



Consultation Response

A smarter ring-fencing regime - Consultation on near-term reforms

November 2023



Introduction

The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

Our Banking, Company & Insolvency and Consumer Law sub-committee's welcomes the opportunity to consider and respond to the HM Treasury consultation: A smarter ring-fencing regime Consultation on near-term reforms¹.

We have the following comments to put forward for consideration.

General Comments

We consider there should be a desire to minimise additional risk to RFBs, and a request to consider an increase to DPS limit and ensure that consumers are kept informed when protection is diluted.

We also suggest that powers should be delegated to the Prudential Regulation Authority (PRA) to adjust exemption tolerances individually or collectively.

We have included some further responses to various of the specific questions raised within the proposals below. Cognisant of the broader policy interest in safeguarding RFB customer interests, these responses largely advocate for a risk-based approach to the relevant concessions to the ring-fencing framework, which are under consideration.

Consultation Questions

Deposit threshold

¹ [A smarter ring-fencing regime - Consultation on near-term reforms.pdf \(publishing.service.gov.uk\)](#)

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

We think the proposed increase to the deposit threshold seems suitable, given the intervening evolution of the banking industry following the initial inception of the ring-fencing regime. It also appears appropriate that this threshold is periodically revisited, with respect to conceivable upward or downward revisions, to accommodate varying industry conditions and the overriding requirement to protect consumers of retail banking services.

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?

We have no comments.

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

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

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

We have no comments.

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?

We have no comments.

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?

We have no comments.

(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?

We have no comments.

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?

We think that the proposal seems logical, given the emphasis upon rationalising *de minimis* and trivial RFI exposures. However, in common with the proposed increase to the ring-fencing deposit threshold to £35 billion, the on-going review of the scope and size of the exposure limit would be beneficial to ensure this is meaningfully calibrated to prevailing industry circumstances and regulatory interests. We think that consideration could also be given to delegating power to revise this limit, within defined parameters and upon occurrence of certain trigger events, to the PRA, given the PRA's regulatory proximity to the ring-fencing regime.

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

With respect to technical compliance, the proposed exemptive threshold would provide a helpful and practical safe harbour to RFBs. In practice, it is both conceivable and likely that RFBs will continue to avoid and minimise RFI exposures. However, the proposed relief would, nonetheless, likely improve the compliance response to minimal RFI exposures, which should benefit both RFBs and limit reporting of non-material exposure contraventions to the PRA.

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

We have no comments.

Geographical restrictions

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

We think this seems an agreeable concession and may yield operational benefits to RFBs. For example, where otherwise permitted, if RFB products and services could be more effectively deployed via a branch in a third country jurisdiction, rather than on a cross-border basis. Retaining some flexibility to maintain third country establishments would also enable RFBs to engage and insource specialist personnel. Presently, RFBs, rendering legitimate business in third countries, that place a high level of reliance on external consultants may receive an uneconomical, less attuned and hence sub-optimal service, in contrast to NRFBs and third country providers. The invariable corollary is that RFBs may face a competitive disadvantage, relative to NRFBs and non-ring-fenced third country peers, that are not similarly constrained.

Mergers & acquisitions

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

Ensuring transitional parity with other analogous M&A-driven scenarios would be sensible. As a broader but relevant item, consideration could be given to enabling the PRA to grant a one-year extension, in prescribed and exigent circumstances, to the prerequisite transition period.

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?

We have no comments.

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?

We have no comments.

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.

We have no comments.

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?

We have no comments.

Exposures to small financial institutions

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

We believe this appears to be a logical concession, in light of the circumscribed scale and risk profile of small RFIs, particularly those with a retail offering chiefly relevant to other RFB customers. Enabling such RFIs to access the same RFB services as other RFB customers may (even if only anecdotally) help such customers achieve better financial outcomes. By example, if an RFI financial advisor banked with and consumed similar or analogous RFB services as one of its advised customers, the advisor may be better placed to provide informed financial advice to its customers on that RFB's services (subject to conflict of interest considerations etc.).

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?

We think that subject to suitable delineation of 'standard' trade finance activities, which would become permissible, this seems a logical concession and may help prevent RFBs being inadvertently disenfranchised from otherwise routine financing transactions.

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.

We have no comments.

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”?

We have no comments.

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?

We have no comments.

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

We have no comments.

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)?

We have no comments.

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)?

We have no comments.

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

We have no comments.

Servicing central banks

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

We have no comments.

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

We have no comments.

Inflation swaps

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

We have no comments.

Mortality risk and lifetime mortgages

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

We have no comments.

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?

We think this would be a prudent revision, which would ultimately further RFB customer interests and lend efficacy to the existing ring-fencing regime.

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

Yes, the RFB's exposure, as principal, should be closed-out as quickly as possible, reflecting the necessarily time-limited and narrow scope of the proposed safe harbour. In other words, the RFB's involvement in the execution of the trade should be solely limited to unwinding the relevant operating (not customer trading) error.

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?

Yes, we agree in principle, particularly in the interests of ensuring commercial parity amongst NRFBs and RFBs in terms of the development of new products and services, this proposal could also prove beneficial. However, as summarised within the proposal, such a concession should be subject to prescribed qualitative and quantitative conditions, to minimise scope for potential misapplication of the relief.

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?

As test trades would be undertaken on a limited basis and for the purposes of assessing new product functionality offered by an RFB (hence the product quantum *should* be reasonably limited), enabling the parallel £100,000 RFI exposure to be incurred for these purposes would seem sufficient. Consideration could, however, be given to delegating power to the PRA to review and revise this limit, should it subsequently prove insufficient.

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?

We have no comments.

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?

We have no comments.

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

We have no comments.

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?

We have no comments.

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?

We have no comments.

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?

We have no comments.

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?

We have no comments.

Notice of determination for onboarding

Question 38 – Do you consider that the NoD requirement should be removed for onboarding NRFB customers, and if so, why? Status of trustees and insolvency practitioners

We have no comments.

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

We have no comments.

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?

We have no comments.

Conduit vehicles

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

We have no comments.

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

We have no comments.

Related undertakings

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

We have no comments.

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

We have no comments.

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?

We have no comments.

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?

We have no comments.

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?

We have no comments.

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

We have no comments.

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.

We have no comments.

Other areas

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

We have no comments.

Impact assessment

Question 51 – What do you expect the impacts to be of the proposed near-term reforms, in particular on: (i) competition in the banking sector; (ii) the competitiveness of banks; (iii) customers (individuals and businesses); and (iv) the UK's financial stability.

We have no comments.

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

We have no comments.

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

We have no comments.

Equalities impact

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

We have no comments.

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

We have no comments.

For further information, please contact:

Gavin Davies
Policy Team
Law Society of Scotland
DD: 0131 370 1985
GavinDavies@lawscot.org.uk