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Compliance with UK Ring-Fencing Rules

As the compliance deadline for the ring-fencing rules is approaching, UK banks are facing a number of implementation challenges that put pressure on their existing operations

The ring-fencing legislation, part of the UK government's response to the financial crisis, is aimed at strengthening the UK banking industry, improving transparency and protecting consumers and taxpayers. Ring-fencing rules mandate that critical banking services for retail and small and medium sized enterprise (SMEs) clients are offered within a ring-fenced bank (RFB), whilst more complex and riskier activities are offered by a non-ring-fenced bank (NRFB). These rules are applicable to any bank with core deposits from retail and SME clients over £25 billion.

Based on these principles, ring-fencing rules have impacted all big UK banks i.e. Barclays, Royal Bank of Scotland (RBS), HSBC, Santander UK and Lloyds. The response to the ring-fencing rules depends heavily on each bank's current and future business model. According to a report published by Moody's last year, for Lloyds and Santander UK their existing principal UK banking entities are likely to become the RFB. For Barclays, HSBC and RBS, on the other hand, their principal existing UK banking entities are likely to become a NRFB.

A key issue on the implementation of the ring-fencing rules is the approach towards the separation of the banking activities. Some banks are expected to book the 'permitted' activities inside the RFBs and the 'non-permitted' to the NRFBs. Other banks may simply choose to move their full institutional and corporate clients' portfolio to the NRFBs.

'Permitted' activities include current accounts, savings, mortgages and some corporate lending. 'Non-permitted' activities include but are not limited to trading activities, debt capital markets products, complex derivatives and most of corporate lending activities. Either way, the expectation is that each of the major UK banks subject to ring-fencing will maintain both RFB and NRFBs within their UK banking groups.

Whichever approach banks take towards ring-fencing there will be a need to migrate clients from the current legal entity to another. Where banks choose to move clients into a new ring-fenced entity it will require the migration of large numbers of retail and SME accounts along with the requisite issuance of new sort codes, account numbers, cheques books, debit and credit cards as well as migrating direct debits and standing orders etc. This is a significant operational task and will require careful management to ensure a seamless transition for customers.

The alternate approach will require moving smaller numbers of customers but more complex products and will also require a greater degree of customer consent to be able to implement the transfer.

The challenges facing banks will vary depending on the approach and the institution but each will need to ensure there is an appropriate banking entity in place to handle the respective activities, as well as ensuring that each entity has a viable standalone business model.

The new entities will require sufficient capital and infrastructure as well as standalone management and governance structures.

Banks need to consider which activities must be standalone and which can be managed at group level to maximise efficiency.

The operational aspect of the transition will also be significant to make sure that the correct exposures are transferred and all relevant parties are aware and informed. To achieve this, customer communication is key. Customers need to be informed of their rights and how their relationships with the banks are changing with respect to terms of business, settlement details and communications.

Banks will also face significant legal due diligence to ensure that the requisite approvals and documentation is in place to be able to transfer exposures from one legal entity to another.

As banks are implementing challenges gradually, it's expected the ring-fencing entities to be up and running from the middle of 2018, well before the January 2019 deadline. In addition, banks need to consider another type of restructuring for when UK leaves the EU in March 2019. The Brexit-related restructuring plans may be delayed depending whether the UK government will secure a transitional arrangement. The uncertainty around Brexit and the ring-fencing plans are putting banks under increased pressure and pushing up their costs.

Getting in touch

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