Agenda Item 5

Chelmsford City Council - Treasury Management and Investment Sub-Committee

19th June 2023

Update on Banking reforms

Report by:
Accountancy Services Manager (S151 Officer)

Officer Contact:
Phil Reeves, Accountancy Services Manager (S151), phil.reeves@chelmsford.gov.uk, 01245 606562

Purpose
To provide an update on potential upcoming changes in the banking system following a review of the ring-fencing regime by an independent panel.

Recommendations
To note the report

1. Background

1.1. The Financial Services (Banking Reform) Act 2013 (the Act) enacted a bank ring-fencing regime as a response to the 2008-09 global financial crisis. The reforms were intended to increase resilience and regulation in the banking sector against significant weaknesses exposed during the crisis and minimise the risk of costs of bailing out banks to taxpayers.

2. Changes brought in by the Act

2.1. The reforms included substantial increase in the requirements for banks to maintain capital and liquid assets as well as more challenging supervisory approach.

2.2. It introduced ring-fencing to separate retail banking services, deemed as more critical, from the riskier non-retail activities of investment and international banking.

2.3. The requirement to ring-fence was to be applied to banks with more than £25 billion of core deposits.

3. Independent review of the regime

3.1. The Act came into effect in January 2019 and included a requirement for a review of the regime to be undertaken by the Treasury after two years in operation.

3.2. The Treasury appointed an independent panel during 2021 to conduct the review and the panel published its report in March 2022.

3.3. The main findings in the report:

3.3.1. That the Ring-fencing regime is worth retaining, in panel's view, the overall package of reforms made retail banking safer than it was before the global financial crisis and ring-fencing contributes to this additional safety by creating distinct retail deposit-taking entities that are well capitalised and liquid.

3.3.2. The panel reported that the benefits of the ring-fencing regime may reduce in the future as the resolution regime designed to ensure the continuation of the critical functions is embedded. The panel recommended that the Treasury should review how better to align the ring-fencing and resolution regimes to ensure a simpler and more coherent regulatory regime in the future.

3.3.3. The report made series of recommendations and measures to reduce the rigidity of the existing regime and to address unintended consequences identified by the panel and to improve the functionality of the existing regime, making it more adaptable and simpler while maintaining appropriate financial stability safeguards.

3.4. The Government has published its response to the report and intends to bring forward secondary legislation later in the year following its consultation on the proposed reforms.

3.5. The Government has stated that the proposed reforms will:

- Take banking groups without major investment banking operations out of the regime, supporting domestic competition by removing requirements from retail-focused banks where ring-fencing does not provide financial stability benefits and removing a barrier to growth for smaller, growing banks.
- Update the definition of Relevant Financial Institution, removing a barrier preventing some small businesses such as high street financial advisers from accessing financial services and removing a disproportionate compliance burden on banks.
- Remove blanket geographical restrictions on ring-fenced banks operating subsidiaries or servicing clients outside the European Economic Area (EEA), helping UK banks to compete internationally and supporting UK businesses operating abroad while leaving space for regulators to manage any associated risks to their objectives.
- Take forward technical amendments outlined in the review to improve the functioning of the regime, removing unintended consequences, and providing benefits for the sector and the economy.
- Review and update the list of activities which ring-fenced banks are restricted from carrying out, to assess whether certain activities could in future be undertaken safely by ring-fenced banks to improve the supply of financial services to consumers and businesses. For example, this review will consider changes which could:
    - allow ring-fenced banks to hedge mortality risk to provide lifetime mortgages;
    - allow ring-fenced banks to provide inflation swaps to facilitate more project finance, including infrastructure;
    - allow ring-fenced banks and businesses greater flexibility to restructure loans through the debt for equity swap exemption; and
    - in specific cases, allow ring-fenced banks to take strategic equity stakes in certain types of technology companies where those enterprises are partnered with the bank to develop innovative solutions to improve and enhance bank customer experiences.

3.6. The Government agreed with the panel’s recommendation for better alignment of the ring-fencing and resolution regimes and issued a public call for evidence in the first quarter of 2023 on benefits of the ring-fencing regime in light of developments in the resolution regime but has not yet publish its outcomes from the consultation findings.

3.7. In addition to the Panel’s recommendations, the Government is also proposing to consult on increasing the limit at which the banks need to apply the ring-fencing regime from £25 billion to £35 billion and the consultation process will consider any potential risk to financial stability and provision of banking services with regard to any competition effect as part of the consultation.

4. Potential risk implication of the proposed reforms

4.1. Council officers consulted with our external treasury advisor, Link, to seek advice on any potential increased risks for the Council arising from the above reforms. The advice given is that the above measures do not appear to seek to deregulate the sector but to address any unintended consequences of the regime in place and provide more flexibility, as it is in the sector's interest to be seen as stable and well regulated.

5. Conclusion

4.1. The changes to the ring-fencing regime are not expected to bring any significant increase in risk for the Council and the Council will not need to make any changes to the treasury strategy as a result of these banking reforms.

List of appendices:

Background papers:

Corporate Implications

Legal/Constitutional: None

Financial: None

Potential impact on climate change and the environment: None

Contribution toward achieving a net zero carbon position by 2030:

N/A

Personnel:

N/A

Risk Management: The strategy does not need to be amended

Equality and Diversity:

N/A

Health and Safety:

N/A

Digital:

N/A

Other:

N/A

Consultees:

Relevant Policies and Strategies:

Treasury Management Strategy