tools or powers to resolve a systemic bank in an orderly way, and so had limited options for managing the failure of large UK banks during the financial crisis. This could have had severe consequences for the financial system and the economy, and so the government intervened by providing direct taxpayer support to the banks. Since that time a lot of work has been done to develop a better approach.

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[1] https://commonslibrary.parliament.uk/research-briefings/sn05748/
[2] https://obr.uk/efo/economic-and-fiscal-outlook-march-2021
[3] http://bankingcommission.s3.amazonaws.com/wp-content/uploads/2010/07/ICB-Final-Report.pdf
[4] https://publications.parliament.uk/pa/jt201213/jtselect/jtpcbs/138/138.pdf

Resolution regime

3.8 A resolution regime was established by the Banking Act 2009 and has been enhanced significantly over the years. One key element was the introduction of "MREL" (Minimum Requirement for own funds and Eligible Liabilities), a form of debt and equity held by investors and shareholders that can be used to absorb losses and recapitalise a bank if it fails, enabling it to continue operating without a taxpayer bailout. Since 2015, UK banks have raised over £220 billion of MREL instruments, more than the £137 billion provided by the government during the financial crisis. [5]

3.9 Another element was the introduction of the Bank of England's Resolvability Assessment Framework. It is designed to make resolution more transparent, better understood, and more successful through a disclosure requirement. Large UK banks are required to assess their preparations for resolution and to publish a summary of this assessment by June 2022. The Bank of England will identify any shortcomings and highlight where banks have more work to do to improve their resolvability.

Higher capital and liquidity requirements

3.10 Capital and liquidity requirements have been strengthened since 2008. These requirements increase banks' resilience to unexpected shocks by giving them a larger cushion to absorb losses. Major UK banks' aggregate capital ratios are more than three times higher than before the 2007-08 financial crisis. [6] Also, leverage ratios require banks to hold capital in proportion to the size of their balance sheet. This protects against risks that are more difficult to measure through risk models alone. [7]

3.11 The introduction of liquidity coverage requirements (LCR) and developments in the PRA's approach to supervising liquidity and funding risks have ensured that banks have adequate levels of liquidity resources and prudent funding profiles. [8]

Stronger governance and stress testing

3.12 How banks are regulated has changed since the crisis with the establishment of the PRA, the FCA, and the Financial Policy Committee (FPC) of the Bank of England. Risks are monitored at both the micro and macro level with new tools developed to gauge more accurately the risk in the system.

3.13 The introduction of stress testing exercises undertaken by the Bank of England at both the bank and system-wide level, help ensure that banks can withstand extreme shocks while continuing to support the economy.

3.14 Rules are now in force to make senior management in banks more accountable, and remuneration rules better align incentives with prudential objectives to discourage excessive risk-taking.

Figure 3.A: Post-crisis regulatory reforms

Source: RFPT Review

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5 https://www.bankofengland.co.uk/-/media/boe/files/paper/2020/boes-review-of-its-approach-to-setting-mrel.pdf
6 https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2020/december
7 https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-uk-leverage-ratio-framework-ss
8 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement

Wider developments in the UK

3.15 As well as large-scale regulatory reform, there have been significant changes to the environment in which UK banks operate, including the fallout from the Covid-19 pandemic, the UK's exit from the EU, and changes in the UK financial sector.

Covid-19

3.16 Since ring-fencing came into force in January 2019, the economy and financial markets have been impacted by Covid-19. While there have been stresses in financial markets, the pandemic has not resulted in a financial crisis, in part due to central bank support which has increased liquidity in financial markets.[9]

3.17 The pandemic has resulted in a large increase in aggregate household savings and banks will need to allocate these funds efficiently to parts of the economy where they are needed.[10] At the same time many households are in financial distress, which could be a source of risk of losses for banks in the future.[11] During the pandemic, banks' capital ratios have increased, however capital levels in value terms have decreased.[12]

"…there have been significant changes to the environment in which UK banks operate, including the fallout from the Covid-19 pandemic, the UK's exit from the EU, and changes in the UK financial sector."

UK departure from the EU

3.18 The UK's departure from the EU was a major structural event that banks had to plan for at the same time as carrying out the restructuring needed for ring-fencing.

3.19 EU membership is not directly relevant to the UK's ring-fencing regime as the regime is based on domestic legislation, and other EU countries did not introduce the same degree of structural reform after the crisis. Nevertheless, it is worth considering ring-fencing in the context of a wider debate about financial regulation following the UK's departure from the EU and the changed environment for UK banks as a result.

Developments in UK financial services

3.20 One of the ICB's aims was to "promote effective competition" in banking. While ring-fencing itself was primarily aimed at improving financial stability, the ICB noted that "eliminating the implicit government guarantee is pro-competitive."[13]

3.21 The experience of personal and business customers of banking and wider financial services has changed since the 2007-08 financial crisis. For instance, the Open Banking reforms allow banking customers to authorise third parties to access their banking data so as to provide better product comparison services and make payments from their accounts directly rather than using Visa or Mastercard. There

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[9] https://www.economicsobservatory.com/how-did-central-banks-respond-coronavirus-crisis

[10] Bank deposits increased by £44.6 bn in Q2 2020. In January 2021, net flow of household deposits were £18.5bn, above the average of £4.8bn. www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/articles/coronavirusanditsimpactontheukinstitutionalsectoraccounts/quarter2 https://www.bankofengland.co.uk/statistics/money-and-credit/2021/january-2021

[11] In May 2020, Citizens Advice estimated that 6 million people had fallen behind on a household bill as a result of the pandemic. https://www.citizensadvice.org.uk/about-us/our-work/policy/policy-research-topics/debt-and-money-policy-research/near-the-cliff-edge

[12] https://www.bankofengland.co.uk/statistics/banking-sector-regulatory-capital/2020/2020-q4

[13] http://bankingcommission.s3.amazonaws.com/wp-content/uploads/2010/07/ICB-Final-Report.pdf

are three million people and businesses, including around half of small businesses, using Open Banking enabled apps and services in their daily lives. [14]

3.22 In addition, a plethora of challenger banks have entered the market aiming to attract customers with improved service offerings, and increasingly doing so without a branch network. [15]

3.23 There is also a more diverse payments landscape where there has been a proliferation of non-bank payment services. By 2019, nearly ten million people in the UK had registered for a mobile payment app such as Apple Pay, Google Pay, and Samsung Pay. [16] These developments for customers coincide with the growth of the UK fintech sector, second in the world only to the US. [17]

"…nearly ten million people in the UK had registered for a mobile payment app such as Apple Pay, Google Pay, and Samsung Pay. These […] coincide with the growth of the UK fintech sector, second in the world only to the US."

3.24 However, for many retail banking customers there have also been areas of relative stability over time. The five large UK banking groups have seen only a small reduction in their combined market share of personal current accounts, with personal current account switching remaining relatively low despite switching being made easier. [18] [19]

3.25 While the major banks retain a strong presence, the banking sector has seen its relative share of the provision of finance to business fall. There has been a notable trend in businesses moving from bank loan-based finance to market-based finance. [20]

3.26 The ring-fencing regime has only been in force for a little over two years, half of which has been impacted by the economic shock caused by Covid-19. Given the significant regulatory and wider developments outlined above, there is a challenge in attributing impacts of the ring-fencing regime and proprietary trading rules. While theoretical literature exists, there is less empirical evidence on the effect of the UK ring-fencing regime. The Review Panel is keen to address that shortfall through this call for evidence.

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14 https://www.openbanking.org.uk/about-us/latest-news/adapting-to-survive-uks-small-businesses-leverage-open-banking-as-part-of-their-covid-19-crisis-recovery/ (accessed 16.3.2021)

15 https://www.ipsos.com/ipsos-mori/en-uk/personal-banking-service-quality-great-britain-february-2021

16 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/904140/2020_template_PLR_CfE_27072020_final.pdf

17 https://www.innovatefinance.com/news/the-uk-retains-its-crown-as-europes-capital-for-fintech-investment/

18 According to Thomson Reuters, the percentage of the retail market using the five largest banks was 77% in Q2 2018, slightly less concentrated than a 2014 CMA's report, itself only slightly less concentrated than the 2011 ICB report where the ***four*** largest banks accounted for 77%.

19 https://www.bacs.co.uk/Resources/FactsAndFigures/Pages/CurrentAccountSwitchServiceStatistics.aspx

20 https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2019/december-2019.pdf?la=en&hash=4A650CF0FB871B5094C614C99689D9AD930CAA01

Annex A

Further considerations for responses

Financial stability

A.1 In line with the requirements set out by the Treasury in the ToRs for this review, a significant proportion of this document refers to the impacts on financial stability. References to financial stability are in line with the Bank of England's interpretation of financial stability, which states that "A stable financial system is one that can provide crucial services to households and business in good times and bad." [1]

A.2 It is also helpful to consider the World Bank description of financial stability as a combination of "the absence of system-wide episodes in which the financial system fails to function (crises)" and "the resilience of financial systems to stress." [2] In this document, increasing or reducing risks to financial stability refers to i) the likelihood of a financial stress or event taking place, and ii) the ability and resilience of the financial system or authorities to manage that stress or event.

A.3 When considering the call for evidence questions relating to potential negative consequences for financial stability, this could arise from a range of issues such as potential fragmentation of liquidity and capital, undesirable interactions with the objectives and operation of other regulatory regimes, changing risk profiles of lending for certain banks, the moving of risks to other parts of the financial system, or the moving of risks beyond the regulated system, to name but a few.

Impacts of ring-fencing

A.4 A number of questions in this call for evidence focus on the impacts of ring-fencing on areas such as the mortgage market and competition. When considering this, it would be useful to think of the impacts of the different components of the ring-fencing regime on:

a. The threshold at which banks fall within the ring-fencing regime;

b. The 'location' of the ring-fence in terms of excluded activities; and

c. The 'height' of the ring-fence in terms of activities between the RFB and NRFB entities.

Market functioning

A.5 When referring to market functioning, the primary interest is in whether particular markets are not operating in an orderly manner due to low liquidity or participation rates, affecting the pricing and quantity of financial instruments. Market volatility in itself is not always evidence of poor market functioning but can be an indicator.

A.6 Overall, the Review Panel would find helpful any examples of market dislocation where assets are no longer priced correctly, as opposed to market corrections as a result of new information or economic shocks, albeit disorderly corrections are of interest.

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[1] https://www.bankofengland.co.uk/knowledgebank/what-is-financial-stability

[2] https://www.worldbank.org/en/publication/gfdr/gfdr-2016/background/financial-stability

Objectives of the RFPT Review

A.7 Within the ToRs set by the Treasury, the Review Panel has considered the following wider objectives for the UK financial sector to be relevant when considering any analysis, assessments and recommendations for ring-fencing and proprietary trading:

a. Ensuring the UK has a resilient financial sector capable of withstanding shocks;

b. Ensuring UK authorities can manage shocks and firm failures, minimising exposure to public finances; and

c. Ensuring the UK has a viable financial sector in order to incentivise innovation and provide a range of high quality, competitive products to all customers.

A.8 Furthermore, in line with the Review Panel's focus on building on the regulatory reforms undertaken to date, it will also have regard to the original objectives and purpose of the legislation that was passed following the ICB and PCBS recommendations.

Outcomes

A.9 Some questions in the call for evidence refer to outcomes for customers or firms. Outcomes for customers (retail or business customers including financial institutions as customers of other financial services) might include the price, quality, availability, or choice of products or services. Outcomes for firms might include the revenue, cost, market share, or profit from selling a product or service. They might also include a firm's product or service mix, its cost of borrowing, or the overall risk profile of its assets. This is not intended as an exhaustive list.

Policy recommendations

A.10 Paragraph 2.6 of 'Chapter 2 – Call for evidence' seeks respondents' views regarding recommendations that the Review Panel may make. When considering this, it may be worth noting that the ring-fencing regime and rules applied to proprietary trading come in the form of primary legislation, secondary legislation and PRA rules, as set out in Table A1.A.

Table A1.A: Components of the ring-fencing regime

Primary Legislation	Secondary Legislation	PRA rules
• Amends FCA & PRA objectives. • Defines 'core activities'. • Defines 'excluded activities'. • Empowers HMT and regulators to make additional ring-fencing rules. • Empowers PRA with new restructuring powers and requires PRA to report annually to Parliament.	• Introduced £25bn 'core deposits' threshold for when the ring-fencing rules kick in. • Sets out more details on the restrictions imposed on the businesses of RFBs. • Defines activities RFBs cannot undertake and type of exposures RFBs cannot have.	Sets out detailed rules and expectations pertaining to, inter alia: • Board composition • Remuneration policy • HR policy • Risk policy • Arm's length terms • Intragroup arrangements • Payments to other group members • Reporting requirements

Source: UK Parliament, Bank of England

A.11 It may also be helpful for respondents to consider the following categories for any proposed recommendations:

a. Potential refinements to existing regulations to clarify areas that may be ambiguous or not well defined;

b. Enhancing or loosening current regulations, for example in the form of thresholds or excluded activities; or

c. Alternative policies that would achieve the same objectives as ring-fencing.

Resilience

A.12 The call for evidence refers to the resilience of RFBs. Resilience is a broad concept. It could include building up an organisation's ability to withstand a shock or reducing an organisation's exposure to a risk thus shielding it from the shock to begin with. The Bank of England defines resilience as "the ability of firms and the financial sector as a whole to prevent, adapt, respond to, recover, and learn from […] disruptions." [3]

Table A1.B: Examples of financial and operational resilience

Financial Resilience	Operational Resilience
• Capital buffers	• Cyber / Information Technology
• Liquidity buffers	• Business continuity
• Stress testing	• Resolution plans
• Recovery plans	• Governance arrangements / reporting

Source: RFPT Review

Risks to public funds and implicit guarantees

A.13 Risks to public funds could materialise as the result of a wide range of circumstances. For this review, the focus is on the narrow set of circumstances established in the Financial Services Act 2012 and the MoU between the Treasury and the Bank of England. [4] These circumstances are where:

a. the Treasury might reasonably be expected to regard it as appropriate to provide financial assistance to or in respect of a financial institution;

b. the Treasury might reasonably be expected to regard it as appropriate to incur expenditure in connection with the exercise of powers under the Special Resolution Regime (SRR);

c. the Financial Services Compensation Scheme (FSCS) might reasonably be expected to request financial assistance from the Treasury; or

d. where the Bank of England makes emergency liquidity assistance (ELA) or liquidity support via the Resolution Liquidity Framework (RLF) available to one or more financial institutions.

A.14 Recent Bank of England work in this area includes quantitative assessments of the 'implicit guarantee' which estimates that the implicit subsidy to UK bank shareholders fell from c.£45 billion in 2010 to less than c. £5 billion at end-2016. [5]

[3] https://www.bankofengland.co.uk/-/media/boe/files/speech/2020/resilience-in-a-time-of-uncertainty-speech-by-nick-strange.pdf
[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/652187/Memorandum_of_Understanding_on_resolution_planning_and_financial_crisis_management_October_2017.pdf
[5] https://www.bankofengland.co.uk/speech/2021/february/dave-ramsden-institute-of-chartered-accountants-in-england-wales