

# COMMENTARY

## THE FINANCIAL SERVICES (BANKING REFORM) ACT 2013 – AN OVERVIEW OF THE RING-FENCING REGULATIONS

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COMES INTO FORCE 1<sup>ST</sup> JANUARY 2019

**This commentary aims to provide an overview of what are now commonly referred to as the “ring-fencing” regulations, introduced by the Financial Services (Banking Reform) Act 2013 (which makes various amendments and inserts provisions into the Financial Services and Markets Act 2000 (FSMA) (the “Act”), which requires the Prudential Regulation Authority (“PRA”) to implement additional regulations for core UK financial services and activities.**

### **WHY HAS THIS COME ABOUT?**

To prevent a repeat of the impact of the global economic crisis which began in late 2007.

To protect consumers, so that their funds are protected.

To protect taxpayers, so that in theory the government will never need to bail out a financial institution (as it did with Royal Bank of Scotland).

To allow structural changes to banking groups, so that if the investment banking division of a bank collapses, the retail division of the bank will still be able to run.

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## WHAT DOES RING-FENCING ACTUALLY MEAN?

**“Ring-fencing is a way to structurally separate retail banking activities from wholesale and investment banking activities.”**

The Act implements the recommendations of the **Independent Commission on Banking** to consider a restructure of the banking sector.

This basically means that UK banks should ring-fence their retail division from the rest of the bank's operations, so both can operate independently.

Martin Waller's quote in 'The Times' sums up ring-fencing: *'The separation of their riskier casino banking activities from the retail side that looks after yours and my money.'*

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## LEGISLATION KEY POINTERS:

Definition of a ring-fenced body: *'means a UK institution which carries on one or more core activities'* (section 142A(1) of the Act).

The Act ring-fences **'core activities'**: defined in section 142B(2) of the Act as *'the regulated activity of accepting deposits...'*

Essentially, banking divisions that undertake core activities must do so in a ring-fenced body.

Institutions that have **more than GBP 25 billion** of core deposits for a three year period will be subject to the ring fencing requirements.

Ring-fenced bodies are prohibited from undertaking **excluded activities** under section 142D of the Act, which again shows the government's commitment to protect retail banking from risks unrelated to it.

**Ring Fencing Transfer Schemes ("RFTS")** (*Schedule 1 of the Act (Part VII of the FSMA) deals with this in detail but I have detailed a few pointers below*):

- RFTS will allow banking divisions to restructure their business to comply with the ring-fencing requirements.
- Procedure: an application must be made to the court along with a **scheme report** to be authored by a person appearing to the PRA to have the skills necessary to enable a person to make a proper report.
- Key questions to be addressed in the scheme report:

*Section 109A (4)(a) whether persons other than the transferor concerned are likely to be adversely affected by the scheme, and*

*Section 109A (4)(b) if so, whether the adverse effect is likely to be greater than is reasonably necessary in order to achieve whichever of the purposes mentioned in section 106B(3) is relevant (known as the **'statutory question'**.)*

- Note that the PRA and the FCA (the key regulators) will work together throughout each individual RFTS process and consult each other as required.
- Banks will also need to ensure that customers are aware and receive information about the transfer, and issue communication to this effect.

## POSSIBLE IMPLICATIONS OF RING FENCING AND WHAT IT COULD MEAN FOR BANKS?

**Tax**  
**Contracts**  
**Employment matters**  
**Disputes**  
**Competition**  
**Cost implications**  
**Property occupation**

### Cost Implications

Expensive to implement the reforms – will these costs be passed onto customers?

### Contracts

If different areas of the banks are now going to be independent, contracts may need to be amended, novated and/or assigned.

Possible knock on effect on all other contracts that govern banks.

Possible new contractual arrangements for ring fenced banks.

### Disputes

Will the separation of banking operations lead to internal disputes between the banking divisions?

### Property Occupation

If the ring-fenced bank is to be separated, where does the new ring-fenced entity now reside?

### Tax

The legal structure of banks may well change, therefore it is inevitable that significant tax implications will follow.

### Competition

Will separation between the banking operations mean that banks are no longer seen as a single entity?

### Employment Matters

Potential impact could extend to moving employees around and the possibility of new employing entities, as opposed to one entity to cover the whole bank.

**Banks have already started to prepare and plan for the implementation of the ring-fencing requirements, as the rules come into play on 1st January 2019. Only time will tell and show the real impact this has on the banking sector and the wider economy as a whole.**

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