Banking Reform Struggles On

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Introduction

The Financial Services (Banking Reform) Act 2013 was passed as part of an ongoing process to improve the stability of the UK's banking system. It does not sit in isolation but is part of a process that has involved the creation of the Prudential Regulation Authority, the Financial Conduct Authority and the adoption of the EU's CRD IV which brings the Basel III banking regulations into EU law. The background for the statute's content was Sir John Vickers' Report[2] into banking reform, published in September 2011, which led in turn in turn to the June 2012 White Paper[3]. At the same time the Parliamentary Commission on Banking Standards was examining accountability and corporate governance in the context of the LIBOR scandal as well as the issues of banking stability and competition[4].

However, the content and aims of the statute sit oddly with the causes and processes of the most recent banking crisis and had it existed at the time it is unlikely to have made much difference. This article will examine the aims and content of the Act and consider what its consequences are likely to be.

The aims of the Act are to separate retail banking deposits from wholesale banking activities by 2019[5]. to increase loss absorbency, and powers are granted to the PRA to facilitate this. Higher standards are imposed on bankers' conduct by introducing a more stringent approval regime for senior managers and a new certificate regime is being brought in for those in "*significant responsibility functions*". A criminal offence of reckless misconduct is created and depositors are given priority on a bank's insolvency[6]. The Act itself also covers the bail in stabilisation option[7], the conduct of people working in the industry[8] and the regulation of both payment systems[9] and infrastructure systems[10]. These will be examined in turn.

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[2] The Independent Commission on Banking: The Vickers Report
[3] Banking reform: delivering stability and supporting a sustainable economy
[4] Parliamentary Commission for Banking Standards: "Changing banking for good"
[5] Part 1 and Sch 1 Financial Services (Banking Reform) Act 2013
[6] Part 2 *ibid*
[7] Part 3 and Sch 2 *ibid*
[8] Part 4 *ibid*
[9] Part 5 *ibid*
[10] Part 7 *ibid*

Ring Fencing

Dealt with by the first part of the Act, this is the long standing matter of whether or not retail banks should be able to involve its depositors' money in investment banking activities. The Act[11] extends the PRA's and FCA's powers to making sure that the business of "ring fenced bodies" is carried on in a manner which safeguards its core business in the UK and which minimises the risk of it causing or becoming involved in systemic failure, though the powers do not extend to building societies[12]. The Treasury[13] is also given power to exercise their powers so as to minimise any adverse effect on competition. The Act[14] also determines that deposit taking is a core activity and core services are those which relate to this. The Treasury has the power to extend the range of activities so defined and to determine[15] that those holding investors' deposits can deal as principal in investments and the range can be extended further having regard to the risks involved. There is however a critical limitation. It can only be done "*if the Treasury are of the opinion that the making of the order is necessary or expedient for the purpose of protecting the continuity of the continuity of the provision in the United Kingdom of core services.*" Conversely the Treasury can also impose limitations[16] for the same reasons. In either event appropriate rules can be passed. Interestingly, breaching the limitation on core activities is not an offence[17], nor does it make contracts void or unenforceable[18] though it will be treated as a contravention of the requirement.

Ring fencing itself is not clearly dealt with in the statute but the PRA/ FCA will have the capacity[19] to rule on shareholdings in other companies to maintain ring fencing. A remuneration policy can also be imposed for the same purpose. The Treasury can over-rule them and so has ultimate power in this regard[20].

Restructuring can be ordered if one of the following conditions is at issue. Core activities are being adversely affected by the activities of other members of the group; the ring fenced body is unable to make decisions independently of the rest of the group, or the ring fenced body is becoming dependant on resources provided by another member of the group which would not then be available in the event of another part of the group failing. Likewise, in the event of insolvency one or more other members of the group would be unable to continue; and the ring fenced body is engaging in an activity that breaches a PRA/ FCA regulatory objective. Orders can be given by both regulators to ring fenced firms and this includes[21]

[11] S. 1 Financial Services (Banking Reform) Act 2013
[12] S.4(1) inserting a new s.142A (2) (b) in the FSMA 2000
[13] S. 4 inserting a new s.142A in the FSMA 2000
[14] New s.142
[15] S. 142 D *ibid*
[16] New s.142E
[17] S.142 G (2) (a)
[18] (b) *ibid*
[19] S. 142 H *ibid*
[20] New s.421 I
[21] New s.142 O

discharging it from any liabilities[22] and some or all of the business can be transferred to a third party.

It is perhaps worrying that the requirement for the procedure should involve the regulator issuing a preliminary notice to the firm concerned and that they must be given a minimum of fourteen days in which they can make representations to that regulator[23]. This could prove a problem in a fast moving crisis. One recalls the three day delay in the nationalisation of Northern Rock caused by the Bank of England's concerns over the impact of the market abuse laws, albeit mistakenly[24]. Presumably when the regulations themselves appear in a future statutory instrument there will be an emergency procedure available. Particular provisions exist to try and safeguard the firm's occupational pension funds[25].

The Treasury can make orders regarding a ring fenced firm's loss absorbency and require it to issue debt paper of a determined type. This is a fine idea in theory, but in practice who would buy such debt paper and what levels of interest would be needed to attract investors into lending to an institution that is in a survival threatening financial crisis? A state guarantee of the bank issuing the bond would obviously make a big difference but this would raise issues of EU competition law and it could be difficult to provide it quickly. In any event the specifics remain unclear[26], although suggestions have been put forward in the PRA's recent Consultation Paper[27].

It remains unclear as to how exactly banks will be split. The UK proposal differs from the old U.S. Glass Steagall Act[28] which required a straight slit between retail and investment banking and the current Dodd Frank[29] which separates proprietary trading from retail banking but which permits the latter to carry out market making. The forthcoming EU approach appears to require proprietary trading and market making to go into a separate company from retail banking, albeit within the same group. There is a vagueness here but also a degree of eccentricity. Deposit taking is stated to be a core activity in certain circumstances in the new draft statutory instrument. Likewise the definition of "excluded activities"[30] is that of "*dealing as principal*" and largely replicates the definition that is used for financial services regulatory purposes in the Regulated Activities Order[31]. This does not sit very well with what most people would regard as non-core banking activities. It is not

[22] New s.142 (5) (c)
[23] New s.142 M (4)
[24] Haynes A, "Market Abuse, Northern Rock and the Bank of England." Journal of International Banking Regulation, vol 10, no 4 p321 – 334. 2009 ISSN 0267-937X.
[25] New s.142 W
[26] See for example Strachan D and Andrews J "UK Bank Resolution: The Alphabet Soup of Loss Absorbency." Deloitte.
[27] CP 13/14, July 2014
[28] U.S. Banking Act 1933, partially repealed by the Gramm-Leach-Biley (Financial Services Moderinization) Act 1999
[29] Wall Street Reform and Consumer Protection Act 2010
[30] The new s.142 *ibid*
[31] SI 2001/544 as amended

totally irrelevant as it is partly drafted to protect clients' money when being invested by either a fund manager in its own name, or if having loaned money to a client, an investment bank then invests in its own name. It does however look rather like the start of a stab at the issue rather than a coherent examination of it.

Problems could also arise for SMEs in the form of higher costs who with their deposits in retail banks and the investment banks being uninterested in the scale of business most of them offer, will find themselves operating in a restricted environment. They could find the limited range of derivatives that are available from a retail bank failing to offer both the protection and opportunity they are seeking. They may also find a more restricted range of trade finance available[32]. Larger companies will probably resolve this problem by moving any deposit outside the retail bank to simplify their banking relations

There may also be higher costs for the banks in terms of operating costs relative to operating profits, leaving the banks less profitable than they would otherwise be. There may be also less money to lend to normal banking clients. In addition there have been criticisms[33] that the main statute should have gone into greater detail so that Parliament would be able to debate the issues more thoroughly, however it is probably better that matters proceed as they are doing so that rules relating to the banks can be drafted by subject specific experts.

The Treasury has issued an Impact Statement[34] to try and clarify how the ring fencing will operate. Tax issues are one potential problem as assets such as derivatives, some intangibles, possibly some loans and assets which in some cases might be assessable for capital gains tax will need to be moved from one company to another inside the overall banking group.

Carrying forward past losses could also be an issue as the current tax regime only permits the carrying forward of past losses against the trade the losses occurred in. In some cases this may be easy to apply. For example losses resulting from a property backed securitisation could presumably see losses carried forward against either the lending book or as a loss on an off shore bond issue through an SPV and the loss end up one side the ring fence or the other. In practice a retail bank would only be left with the option of the former. However, where an investment bank has a choice the decision needs making up front and an educated guess made as to where it will be most profitable to carry forward the loss. The extent to which a loss remains be the "deferred tax asset" element, which sits on the bank's balance sheet as an asset, and may need wholly or partly writing off, which has obvious potential capital adequacy implications.

[32] Fleming S. Financial Times, 15th December 2013.
[33] In particular from the Law Society
[34] Financial Services (Banking Reform) Bill (Impact Assessment)

VAT issues are not likely to prove a major problem. Most banking activities are not VAT able, and those that are (leasing, intangible, legal and accountancy support etc) represent a small part of the business. However, as the law currently stands there would be issues with ring fencing as the cross firm, intra group liability for claiming and recovering VAT presumably would not work across such a barrier and so any VAT would not be recoverable across them[35].

There should not be too many issues here, but if any insurmountable ones do appear there seems to be plenty of time spare for lobbying the Chancellor to amend the tax regime. The Treasury have already indicated that they will look at resolving any potential problems.

Preferential debts and Depositor Preference

Bank deposits are now deemed a preferential debt for insolvency purposes up to the amount covered at the time by the Investors' Compensation Scheme[36]. This is slightly odd in that it appears to tread on part of the same ground as the Financial Services Compensation Scheme. Depositor preference will place depositors on a preferential position over other creditors if a bank fails. This does not provide double protection as the depositors get back their money, up to the protected limit, but the first call will be to take the money from the failed institution to the exclusion of other creditors[37] rather than the government. There is justification for this in that the cost is moved from the state to the bank's creditors. The counter argument would be that the state is happy to make large profits from the taxation of banks and tax receipts from its employees when it is successful. Why should they not contribute if it fails?

The limit for protection is £85,000 which may make sense, but what of someone handling an inheritance or moving house who might temporarily be in possession of a larger amount. This has now been approached as an issue by the PRA[38] with a proposal that the Bank of England provides a higher level of depositor protection at £1 million where the funds concerned fall into a restricted range of circumstances. This will be for a period of between three and twelve months and cover "*temporary high balances*" relating to deposits from real estate transactions, those linked to events such as marriage, divorce, retirement, dismissal, redundancy and death and those relating to insurance pay outs and compensation. Many smaller businesses are also the sole or primary source of finance for its owners but unfortunately these would not be protected.

[35] www.deloitte.com 16th September 2014
[36] S.13 *ibid* inserting a new paragraph after 15 A in Sch 6 of the Insolvency Act 1986
[37] Presumably other than secured creditors and liquidator's costs
[38] See PRA Consultation Paper 20/14

Bail in stabilisation

To stabilise an institution the Treasury has the power[39] to order the Bank of England to require a building society to be converted into a company and to transfer its business accordingly. In essence the proposal[40] gives the authorities the capacity to shift potential losses from the depositors and creditors to the shareholders. Debts can also be cancelled.

The question arises as to what part of a banking group's activities should be covered by this. Will it be limited to converting debt and convertibles into equity or writing them off? The obvious danger is that it pushes up the cost to banks of raising capital and if debt paper is issued on the basis of potential convertibility part of the market may not take it up. Pension funds in many cases will be prohibited by their own investment requirements from being able to do so, even if their fund managers were interested in such an offer. The EU rules in the final version of the Recovery and Resolution Directive are still awaited and it may be worth considering whether to await them[41].

Conduct of Business of Financial Services employees

There is a tightening up of the approval of senior categories of approved persons and a strengthening of the capacity to vary any approval[42]. "*Misconduct*" is specifically stated to cover a relevant person failing to comply with a PRA or FCA requirement[43]. There is a noticeable tightening of the responsibilities placed on senior people in banking and financial services institutions. This is an important area, albeit one that may take a long time to fully detail and put in place. "*Senior management functions*" will be defined by the PRA/ FCA and seem to be broadly determined to include anyone involved in decision making such as the head of business areas, senior managers of group entities and significant responsibility functions. This will cover non executives and could in certain circumstances potentially include in house legal advisers[44] and senior people in parent companies where they have been involved in a subsidiary's decision making process. It is perhaps positive that the regulator will require such people to have a "*statement of responsibilities*" setting out precisely what they will be doing, with particular regard to their management function. This process is already beginning.

There is also a reverse burden of proof in general regulatory control involved in as much that senior managers will be presumed guilty of misconduct if their firm has broken the regulatory requirements. To defend themselves against this they need to be able to show that they took reasonable steps to stop the breach occurring.

[39] Under s.17 *ibid*
[40] Which is broadly in line with the EU's Recovery and Resolution DIrective
[41] Consultation closed on 28th September 2014
[42] S.63 ZA to 63 ZE Financial Services and Markets Act 2000, as amended
[43] S.66 A and B *ibid*
[44] Law Society response to the Parliamentary Commission on Banking Standards.

Matters remain unclear, especially as there is further examination taking place this year of the functions of chief risk officer, head of compliance, head of internal audit and non-executive directors. Further developments are inevitable.

Criminal sanctions

There is a new criminal offence[45] of making a decision that causes a financial institution to fail. It is widely defined in the sense that it states that a person "(i) *takes, or agrees to the taking of, a decision by or on behalf of (the firm) as to the way in which the business of a group institution is to be carried on, or (ii) fails to take steps that (they) could take to prevent such a decision being taken.*" The person must have been aware that there was a risk that the decision could affect the institution's survival. The offence is punishable by up to 12 months[46] and/ or a fine on summary conviction or up to 7 years and/ or a fine on indictment. Oddly insurers are excluded from this.

There is a narrowness in the definition, the institution actually has to fail in as much that its survival is at issue. If this section is to have any possibility of working this needs to be defined to include the bank being nationalised, because being realistic that is what *in extremis* will happen if an institution looks as though it is going under. This is a result of the experience of BCCI's failure, where large numbers of small businesses collapsed because they lost their overdraft facilities at short notice. Political expediency is another. There is a second narrowness in that the individual must engage in behaviour that falls "*far below*" that which would be expected. A qualification that seems to be designed to make sure that there is no reasonable prospect of a successful prosecution ever being brought! As this is an area of criminal law it is not surprising that the reverse burden of proof does not apply here as well.

It also means that, if a case was brought, a judge or jury are going to have to determine, probably years after the event, whether or not the decisions made were reckless at the time. Matters may appear greatly different with hindsight and whilst part of the job of being a senior manager or director should involve a degree or prescience, omniscience is not really something they can be expected to provide. The potential criminal liability will tend to be difficult to determine. Northern Rock's lending and securitisation policy was reckless and became increasingly so as it progressed, but would the directors have been found guilty had the new law applied? They could have pointed to the fact that the regulator had carried out a full stress test of the bank six months before it failed and deemed the approach adopted to be successful. The risk is that it will make bank directors defensive and unwilling to take sensible commercial risks.

[45] S. 36 *ibid*
[46] In England and Scotland or 6 months in Northern Ireland

On the other hand, is there really any appetite in the British establishment to actually take such steps? For example, looking back to the 2008 crisis. At the time the FSA (now FCA) Principle for Approved Persons read:

"*An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his accountable function*."[47]

There cannot be any serious doubt that many of those on the boards of directors of the banks which failed in 2008 had failed this test completely. However, how many of them were fined under this provision? None.

At the Royal Bank of Scotland group no-one was punished by the regulators for its overall failure. To quote from the FSA report: "*RBS made a series of bad decisions…these bad decisions were not the result of a lack of integrity of any individual and we did not identify any instances of fraud or dishonest activity by RBS senior individuals or a failure of governance on the part of the board*"

This suggests that the FSA either did not understand their own rule book or wilfully affected no to. The disciplinary steps available were not limited to instances of a lack of integrity but a failure to perform their functions to an appropriate standard. No one expects other regulators, such as those responsible for solicitors, barristers and accountants to fail to take action unless there is evidence of "*fraud or dishonest activity*". Where appropriate they will take steps for negligence, and what would be relevant here, for gross negligence.

The FSA then cheerfully contradicted themselves by stating that "*The competence of RBS individuals can, and will be taken into account in any future applications made by them to work at FSA regulated firms.*" This suggests that there were serious doubts about the competence of the directors concerned.

It should be added that there is an additional FCA Principle that has potential use in this context, namely Principle for approved Persons 5 which states that senior people

"*…must take reasonable steps to ensure the business of the firm for which he is responsible in his accountable function is organised so that it can be controlled effectively."*

It is sometimes nicknamed the Barings Principle because the reason for Barings failure was the bank's management's incapacity to determine that the rogue traders' activities were occurring at all, never mind threatening the bank's survival until the bank actually started collapsing. There may have been scope for utilising this Principle given that the directors of all three key banking groups which failed in this country did not seem capable of understanding the risk their businesses were involved with in part due to their on

[47] The version of the FSA Principles as they then were at the time of the financial crisis did not include the words in blue.

management structures, which stopped an understanding of risk reaching the board in an appropriate manner. At the three major banks that failed there was clearly a failure to get a clear understanding of risk to the top of the institution and that was in part a structural issue, even if personalities were sometimes an aggravating one.

The only step against RBS seems to have been the ban on director John Cameron from working in banking. There seems to be strange discrepancy between this and the FSA's fining of RBS the sum of £5.6m for failing to satisfy money laundering regulations. Compare this also with the FSA's failure to take any action over the 2008 share issue where those who bought the shares later complained that they had not been told the truth about the situation at the bank. This potentially was potentially a criminal offence, amongst others, under the then applicable s.397 FSMA[48] with a maximum sentence of seven years imprisonment.

At HBOS Peter Cummings, the Head of Corporate Banking got a life time ban and a £500,000 fine for "*very serious misconduct*" and the rest of the directors were let off despite the fact that the FSA's own report stated that other senior people were involved in the same decisions. At Northern Rock David jones the Finance director was fined £320,000 and banned for misreporting mortgage arrears "*which he knew to be* false" and the ICAEW required him to pay £3,620 in costs after an investigation into him but did not add a fine because of the scale of the one the FSA had imposed. There were other steps against directors. Deputy Chief Executive David Baker was fined £504,000 for misreporting mortgage arrears and credit director Richard Barclay £104,000 for failing to ensure accurate financial information. Yet no other FSA steps were taken despite the House of Commons Treasury Select Committee reporting[49] that "*the (former) Directors of Northern rock were the principal authors of its difficulties*."

The replacement directors of the bank refused to take *negligence* proceedings against the former directors on the grounds that "*insufficient grounds for doing so*." Their wariness is more understandable.

Where does this leave us? We are left with a regulator who will not take action where the consequences of acts are enormous unless they can show that there has been criminal misconduct despite the fact that their own rules give them power to act on a wider basis. What is troubling is that the regulator seems relaxed about adopting a different approach with smaller firms. Not maintaining sufficiently high standards repeatedly shows up as a basis for acting in such cases[50].

Perhaps though it reflects a deeper instinct, namely that if an issue appears to threaten an aspect the British establishment the matter is swept under the carpet as quickly as possible.

[48] Since replaced by sections 89 to 91 Financial Services Act 2012

[49] October 2007

[50] FSA Enforcement actions: Casoni 20th March 2007, Wolfson Microelectronics plc 20th January 2009, Entertainment Rights plc 23rd January 2009, Perkins 29th June 2010, Cameron 6th July 2010, Betton 6th December 2010, Gower 13th January 2011, Alexander 14th June 2011, Goenka 9th November 2011, Osborne 16th February 2012 and Tribunal decisions such as Visser and Fagbulu 15th August 2011, Geddis 2nd September 2011 and Sejuan 28th September 2012 all illustrate this general approach

The extensive expenses scandal that hit the Houses of Commons and Lords was largely cleared up by requesting the money back and asking those responsible to apologise with prosecutions only being brought when people refused to. An arrangement many bank robbers would be happy to avail themselves of, but will never get the chance!

Alternately, it may simply be an unwillingness to take on tough opposition and can be repeatedly seen in the past in relation to the regulator's unwillingness (albeit the Bank of England in that case) to take steps against BCCI 15 years ago. There it was left to the Americans to force the closure of the bank and to take the necessary steps to try and extradite Hassan Abedi from Pakistan whilst the British did nothing, despite the fact that the banks *de facto* base of operations was in London.

The previous major financial scandal prior to 2008 was the Lloyd's of London crisis twenty years or so ago. A major scandal was dealt with by quietly doing very little and the perpetrators walked free. This being the prevalent establishment attitude it is difficult to see there ever being the political will to bring criminal prosecutions against bank directors in this country, regardless of the political party in power, unless they have engaged in transparently dishonest behaviour.

Payment Systems Regulator

The FCA has had to establish a payment systems regulator although it is not yet operating[51]. Its purpose is to regulate the payment systems which move money between individuals, businesses and government and in so doing it must promote competition and innovation and protect those whose money is being moved[52]. The new regulator does not cover cash settlement systems, securities or recognised clearing houses. There is a requirement that the regulators (the new Regulator, the Bank of England, the PRA and the FCA) co-ordinate their functions[53]. As the Bank has the power to require the Regulator to refrain from specified action[54] it is clearly going to function as more of a *primus inter pares* than was originally assumed by most observers when the new system was created last year. This is probably both necessary and inevitable. The PRA and FCA can also so require[55] and as they sit beneath the Bank of England in terms of effective power a definable pecking order emerges.

Special Administration for Operators of Certain Infrastructure Systems

There is provision[56] for a financial markets administration procedure to be created and the Bank of England is put in charge of it. It is primarily aimed at regulating inter-bank payment

[51] S.40 Financial Services (Banking Reform) Act 2013. It commences operating in April 2015
[52] See www.fca.org.uk. "Payment Systems Regulator". 3rd November 2014
[53] S.98 *ibid*
[54] S. 100 *ibid*
[55] Ss. 101 and 102 *ibid*
[56] S. 111 *ibid*

systems. The Bank may ask for an administration order against such an entity by court order[57] where it believes the entity is unable to pay its debts or is unlikely to be able to. Settlement risk will be reduced through participants being required to prefund their payments with cash held at the Bank of England[58].

Parent Undertakings

The PRA and FCA have the power to require the parent undertaking of a ring fenced body to accept such rules as the regulator deems necessary for the purpose of ring fencing. It should be incorporated in or have a place of business in the UK. The Bank can require debt paper to be issued by the parent, though in those circumstances it is difficult to see who would buy it. The powers extend to subsidiaries. The PRA and FCA must also meet the auditors at least once a year of UK based licensed Deposit takers. Insurers are treated differently.

Ring fencing transfer schemes are provided for[59] and also the key ingredients of stabilisation[60]. A key element is that bail in provisions made be made with regard to a specified bank and that can include the requirement that securities issued by that bank can be transferred to an administrator. Provision can also be made for the future ownership of the bank[61].

Other powers granted in this context include the crucial power to rearrange priorities between creditors by reference to the principles the Bank of England is meant to apply. The administrator can also draw up a business reorganisation plan for submission to the Bank. The administrator can also manage the bank's business[62]. The Bank can remove bank directors, vary their contract of service or appoint a new one[63]. The Bank can also make a bail in of a bank. There are also provisions requiring the Treasury to direct any administrator as necessary where state aid is proposed. There is acknowledgement that this potentially breaches the provisions of Articles 107 or 108 of the Treaty of Rome. This would have to be factored in at the time the decisions were being made.

Finally, secondary legislation has appeared in draft form[64] but too much seems to have been left outside the ring fence when viewed from the vantage point of the banks inside. Concerns specifically relate to[65] the limiting of trade financial services to the issuing of confirmation of documentary credits and guarantees, and the limitation of qualifying

[57] S.116 *ibid*
[58] PRA Consultation Paper CP 13/14. "Implementing the Banking Recovery and Resolution Directive." July 2014
[59] Sch 1 *ibid*
[60] Sch 2 *ibid*
[61] New s.12 A Banking Act 2009 inserted by Sch 2 Part 1
[62] S. 48 I *ibid*
[63] S.48 N *ibid*
[64] The Financial Services and Markets Act (Ring-fenced Bodies and Core Activities) Order 2014
[65] See for example the British Bankers Association, Secondary Legislation Consultation Response. 11th October 2013

instruments. With regard to the former it remains unclear at the time of writing[66] whether banks can provide standby letters of credit, avalisation or bank SWIFT payment obligations. Also, to be eligible in the ring fenced banking sector contracts must be drawn up under UCP 600[67]. This is not the case with standby letters of credit, Islamic trade finance and sovereign export credits, so problems arise in these areas.

Will it work?

There is still a great deal of uncertainty in what the precise make-up of the rules will be, especially with regard to ring fencing, which at least leaves the door open for future lobbying and decisions to be made on how and whether to tie the arrangements in with the forthcoming EU developments. There is a draft statutory instrument available[68] but on the strength of that the details will be in PRA regulations rather than future statutory instruments, which is probably wise, especially when it becomes necessary from time to time to amend them.

There is also the risk that banks could end up having to spilt into three parts with one satisfying the core activities, the second those activities the EU may regard as a core activity or equivalent which is outside the UK definition (or the other way round) and then the other activities in a third company. Thus there would be two ring fences not one.

UK banks will find themselves with their ability to make profits squeezed and competing in the market place with overseas banks, many of whom do not have the same restrictions on their banking activities. The potential profits of the banking group will reduce through higher overheads and the banks concerned be driven to take greater risks to drive up profits. The exact opposite result than the one planned.

Overall there is a bigger problem. The last banking crisis would still have occurred had this Act already been in place at the time. The banks failed last time in this country through the excessive use of off shore securitised bond issues funding excessive mortgage lending (Northern Rock), reckless takeover activity (RBS) and excessive lending, poor risk control and inadequate liquidity (HBOS). Separating retail from investment banking was not really the issue, despite the repeated calls from politicians to protect retail banks from what they describe as “casino” banks as the solution to the problem. The remainder of the proposals in the Act are essentially beneficial but which cannot pretend to be solutions to the problem of potential banking failure.

[66] 1st November 2014
[67] Uniform Customs and Practice Documentary Credits
[68] Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014/xxx