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Regulatory and prudential control issues in the UK banking sector: the regulatory tsunami

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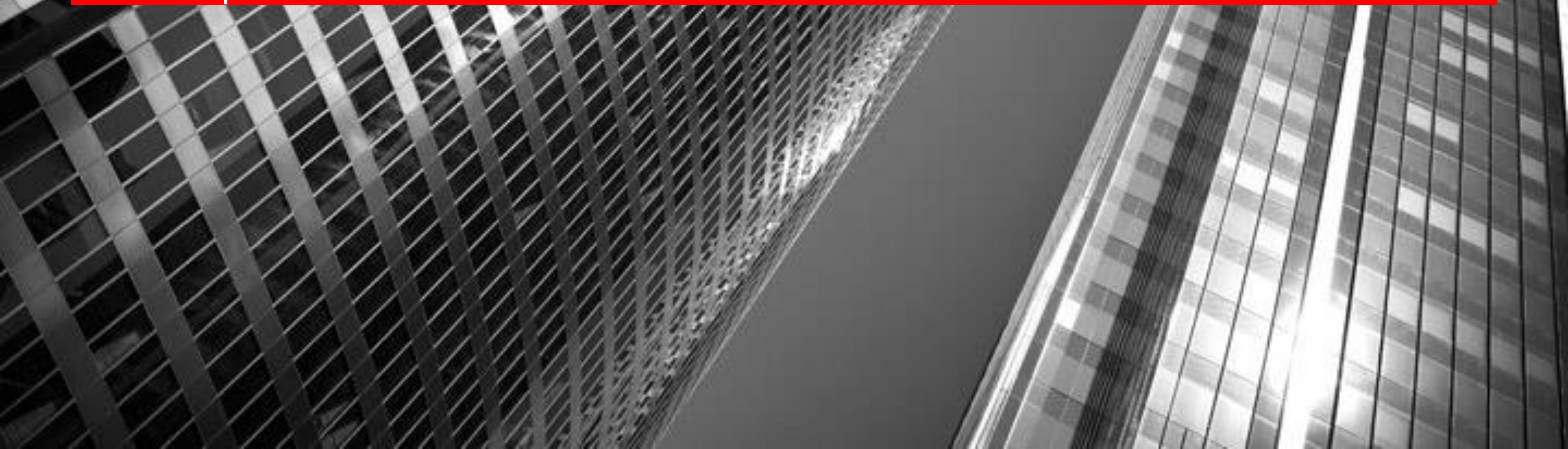
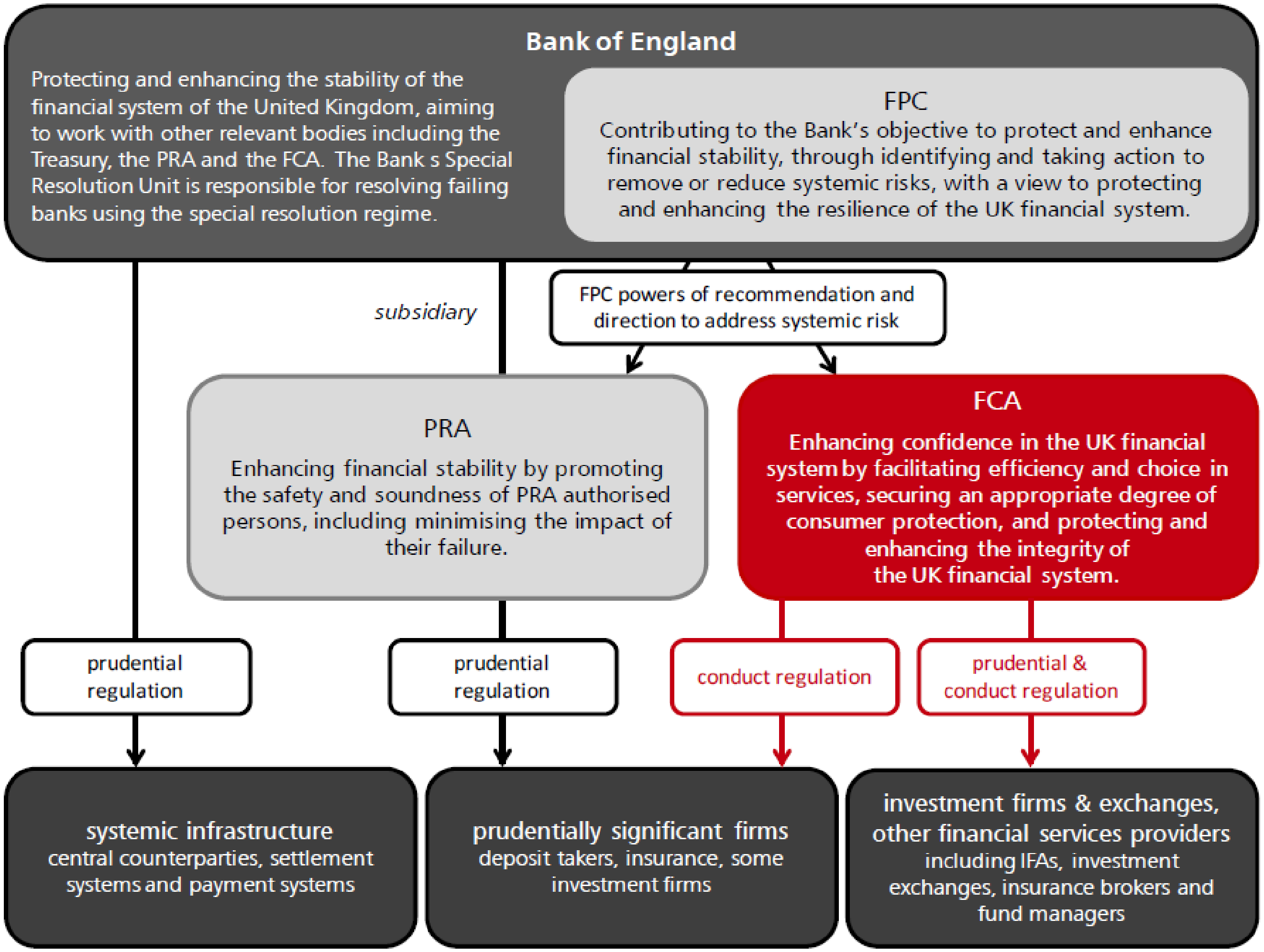


The overall new structure

Roles of the bodies in the new regulatory architecture



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PRA: the banks' prudential regulator

- More "judgment based" style of supervision:
  - Reference to supervision going "well beyond" assessing compliance with rules
  - Nature and intensity commensurate with the firm's level of risk
  - Creative compliance by firms discouraged
  - Supervisory assessment to cover all relevant entities within the consolidated group
- More intensive supervisory assessment

How banks should gear up for the changes

- Implementation team/regulatory secretariat:
  - Overall responsibility for implementation and liaison with senior management
  - Keeping track of the Government and FCA/PRA papers and reviewing interaction with European initiatives
  - PRA policy developments and how they relate to different business lines
  - FCA policy developments and how they relate to different business lines
  - Ring-fencing and the interface with the new regime
  - Managing relationship with new regulators
  - Updating and provision of information
  - Internal policy and distribution of information
  - Training and preparation
- Education:
  - How briefed are your board and senior managers?
  - How would your existing products and fin proms cope under the new regime?
  - Have you identified any pressure points the new regime would create for your business?
- Cost

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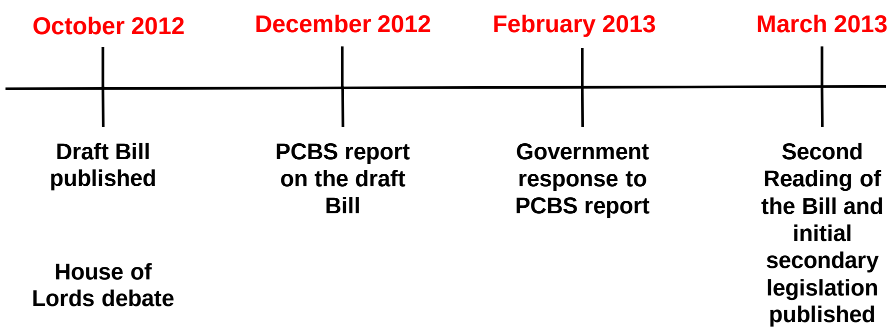
Financial Services (Banking Reform) Bill- 2012-2013

Bill timetable

- The Bill represents a far reaching response to the 2008 banking crisis
- UK changes are a forerunner to Europe
- Development timeline of the Bill:



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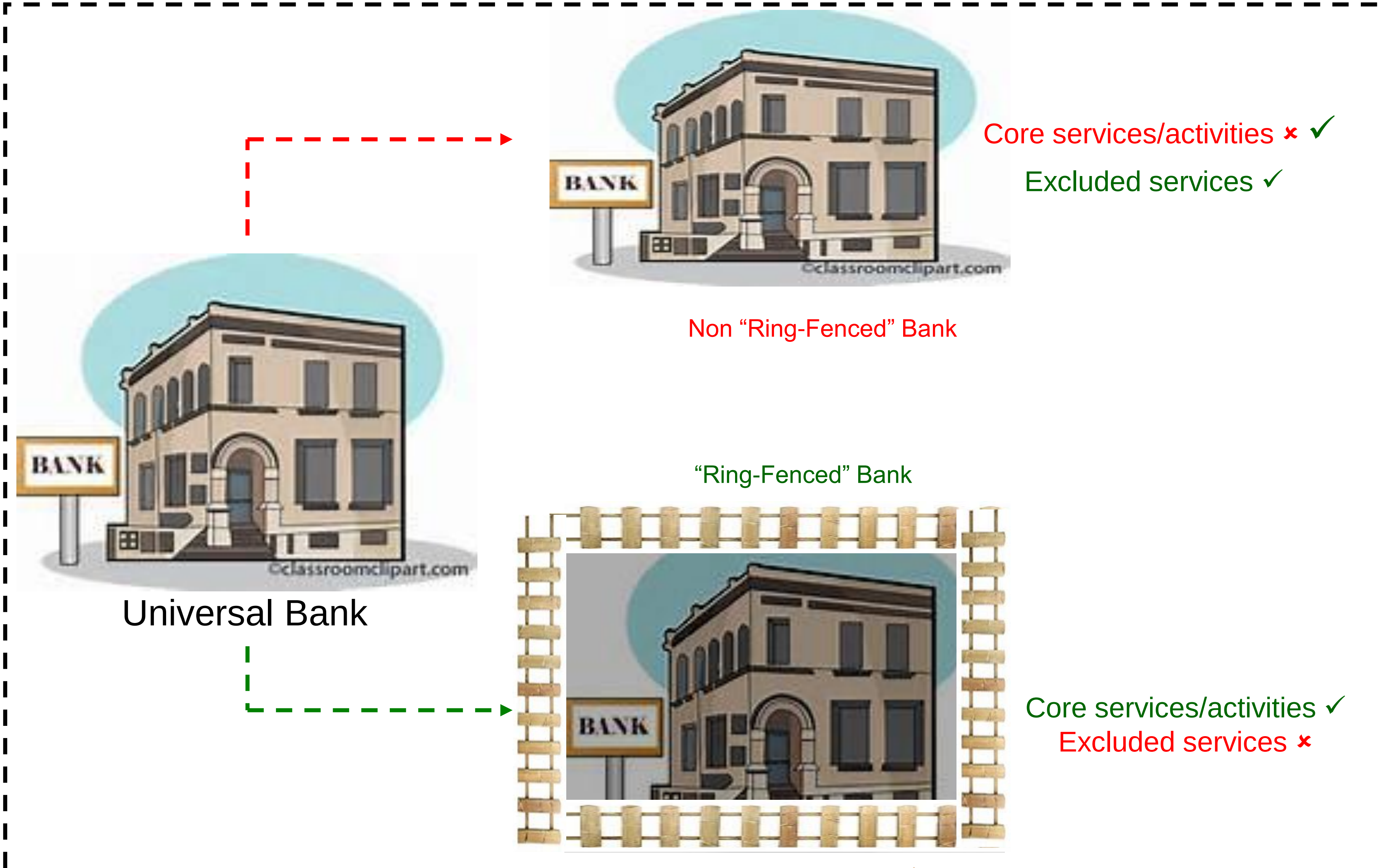
Structure of the Bill

- Relatively short (heavy reliance on secondary legislation)
- Material secondary legislation to go before the house
- Primary and Secondary legislation to be completed by end of current Parliament (May 2015)

Function of the Bill – “Ring-fencing”



Which banks are caught?

Key:

1) "High net-worth individual" means having free and investable assets to the value of £250,000 or more
2) "SME" means an enterprise which (i) employs fewer than 50 staff and (ii) has a turnover of not more than £6.5 million or an annual balance sheet total of not more than £3.26 million OR which is a charity or voluntary organisation which has a gross income of not more than £6.5 million

"UK institutions" (incorporated in the UK)

↓

Carries on "core activities" → Accepting deposits

↓

Holds "core deposits" > £25billion → Deposits held within the institution within EEA accounts for (i) non-high net worth individuals and (ii) SMEs

↓

Core deposits of group members that are "UK institutions" aggregated for the purposes of assessing £25billion threshold → Clydesdale bank and Yorkshire Bank would be aggregated on this basis

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Ring-fencing rules contemplated

- Designed to ensure core activities not impacted by acts or omissions of other group members
- Focused on creating operational independence (e.g. if a group member providing services becomes insolvent)
- Contracts with other group members must be on “arm's length terms”
- Potential restriction on dividends to other group members
- Disclosure of transactions with other group members
- Board independence from other group members
- Treasury can force the regulator to impose rules in certain situations
- PRA to review rules every 5 years and report to Parliament

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Approach of other countries

- USA
  - no ring-fencing
  - Dodd-Frank Act requires derivatives trading businesses to be operated from a separate entity to banking activities
  - “Volcker Rule” prevents banks (i) proprietary trading (ii) investing in or sponsoring hedge funds or private equity funds
- France
  - no ring-fencing
  - “dedicated subsidiary” route for (i) own account dealing in financial instruments (but prohibition on certain high frequency trading or where the underlying subject matter of the instrument is agricultural commodities) (ii) investing in or providing unsecured financing to hedge funds or similar funds (similar to “Volcker Rule”)
- Global model?

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