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# Introduction

It is now seven years on from the first (and hopefully the last) financial crisis of the 21st Century[[1]](#footnote-1), and four years since the Independent Commission on Banking (ICB) proposed ring-fenced banking (RFB) as a contributing solution to future crises. The RFB approach is intended to ensure that if government intervention is required it can be applied in a way that is restricted to saving banking activity that supports the national economy.

Unlike many previous crises the globalisation of financial services in the latter part of the 20thCentury made this the first truly global financial crisis, and as such it has been met with a global response. In this respect we have seen regulatory initiatives from the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS), a re-structuring of European regulation, and a re-structuring of UK financial regulation.

Although much has been done to improve the resilience of the global, European, and national banking systems, now that the dust is starting to settle, conditions are starting to become more benign, and bank profitability has been restored, banks are starting to push back on the tide of regulation and becoming increasingly vocal, in particular in respect of RFB.

In particular Sir David Walker (the former Chairman of Barclays) writing in a personal capacity in the Telegraph[[2]](#footnote-2)on 2nd June 2015, and using the Keynes dictum ‘*when facts change I change my mind*’ urged that the justification for RFB is looked at again, noting that:

*“The landscape within which UK banking now operates has been transformed for the better. Demanding new requirements on capital, liquidity, leverage and provision for resolution and recovery – partly as a result of other recommendations of the Banking Commission – have increased both the resilience of UK banking and protection for the wider economy.*

*It is hard to see how the complex structural re-engineering involved will further boost the resilience of banks beyond the new capital and leverage requirements that have been put in place elsewhere. Ring-fencing’s role in effective resolution – crucial to protect the taxpayer – is also now redundant as banks adopt comprehensive standalone mechanisms as part of the EU Recovery and Resolution Directive.”*

These comments contributed to the line of questioning at the House of Lords Economic Affairs Committee on 30th June 2015[[3]](#footnote-3) where Sir John Vickers, who led the ICB review responded that the case for RFB:

“*is every bit as strong today as it was when we made our report four years ago – arguably, if anything stronger still.”[[4]](#footnote-4)*

He also noted that:

“*One of the reasons why our crisis was so bad was that, particularly in the case of RBS, the government’s completely understandable desire to save the retail banking on which the economy depends necessitated saving the entire structure*”[[5]](#footnote-5)

and that following the implementation of the RFB reforms

*“...in the next crisis the government of the day... can adopt different policies for retail as for global investment banking*”[[6]](#footnote-6)

The issue and outcome illustrated in the two quotes above are at the heart of why the Independent Commission on Banking (ICB) was established[[7]](#footnote-7). Although there was little challenge to the Commissions recommendations[[8]](#footnote-8) when they were first issued, and a report has since been published on RBS[[9]](#footnote-9), the larger universal banks are now starting to push back, arguing, in the case of Barclays[[10]](#footnote-10), that the work done since the crisis has made the ring-fencing proposals redundant, and, in the case of HSBC[[11]](#footnote-11), the cost and the distraction to running its business.

The Chancellor of the Exchequer has recently indicated the current period of intense regulatory change should be allowed to settle down, including ring-fencing and that the government would not be backtracking on the ring-fence rules[[12]](#footnote-12).

This dissertation sets out the changes in retail banking over the last twenty years, looks at the recent regulatory changes that have been applied to banking to make it more resilient, and concludes that although the probability of failure has reduced, the impact that RFB is intended to address has not.

# Background and History

The economic rationale for financial regulation is based on achieving three core objectives: (1) sustaining systemic stability;(2) maintaining the safety and soundness of financial institutions; and (3) protecting the consumer[[13]](#footnote-13).For much of the twenty year period up to the emergence of the recent financial crisis, regulation was not effective, particularly in the consumer arena, with increased mis-selling scandals, and ever increasing fines that seemed to have little effect. Much criticism was also made of the light touch approach to regulation, with prudential regulation tightened up after the run on Northern Rock, the first run on a UK bank in one hundred years[[14]](#footnote-14). This twenty year period (1987 – 2007) had witnessed substantial change in the structure of the way that financial services are carried out, and it is arguable that much of this structural change contributed to the problems that are being addressed today[[15]](#footnote-15).

In the early 1980s there was a very clear distinction between high street banking and investment banking, with two very separate cultures. High street banking was branch based, focussed on relationships and was characterised by the ‘*banker-customer relationship*’, with bankers acting in the best interests of their customers[[16]](#footnote-16). Investment banking on the other hand was transaction based and adhered to the standard of ‘*my word is my bond*’. The relationships were characterised by different information asymmetries – the general public in the high street banking context needing much more support than the knowledgeable counterparties in the investment banking markets.

Following the 1984 Gower review[[17]](#footnote-17), the government enacted the Financial Services Act 1986 and introduced a segmented system of regulation focussing on particular activities, e.g. the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO), and the Investment Management Regulatory Organisation (IMRO) – co-ordinated by an overarching Securities and Investment Board (SIB). Banking regulation at this time remained with the Bank of England (BoE). The government of the day also decided to de-regulate the UK’s financial markets, de-regulation on such a major scale that it was colloquially known as ‘Big Bang’.

‘Big Bang’ occurred on the 27th October 1986 and led to major changes in the UK financial services industry, in particular, it allowed high street banks to buy investment banks and investment banks to buy high street banks. A good example is Barclays who bought DeZoete and Bevan and Wedd Durlacher and created an investment banking arm known as Barclays DeZoete Wedd (BZW) – later known as Barclays Capital. In all banks where investment banking and high street banking have been combined the investment banking culture has dominated with high street banking shifting to a transaction based approach and in most cases re-named as retail banking – implying that banking is about sales. This shift from a relationship based approach to a transaction based approach is at the heart of most mis-selling issues. This also led to a change in financial services education, where the focus was on selling techniques, rather than the technical banking knowledge that is required to provide customers with the services that they need. In support of this change, reward and bonus structures that incentivise sales were introduced.

Following the bank failures of the 1990s[[18]](#footnote-18), in particular, Bank of Credit and Commerce International[[19]](#footnote-19) and Barings[[20]](#footnote-20), and the mis-selling events of the late 1990s (pensions and endownment mortgages) the government, in 1997, decided to make the BoE independent and created a new super regulator[[21]](#footnote-21), the Financial Services Authority (FSA) to cover banking, insurance and securities regulation. The FSA recognised the changed nature of the high street banking industry, and did some early work on ethics[[22]](#footnote-22) and Treating Customer Fairly (TCF)[[23]](#footnote-23).

TCF became a major programme throughout the first decade of the 21st century[[24]](#footnote-24) and although associated with principles based regulation[[25]](#footnote-25) which has come in for criticism, its importance for re-establishing a relationship management culture has been recognised, andit has been continued, albeit in a lower key way, by its successor, the Financial Conduct Authority. This culture issue has been examined by the Parliamentary Commission on Banking Standards[[26]](#footnote-26), considered by the Banking Standards Review Council[[27]](#footnote-27) (now known as the Banking Standards Board), and on the investment banking side by the Fair and Efficient Markets Review[[28]](#footnote-28).

The RFB proposals are intended to contribute to resolving some of the issues identified in this introduction, albeit that the proposals and final approach take a narrow focus on prudential regulation, which is arguably the key issue that leaves them open to attack – critics arguing that the prudential weaknesses have already been addressed.

## The Financial Crisis and Changing Regulation

Although there have been other financial crises throughout history[[29]](#footnote-29), recorded as far back as AD33[[30]](#footnote-30), the crash of 1929 in the last century is seen as the first modern crash and the progenitor of much of today’s regulatory architecture, albeit watered down somewhat since the 1930s. More recent crashes have included the secondary banking crisis in the UK[[31]](#footnote-31), the stock-market crash of 1987, the Asian financial crisis of the late 1990s, the dot-come bubble bursting at the start of the century. However, the 2007-8 financial crisis was the first financial crisis following the globalisation of the financial services industry.

As is so often the case, the 2007-2008 financial crisis prompted a review of both regulation[[32]](#footnote-32) and corporate governance[[33]](#footnote-33) in the UK. Another newly elected government decided to completely change the regulatory architecture again[[34]](#footnote-34) - a so-called twin peaks approach[[35]](#footnote-35) - which has now been in place since 1st April 2013. It remains to be seen whether this new architecture change will deliver regulation more effectively and efficiently[[36]](#footnote-36).The new approach has created a new subsidiary[[37]](#footnote-37) of the BoE, the Prudential Regulation Authority (PRA) which will be responsible for the first two of the core objectives[[38]](#footnote-38), with the Financial Conduct Authority (FCA) (the re-named Financial Services Authority (FSA)) responsible for protecting the consumer.

In addition to the new regulatory infrastructure in the UK, the global impact of the 2007-2008 financial crisis prompted a major re-think of regulation[[39]](#footnote-39) and the global regulatory architecture. This has had profound effects on the UK, and has created the biggest wave of new regulation ever seen. At an international level the old Financial Stability Forum has been upgraded and re-named Financial Stability Board (FSB) and has been pro-active since the financial crisis in a number of areas that will impact on Ring Fenced Banks (RFBs), for example, recovery and resolution[[40]](#footnote-40). Added to this the Basel Committee on Banking Supervision (BCBS) introduced Basel III[[41]](#footnote-41), and has decided to review a number of its capital calculation methodologies, for example, credit risk[[42]](#footnote-42), operational risk[[43]](#footnote-43), interest rate risk[[44]](#footnote-44) – all of which will have an impact on RFBs.

There has also been major regulatory change in the EU for banking regulation as part of the new European System of Financial Supervision (ESFS). Pre the financial crisis EU banking regulation was conducted by Directive (leaving considerable power with the national competent authorities – the FSA in the case of the UK), and supported by guidance from the Committee of Banking Supervisors (CEBS) – a Lamfalussy Committee[[45]](#footnote-45).However, following the financial crisis the EU have taken the opportunity to introduce a single rulebook (increasing power at the centre and reducing the power of national competent authorities – now the PRA) – the Capital Requirements Regulation[[46]](#footnote-46) (CRR) supported by a fourth Capital Requirements Directive[[47]](#footnote-47) (CRD IV). The de Larosiérè Committee[[48]](#footnote-48) has also moved the guidance regime of the Lamfalussy Committees (e.g. CEBS) to a quasi-regulator in that CEBS’ replacement the European Banking Authority (EBA) has the power to, and is obliged to recommend Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) in relation to various sections of both the CRR and CRD IV, which when adopted by the European Commission become Regulations. The EBA also has the authority to issue guidance[[49]](#footnote-49) to ‘competent authorities’ (i.e. national regulators), which is a bit of a misnomer as competent authorities are required to make every effort to implement the guidance[[50]](#footnote-50) and confirm that they have done so.

Whilst this new regime minimises the risk of regulatory arbitrage in the EU, it is a challenge for banks to manage and integrate. UK banks now have to watch the pronouncements of the FSB, BCBS, EU Commission, EBA, and the PRA – and that is just for prudential regulation. This is also true in the case of RFBs.

A key focus of regulatory reform is the structure of the banking industry in the form of ring-fencing[[51]](#footnote-51), with different perspectives – ring fence the risky activities (the Volcker approach), ring fence the activities that are critical to the effective functioning of the economy (the Vickers approach), do one or both (the Liikanen approach)[[52]](#footnote-52). Ironically, this is the same type of structural reform that was considered essential to protecting the US economy post the 1929 crash, implemented by the 1933 Glass-Steagall Act.

## The Glass – Steagall Act of 1933

The idea of ring fencing banking is not new, having been introduced in the United States (US) Banking Act of 1933 to address a perceived cause of the 1929 stock market crash[[53]](#footnote-53) that led to the Great Depression in the US. The 1933 Act, sponsored by Senators’ Carter Glass and Henry Steagall, is better known as the Glass-Steagall Act (GSA). The main focus of the GSA was to separate commercial banking from investment banking[[54]](#footnote-54) and make sure that the former supported the key sectors of the economy, such as the commerce, industrial and agricultural sectors[[55]](#footnote-55). In this sense it was a form of structural regulation[[56]](#footnote-56), and a model that at the time was copied by many countries[[57]](#footnote-57).

The GSA also created the Federal Deposit Insurance Corporation (FDIC) creating certainty in the security of customer deposits – up to $2,500 at the time[[58]](#footnote-58) and currently $250,000[[59]](#footnote-59) - a deposit protection model that has also been copied around the world[[60]](#footnote-60).

The power of the GSA had been eroded long before the origins of the financial crisis[[61]](#footnote-61) with continual moves towards de-regulation in the US in the 1970s, and a large move towards the ‘Chicago School of Economics’[[62]](#footnote-62) view of profit maximisation and confidence in the ability of the market to correct itself. The key sections were finally repealed in 1999 by the Financial Services Modernization Act, known as the Gramm-Leach-Bliley Act (GLBA), however there are some small provisions that remain, that prohibit deposit taking banks from underwriting securities and trading corporate securities (although a subsidiary in the same group could do so[[63]](#footnote-63)). Taken together with the Federal Reserve’s ‘Regulation W’[[64]](#footnote-64), which has been strengthened by the Dodd-Frank Act[[65]](#footnote-65),restricting dealings between affiliates, it is arguable that there remains a degree of ring-fencing in the US.

The repeal of the GSA by the GLBA was not viewed as particularly controversial in 1999, however, it has become a focus of increased debate since the financial crisis, with the Group of Thirty (chaired by Paul Volcker at the time) issuing a paper in 2009[[66]](#footnote-66) arguing for separation, with others against, highlighting that securitisation (seen as a key influence in the crisis) would have happened anyway[[67]](#footnote-67), and others arguing that a re-introduction of the GSA would be very detrimental to Europe’s banking industry[[68]](#footnote-68). The repeal of the GSA remains a topic of debate[[69]](#footnote-69), and we will see it being partly re-introduced in a number of countries – France[[70]](#footnote-70), Germany[[71]](#footnote-71), and the UK are all introducing some form of ring-fencing, and Liikanen will introduce such provisions across the EU.

# Other Ring-Fencing Initiatives

The pre-crisis model of Universal banking is now under attack, particularly from the perspective of the concern that deposit protection schemes, and tax payer support will be used to support failing investment banks. A 2012 IMF report notes that some areas of financial regulation still need further global level discussion, in particular:

“*a global level discussion on the pros and cons of direct restrictions on business models..*.[[72]](#footnote-72)”

There are three key types of separation that have been debated (1) Narrow banking; (2) a ban on proprietary trading; and (3) ring fenced banking[[73]](#footnote-73).

The narrowest form of banking is a system that allows for collection of deposits and invests in high quality liquid assets and predominantly acts as payment mechanism[[74]](#footnote-74).As Vickers notes, these high quality liquid assets would most likely be government bonds which are (1) not always safe (2) not plentiful enough in supply; (3) would reduce the availability of such bonds to pension funds; and (4) most importantly would restrict the availability of money to individuals and businesses in the form of overdrafts and longer term maturity transformation[[75]](#footnote-75).

This leaves the less narrow interpretation and one that is closer to the UKs current RFB proposal - a bank that also supports the economy by engaging in the important activity of maturity transformation by engaging in mortgage lending and retail and small and medium enterprise (SME) lending[[76]](#footnote-76). Ring-fenced banking and the ban on proprietary trading are in essence two different versions of a ring fence.

Within the ring-fence category there have been three major initiatives that have looked at the structure of banking in the aftermath of the financial crisis: (1) the introduction of the Volcker Rule in the US; (2) the proposals for ring-fenced banking in the UK; and (3) the Liikanen proposals in the EU. Although this dissertation is focussing on the UK proposals for ring-fencing it is helpful to put it in the context of other major initiatives.

Fundamental to all of these initiatives are two issues:

* The type of banking that should benefit from support when an individual bank or the banking system gets into difficulty (support by way of deposit protection, a lender of last resort facility, or as a last resort direct government intervention); and
* Moral hazard -getting management to take responsibility for the management of the bank and not place reliance on implicit support – regulation attempts to achieve this. There is also a moral hazard dimension in respect of customers in that that deposit protection reduces the ‘caveat emptor’ incentive to assess the risk of the institution that they lend to.

These two issues are linked in that moral hazard is usually a consequence of support and creates an environment where individuals and firms may pay less attention to their decisions in the knowledge that there is a safety net[[77]](#footnote-77).

## Volcker

The Volcker Rule is named after Paul Volcker, a former Federal Reserve Chairman[[78]](#footnote-78). Interestingly, Stiglitz[[79]](#footnote-79) identifies one of the root causes of the financial crisis as the Reagan Administration’s replacement of Paul Volcker (pro regulation of financial markets), with Alan Greenspan (free market proponent)–the latter, who appears to have presided over more than his fair share of crises[[80]](#footnote-80) during his time as Chairman of the Federal Reserve.

The Volcker Rule forbids proprietary trading by banks. It was originally intended to also prohibit engaging in hedge fund activity and private equity, however, in a testament to the power of the financial services industry’s lobbying it has been watered down and now allows for some limited hedge fund and private equity activity. The rule has been implemented along with the other Dodd-Frank reforms[[81]](#footnote-81).

Vickers acknowledges that the ICB recommendations were influenced by Volcker but came to the view that a different approach was required for the UK due to the difficulty in distinguishing between market-making on behalf of customers and proprietary trading. The ICB believed that there was wider variety of trading activity in the UK which core retail activities should be protected from, did not want to ban proprietary trading activity in all subsidiaries in a group, and that the UK environment is different to the US[[82]](#footnote-82).

## Likkanen

With in excess of eight thousand banks in the European Union (EU), including some of the largest universal banks in the world, for example, Germany’s Deutsche Bank, France’s Societe Generale, and the UK’s Barclays, it is not surprising that the EU should also be concerned with the stability of the banking system.

A High Level Expert Group (HLEG)[[83]](#footnote-83) led by Erkki Liikanen (and known as the Liikanen Group) also recommended the separation of high risk trading activity from banking similar to the recommendations of the Vickers Commissions. The Group had UK representation in the form of Carol Sergeant, a former FSA Managing Director and the former Chief Risk Officer of Lloyds TSB.

Whilst acknowledging that the EU (and global) regulatory reform activity will make a significant contribution to improving the resilience of the financial sector, the Liikanen Group was concerned that there was a small group of banks in the EU that remain:

“*too-big-to-fail, too-big-to-save, and too complex to manage, supervise and resolve*”[[84]](#footnote-84)

The Liikanen Group noted that there were two ways to achieve separation to help resolve these issues:

* separate proprietary trading from the remaining banking operations; or
* ring-fence core retail banking.

The latter option is important in a UK context as it in effect means that the RFB proposal being implemented in the UK will benefit from a ‘carve-out’ in respect of the EU reforms[[85]](#footnote-85). As a result the RFB provisions will make the UK compliant with Liikanen, and the subsequent Regulation that will implement the HLEG recommendations[[86]](#footnote-86).

# The Independent Commission on Banking

Following the 2007-08 crisis the government commenced an inquiry to look into structural and non-structural reform, with a primary view to promote financial stability and improve competition in the banking sector. To do this it established the Independent Commission on Banking (ICB), chaired by Sir John Vickers, and now commonly known as the Vickers Committee and / or Vickers reforms. The ICB was established in June 2010 with terms of reference[[87]](#footnote-87), that required it to formulate policy recommendations with a view to:

* “*reducing systemic risk in the banking sector, exploring the risk posed by banks of different size, scale and function;*
* *mitigating moral hazard in the banking system;*
* *reducing both the likelihood and the impact of firm failure; and*
* *promoting competition in both retail and investment banking with a view to ensuring that the needs of banks’ customers and clients are efficiently served, and in particular considering the extent to which large banks gain competitive advantage from being perceived as too big to fail.”*

The approach of the ICB, in line with its predominantly prudentially focussed mandate, looked mainly at the too big to fail problem[[88]](#footnote-88). The ICB produced its final report and recommendations in September 2011[[89]](#footnote-89), and focussed on three things: (1) the retail ring-fence; (2) loss-absorbency; and (3) competition. The ICB’s recommendation on Primary Loss Absorbing Capacity (PLAC) have been overtaken by the FSB’s Total Loss Absorbing Capacity (TLAC) requirement and the European Union’s Minimum Requirement for own funds and Eligible Liabilities (MREL) (see Appendix 4), and the competition recommendation has been addressed by adding competition as a secondary objective to both the PRA and the FCA’s statutory objectives, leaving the main focus as the RFB proposals.

The government issued a response to the ICB proposals[[90]](#footnote-90)with a further two papers, one on delivering stability and supporting a sustainable economy[[91]](#footnote-91), and the other on a new structure for stability and growth[[92]](#footnote-92). The outcome of these government responses was the enactment of the Financial Services (Banking Reform) Act 2013 (FSBRA 2013) which makes changes to FSMA 2000. FSBRA 2013 requires the PRA to implement the regulation and rules for ring fenced banking, which they are currently in the process of doing[[93]](#footnote-93). There are also two supporting statutory instruments assisting the PRA in completing this activity, one addressing core activities[[94]](#footnote-94), and the other addressing exclusions and prohibitions[[95]](#footnote-95).

The term RFB is a little misleading as it implies that the bank is being ring-fenced from a Group. Whilst this will be correct in many cases, a stand-alone bank can be an RFB. The Act[[96]](#footnote-96)defines a ‘ring-fenced body as:

“....a UK institution which carries on one or more core activities in relation to which it has a Part 4A permission[[97]](#footnote-97)”

The only core activity covered is that of accepting deposits[[98]](#footnote-98), and it is clear that the provision applies to banks with core deposits (liabilities) equal to or more than £25bn which are not a member of a group[[99]](#footnote-99), and those which are a member of a Group[[100]](#footnote-100).

In addition to defining the core activity as accepting deposits, the Act also defines three core services[[101]](#footnote-101)for RFB, as those banks with:

* facilities for accepting deposits;
* facilities for withdrawing money and making payments; and
* providing overdraft facilities.

The FSBRA 2013 also modified the PRA’s safety and soundness objective[[102]](#footnote-102) such that the PRA should seek to:

* ensure that the business of RFBs is carried on in a way that avoids any adverse effect on the continuity of the provision in the UK of core services;
* ensure that the business of RFBs is protected from risks (arising in the UK or elsewhere) that could adversely affect the continuity of the provision in the UK or core services; and
* minimise the risk that the failure of an RFB or a member of an RFBs group could affect the continuity of the provision in the UK of core services.

Despite these provisions the PRA (as with the FSA before it) have publicly stated that the regulatory regime is not a no failure regime[[103]](#footnote-103), so although, as noted earlier, the safety and soundness of firms is one of the underlying economic justifications for regulation, it is not unlimited, the key now being that the bank can be recovered, or if necessary, resolved with the minimum of impact on both the economy and the taxpayer.

Three key areas of concern for the PRA, which they have consulted on[[104]](#footnote-104) and recently published a Policy Statement[[105]](#footnote-105) are the legal structure of banking groups, governance[[106]](#footnote-106), and continuity of services and facilities. In addition to RFB application, this is also part of the wider international, European, and UK resilience agenda, including looking at depositor protection[[107]](#footnote-107), and operational continuity[[108]](#footnote-108), supporting a prudential regulatory perspective that RFBs are about resilience.

In December 2011 the House of Lords Economic Affairs Committee (EAC) issued a findings paper [[109]](#footnote-109) on the ICB’s final report, having taken oral evidence from the major clearing banks (Lloyds, HSBC, Barclays and RBS) and from Sir John Vickers. The bank’s doubted the effectiveness of the RFB proposals but had no proposal of their own to put forward.

As highlighted in the introduction, the EAC re-visited the issues on June 30 2015, again inviting the banks and Sir John Vickers to attend. It was noted by all the banks that the cost of implementing the RFB proposals was very high and they were not happy. As noted in the introduction Barclay’s former chairman, Sir David Walker, had previously asserted that the new capital and liquidity requirements together with the implementing of the new recovery and resolution regimes meant that there was no longer a need to ring fence banks[[110]](#footnote-110). Despite having plans to move their RFB to Birmingham, HSBC has also been indicating that the RFB requirement may be a contributing factor in any decision that they make to re-locate their head office away from London to Hong Kong[[111]](#footnote-111). The very recent sacking of the Barclays CEO, and the bank’s new chairman (Sir David Walker’s successor) indicating a desire to focus on the performance of the investment bank may lead to further lobbying against the RFP proposals. On the other hand Lloyds Banking Group has been calling for the ring-fence[[112]](#footnote-112), and Santander have already started to implement it[[113]](#footnote-113).

For some banks it will be easier to create an RFB than others, for example the majority (95% plus) of Lloyds Banking Group would be in the ring-fence, whereas for banks like Barclays with a large investment bank it is a much more challenging process. All banks will have to either identify a legal entity, or create a legal entity that can become the RFB. For a new bank there will be a need to go through an authorisation process. For an existing bank, there is likely to be a re-structuring within the group that will require a Part VII transfer of assets and liabilities[[114]](#footnote-114) and some element of re-capitalisation to support the transferring assets and liabilities.

The government, at the request of the PCBS, has created a reserve power for the regulator, known as ‘electrification’ which allows for enforced separation in specified circumstances[[115]](#footnote-115). The PCBS was concerned about banks trying to game the system and / or lobbying politicians to have the provisions applied in a light-touch way.

The process of setting up a bank and the prudential regulation of banks have been radically overhauled since the financial crisis, and applies to all banks (including RFBs). There are some provisions specific to RFBs which are brought out in the practice detail below.

# The Practice of Creating a Ring-Fenced Bank

The RFB provisions take effect in January 2019 and there is much for the banks to do. There are some stand-alone banks, which by the nature of their business, become RFBs (deposits in excess of £25bn and not part of a group), however, for those that are part of a group there will be a need to create an RFB (deposits in excess of £25bn and are part of a group). Some groups may naturally have a subsidiary that fits the criteria, but it is likely that they may need to transfer other assets and liabilities into it – and possibly some out (this will require a Part VII transfer).

In some cases there will be a need to create a new legal entity, and apply for a new authorisation. In all cases of a new bank or re-structuring an existing bank, it will be necessary to provide four key documents (1) an Individual Capital Adequacy Assessment Process (ICAAP); (2) an Individual Liquidity Adequacy Assessment Process (ILAAP); (3) a Recovery Plan; and (4) a Resolution Pack – the last two are regularly referred to together as the Recovery and Resolution Plan (RRP).Banks that are in effect already ring-fenced will also have to produce these documents on an annual basis. In the case of a new bank the documents will form part of a Banking Licence Application.

## Authorisation

In the case of the need to create a new bank, a key part of creating the RFB is obtaining authorisation for the new legal entity. All of the ring-fenced banks will be authorised and regulated by the PRA and also regulated by the FCA. As part of the authorisation process the RFB will need to deliver a credible business plan, workable organisational structure, details of the firm’s governance arrangements, enterprise wide risk management arrangements together with the four key supporting regulatory documents the ICAAP, the ILAAP, and the RRP (plan and pack).

For both the FCA and the PRA the applicant must comply with the threshold conditions[[116]](#footnote-116), and for the PRA the Fundamental Rules, and for the FCA the Principles for Business. There is a detailed form to complete[[117]](#footnote-117) that must be submitted to the PRA with all relevant key documentation. The regulator generally expects to complete a new authorisation in six months, but has up to 12 months in the event that the application is incomplete. In any event it is normal for the regulator to initiate a number of ‘deep dive’ investigations during the course of the authorisation process.

## Business Plan and Organisational Structure

When applying for a banking licence an RFB must submit details of it legal structure and its business plan. The RFB should not have an ownership interest in subsidiaries that engage in prohibited activities, however, there may be subsidiaries in the group that carry on prohibited activities[[118]](#footnote-118). This is expected be addressed in structural arrangement known as a ‘sibling structure’, where the holding company can have a cluster of subsidiaries engaging in RFB prohibited activity, and a cluster engaging in RFB activities[[119]](#footnote-119). The RFB is not legally required to have a holding company, however, the PRA has expressed a preference for a holding company structure[[120]](#footnote-120). In the event of resolution the debts of the RFB can be transferred into the holding company and the BoE (the Resolution Authority) can use the holding company as the Single Point of Entry (SPE) to resolve the RFB.

The RFB may not have subsidiaries or branches outside the EEA, although there is an exemption for ancillary services that do not constitute activities that would be regulated in the UK[[121]](#footnote-121). However, an RFB can operate branches and / or conduct activities in the EU under the EU pass-porting rights.

Pass-porting rights have been an area of confusion for banks. It is clear when establishing a branch that a passport waiver application has to be made to the regulator, however in the case ofthe provision of cross-border services and modern communication capabilities it is more complicated. EEA regulators appear to have taken different positions on the issue with two different tests:

* the ‘characteristic performance test’ – the place of provision of the service, i.e. the essential supply for which payment is due must be determined
* the ‘solicitation test’ – the location under which the transaction that is conducted was solicited by the bank.

The UK has followed an EU interpretative communication[[122]](#footnote-122), and applies the characteristic performance test. Unfortunately neither the PRA, nor the EU Communication, have defined or articulated how to apply the test, with the Communication acknowledging:

*“...any credit institution is at liberty to choose, for reasons of legal certainty, to make use of the notification procedures provided for in the Second Directive, even, if according to the criteria proposed above, notification may not be necessary.”*

Given modern communications banks are erring on the side of caution and the recently established TSB Bank (which will in due course become an RFB) applied for thirty passports.

The majority of RFBs will be serving both Personal Customers and Corporate Customers (mainly SMEs) and may choose to use a simple two Division structure. The business plan should indicate the segments that the bank currently operates in, its plans for growth over the next five years (the ICAAP assessment period), any plans to introduce new products or services, its marketing strategy and anything else that assists the PRA (from a prudential perspective) and the FCA (from a conduct perspective) in assessing the bank’s plans.

## Governance Arrangements

The UK operates a unitary board system with a Board made up of both executive directors and non-executive directors. This creates some difficulty as European legislation in the past had a very clear distinction between the ‘governing body’ and the ‘management body’ – largely to cater for the fact that many European Countries operate a two tier Board system. This was satisfactory for the UK, where the ‘governing body’ was seen as the Board with responsibility for direction and oversight, and the ‘management body’ as the Executive Committee with responsibility for managing the business. This created a healthy tension between the Board and the Executive Committee management (similar to two-tier Boards), albeit that some Board members had (and still have) a functional role in respect of managing the business (usually the Chief Executive Officer, Chief Finance Officer, and Chief Risk Officer) and a collective responsibility role for direction and oversight as members of the Board.

Recent regulation has caused some confusion here where both EU regulators have started to use ‘governing body’ and ‘management body’ interchangeably, and in particular management body to represent the Board[[123]](#footnote-123).

The Financial Services (Banking Reform) Act 2013 (the FSBRA) requires the PRA to make rules[[124]](#footnote-124) requiring an RFB to have a board of directors which includes members who are treated by the rules as:

* being independent of other members of the RFB’s group;
* being independent of the RFB itself; and
* non-executive members.

In accordance with the FSBRA, the PRA has introduced rules to achieve the following outcomes:

* *“RFBs are able to take decisions independently of other members of the group;*
* *RFBs take all reasonable steps to identify and manage conflicts of interest with other group members;*
* *RFBs take reasonable steps to identify and manage any conflicts between the duties senior management owe to the RFB and other interest that they may have; and*
* *RFBs can demonstrate that they are meeting the ring-fencing rules.[[125]](#footnote-125)”*

No matter how much liquidity and capital the RFB has a key factor in its success will be the quality, training, professionalism, and behaviour of its staff. The FSA introduced an Approved Persons regime with FSMA 2000[[126]](#footnote-126). Up until the financial crisis, banks would apply for a person to be an Approved Person and they would largely be approved as it was the responsibility of the bank to ensure that they met the ‘fit and proper’ criteria[[127]](#footnote-127).

The Approved Persons regime was the subject of severe criticism during the financial crisis and the regime was reinforced with all Significant Influence Functions (those with direction and senior management responsibility, in particular the Board and executive management) required to be interviewed by the FSA. This was also criticised as creating moral hazard in that firms were selecting employees and using the FSA to do the ‘fit and proper’ assessment. This came to a head with the appointment of the Chairman of the Co-op, who was interviewed by the FSA and whose appointment was approved despite the fact that he had little experience of banking[[128]](#footnote-128).

This issue was not addressed by Vickers but was picked up by the PCBS review who, in their report, mandated a new regime for approving people into senior banking position, and is addressed in the FSBRA 2013[[129]](#footnote-129). The PRA and the FCA initiated a joint consultation on the new regime in July 2014[[130]](#footnote-130)with a view to encouraging accountability for decision making and aiming for good conduct at all levels in the organisation. This will bring in two new individual accountability regimes from 7th March 2016 – a Senior Managers Regime (SMR), and a Certification Regime (CR). The final Policy Statement was published in July 2015[[131]](#footnote-131).

*Senior Managers Regime*

The SMR divides the Senior Management Functions (SMFs) into Oversight SMFs and Executive SMFs. The Executive SMFs are those that have functional responsibility for the management of the business, e.g. the Chief Executive Officer[[132]](#footnote-132) (CEO), the Chief Financial Officer[[133]](#footnote-133) (CFO) and the Chief Risk Officer[[134]](#footnote-134) (CRO), and other Executive Directors[[135]](#footnote-135). The regime also applies to those in charge of a Key Business Area[[136]](#footnote-136).

Oversight SMFs, on the other hand, are those that carry out non-executive roles. The regime does not apply to all non-executive directors, but only the Chair roles (Chairman of the Board[[137]](#footnote-137); Chairman of the Risk Committee[[138]](#footnote-138); Chairman of the Audit Committee[[139]](#footnote-139); Chairman of the Remuneration Committee[[140]](#footnote-140); and Chairman of the Nomination Committee[[141]](#footnote-141)) and the Senior Independent Director[[142]](#footnote-142) (SID).

The SMR requires, in line with the UK Corporate Governance Code[[143]](#footnote-143), that the Chairman of the Board and the CEO are different people[[144]](#footnote-144). It also requires that the CEO and the CFO are different people (compliance with the ‘four eyes’ principle) and that RFBs will have a Chairman, CEO and CFO.

CRD IV requires significant CRR firms to establish Risk, Remuneration, and Nomination Committees. This PRA have indicated that significant firms will be those that are classed by the PRA as Category 1 and Category 2 firms[[145]](#footnote-145). Given the deposit requirement (£25bn) for RFBs it is reasonable to assume that all RFBs will be either Category 1 or Category 2 and therefore must have these committees.

The introduction of the new SMR regime has caused concern in the industry as in the case of breaching a ‘relevant requirement[[146]](#footnote-146), there is a presumption of responsibility with the onus on the SMF to show that he/she has acted appropriately in relation to the issue[[147]](#footnote-147). An SMF can also be guilty of misconduct if they breach a conduct rule[[148]](#footnote-148) or are in contravention of a relevant requirement[[149]](#footnote-149).

In respect of all bank directors (not just SMF directors) CRD IV has restricted the number of director roles that a bank director can hold as follows[[150]](#footnote-150):

* One executive directorship with two non-executive directorships; or
* Four non-executive directorships.

The regulator may, at its discretion, allow one additional non-executive directorship[[151]](#footnote-151). Several non-executive directorships in the same group count as a single non-executive director role[[152]](#footnote-152).

The PRA has also indicated that it will, if necessary consider using powers in respect of the role of Chairs (Chairman of the Board and of the Committees) to limit their ability to take on other external roles to ensure that they devote adequate time to their role in the authorised institution[[153]](#footnote-153).

One of the aspects of the Senior Independent Director (SID) role expected by the PRA is an assessment of the resources allocated to the Chairman’s office. This is particularly important given that the regulator not only expects the Board to be aware of the Threshold Conditions (for achieving and maintaining authorisation) but also the more detailed rules in the PRA Rulebook.

As part of the SMR the PRA have reiterated their expectation of the SMF holders to play a role in ensuring that their firms have an appropriate and sustainable culture[[154]](#footnote-154), in particular the role of the Chairman and the CEO.

As part of the SMR each SMF must have a Statement of Responsibility, and re-submit a new one anytime the role changes[[155]](#footnote-155). In allocating responsibilities, the RFB must document and maintain a Management Responsibilities Map for the bank.

*Certification Regime*

The Certification Regime (CR) is also applied by both the PRA and FCA. In the PRA’s case it is applied to what the PRA calls a Significant Risk Taker, which is aligned to the definition of material Risk Taker – which for remuneration purposes is defined in the Material Risk Takers Regulation[[156]](#footnote-156). The FCA CR is wider and includes staff that have customer responsibilities.

The CR requires a ‘fit and proper’ assessment[[157]](#footnote-157) and the issuing of a certificate[[158]](#footnote-158).

## Enterprise Wide Risk Management Arrangements

In parallel with the Basel Committee’s work on credit risk management, market risk management, and operational risk management in Basel II, an organisation in the US known as the Committee of the Sponsoring Organisations of the Treadway Commission (COSO) had started to look at control infrastructure in response to US accounting failings and published two influential papers, the first on internal control in 1992[[159]](#footnote-159), and the second on enterprise risk management in 2004[[160]](#footnote-160). COSO described Enterprise Risk Management as:

*‘a process, effected by an entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives*’.

This has been picked up by regulators around the world and it is now an expectation that a bank (including an RFB) will have an Enterprise Wide Risk Management (EWRM) framework led by a Chief Risk Officer (CRO). The Financial Stability Board noted in a 2013 thematic review that:

‘*At the core of effective risk governance is a well-designed and articulated enterprise risk management framework, which reflects the firm’s risk culture and enumerates the firm’s risk appetite.[[161]](#footnote-161)*’

Key to effective risk management, and an approach that has now become standard in the financial services industry, is that of the ‘three lines of defence’. The three lines of defence is a business risk management model that creates a system of checks and balances in the RFB’s management of risk. The Board delegates the execution of strategy and the management of risk to strategy to the CEO, and the CEO uses the three lines of defence to ensure effective oversight over the management of risk – the three lines of defence are:

* First line of defence – the Business;
* Second line of defence – the Risk Function; and
* Third line of defence – Internal Audit.

The second line of defence is usually led by the CRO who is accountable to the CEO for the oversight of the management of risk, with a dotted reporting line to the Chair of the Board Risk Committee.

The two things that lead to failure of a bank are (1) inability to pay its debts as they fall due, addressed by the management of Liquidity Risk; and (2) the banks liabilities are greater than its assets addressed by the management of Capital Adequacy (all other risks). Liquidity management and Capital Adequacy management are highly technical activities in bank regulation. The core information for these activities is set out in the Internal Liquidity Assessment Process (ILAAP) and Internal Capital Adequacy Assessment Process (ICAAP). The production of both of these documents is usually co-ordinated by the EWRM team. A key component of both documents is the risk appetite that guides the development of the framework.

*Risk Appetite*

A key aspect of any enterprise wide risk management framework is establishing what the firm’s appetite for risk is. Risk appetite in banking and RFBs is inextricably linked with liquidity and capital through the risk categories credit risk and market risk (the risks that banks take to generate a return) and operational risk (which is a risk that has to be managed and is a cost of doing business).

Large banks often have a banking book (lending and credit risk) and a trading book (trading and market risk). RFBs cannot have a trading book and therefore do not need to hold capital against market risk. This does not however meant that they do not have to manage market risk – although they will not have traded market risk they may have non-traded market risk from their treasury departments hedging activities, and all will have to manage interest rate risk in the banking book (IRRBB) – see Appendix 1. The three key risks, for which an appetite must be set, will be credit risk, and operational risk which must be addressed in the ICAAP, and liquidity risk which must be addressed in the ILAAP.

A risk appetite approach and language was set out by the FSB[[162]](#footnote-162), which is logical and which RFBs could use. A number of consultancies have also published papers on risk appetite[[163]](#footnote-163).

*Credit Risk*

This is the key risk for an RFB and a risk that RFBs need to take to be able to pay interest to their depositors and bondholders, and earn a return for their shareholders. It is also the risk that supports maturity transformation and lending to the wider economy (both personal customers and SME businesses). In modern banking, both retail credit risk and SME credit risk are managed using statistical techniques that allow for volume lending. Private banking and large corporate tend to get a more bespoke service. Other risks that will need to be covered under credit risk are Counterparty Risk and Concentration Risk – see Appendix 1.

SME are a key part of the economy and often generate the majority of an economy’s employment. For this reason they are in the RFB as the government would want to rescue a bank that is supporting the national economy and generating employment. The importance of SME’s to national economies was also recognised in the CRR and the regulation allows an SME discount for the bank in respect of lending to SMEs[[164]](#footnote-164).

The RFBs approach to credit risk will need to be described in its ICAAP.

*Operational Risk*

Following the numerous operational risk failings in the 1990s[[165]](#footnote-165), the Basel Committee made operational risk one of their priorities[[166]](#footnote-166) and introduced a requirement to hold capital in respect of operational risk in the Basel II Accord[[167]](#footnote-167). Following the financial crisis there has been further interest in operational risk, and update of the Sound Practices paper[[168]](#footnote-168), and feedback on best practices in operational risk management[[169]](#footnote-169).

The definition of operational risk indicates why it is such an important risk:

*“the risk of loss resulting from inadequate or failed internal processes, people and systems, or external events. This definition includes legal risk, but excludes strategic and reputational risk[[170]](#footnote-170)”*

There is no function in an RFB (or any modern organisation) that can be run without effective ‘processes, people and systems’ and as such operational risk is a key business enabler[[171]](#footnote-171) in respect of both quality control and culture[[172]](#footnote-172).

*Outsourcing*

Outsourcing was a key focus for the regulator at the beginning of the century, with banks having come late to outsourcing suddenly saw it as a major cost reduction tool. The regulatory principles for managing outsourcing risks have not changed that much[[173]](#footnote-173). The provisions and risk broadly remain the same, although the regulator is unlikely to allow major outsourcing to the parent as it will create a critical dependency, with many firms looking at systems cloning approaches.

*Liquidity Risk*

Liquidity risk become particularly important after the financial crisis, in particular in recognition that Northern Rock was not insolvent but got into difficulty form a liquidity perspective based on the level of wholesale funding that it was using – leaving it vulnerable when the market froze. The FSA introduced stringent liquidity provisions immediately after this and these have been broadly implemented around the world – see Appendix 3.

## ICAAP

The ICAAP is the most important prudential regulatory document that an RFB has to produce (or any bank for that matter) and was introduced by the Basel II Accord. Further detail on the ICAAP is set out in Appendix 1.

A unique function of banks is there ability to create money (the credit multiplier), and it has been the practice for many central banks prior to the Basel Accords to use reserve asset ratios as a means to controlling credit expansion – a macro-economic tool to control money supply, but also a form of enforced liquidity management. However, this did not stop banks from taking unhealthy credit concentrations onto their balance sheets, as seen in the secondary banking crisis in the early 1970s[[174]](#footnote-174).

Following an international settlement failure, also in the early 1970s, at Bankhaus Herstatt (settlement risk sometimes known as Herstatt Risk) the Basel Committee on Banking Supervision was established at the Bank for International Settlements in 1974[[175]](#footnote-175). Two key issues that they addressed at a very early stage were provisions to address ‘large exposures’ to address issues like the secondary banking crisis and more specifically the later Johnson Matthey rescue[[176]](#footnote-176), and capital adequacy (a replacement for the reserve asset ratio system) in what has become known as Basel 1 (although without a leverage ratio to restrict banks from leveraging their balance sheets to dangerous levels).

Basel 1 was completed in 1988[[177]](#footnote-177) (although not required to be implemented until 1992) and introduced a simple form of calculating capital adequacy by applying a risk weight to a bank’s assets (loans) and calculating the amount of capital that the bank must hold. For example a loan secured on residential property by way of mortgage was risk weighted at 50%, so that if a bank had a mortgage book of £200m, for capital adequacy purposes it would constitute a risk weighted asset of £100m. The bank would then apply the Basel capital ratio of 8% meaning that it would be required to hold £8m of capital in respect of its £200m mortgage book. However, the regulator, based on its supervisory review had the power to vary the 8% based on its assessment of the risk profile of the institution - with some banks having an Individual Capital ratio in excess of 20%. Although only intended to apply to the Basel Committee’s G10 members the Basel 1 Accord was adopted by over 120 countries. Although not acknowledged by the BCBS[[178]](#footnote-178) the development and growth of securitisation was a response to Basel 1 allowing banks to engage in more lending by moving assets off balance sheet and obtaining funding at the same time.

Basel 1 only addressed credit risk, and in 1996, BCBS addressed market risk in a formal amendment to the Capital Accord[[179]](#footnote-179) splitting the banks activities into a ‘banking book’ (lending) and ‘trading book’ (trading) and allowing the use of Value-at-Risk (VaR) models for calculating market risk capital[[180]](#footnote-180). However, the real change came with the Basel II Accord, which introduced a requirement for firms to hold capital against operational risk, and allowed for modelling approaches (subject to regulatory approval) for calculating credit risk capital (Internal Ratings Based (IRB) models) and for calculating operational risk capital (an Advanced Measurement Approach (AMA) model). Following the financial crisis, all of these approaches have been reviewed and / or are currently under review.

Although there has been much criticism of the Basel II modelling approach (much of which is being currently reviewed and revised)[[181]](#footnote-181), the Internal Capital Adequacy Assessment Process (ICAAP) and Supervisory Review and Evaluation Process (SREP) have been retained, and have been extended to liquidity with an Internal Liquidity Adequacy Assessment Process (ILAAP) and Liquidity Supervisory Review and Evaluation Process (L-SREP)[[182]](#footnote-182).

The ICAAP is one of two documents that has to be submitted to the PRA on an annual basis. The other document is the ILAAP. The purpose of the ICAAP is to inform the Board of the on-going assessment of the RFB’s risks relative to its five year strategic plan, how the RFB intends to manage and mitigate those risks, and how much current and future capital is necessary having considered other mitigating factors. Technical detail on the ICAAP is set out in Appendix 1, with detail on capital structure in Appendix 2.

It is also used to formalise the RFB’s approach to understanding its risk profile, its capital demand, and the processes and systems that it needs in place to assess, quantify and monitor its risks. Risk identification and assessment is a core part of the ICAAP process and ensures that the RFB will have sufficient capital to cover its risk profile over the five year planning horizon. RFBs should adopt an integrated approach to risk assessment to ensure all risks are identified, assessed, mitigated and monitored on an ongoing basis.

As the PRA, using its Supervisory Review and Evaluation Process (SREP) will be basing many of its views on the information contained in the ICAAP document it is important that the RFB senior management and Board formally approve its contents. The document should be in a format that is easily understood and contains all the relevant information that is necessary for the Board and the PRA to make an informed judgement and decision as to the appropriate capital level and risk management approach. The submission of the ICAAP is ultimately the bank’s assessment of its capital demand for supporting the existing risk profile and predicted risk profile of its business – in accordance with its strategic plan. The outcome of the PRA SREP review – which is a regulatory evaluation of the bank’s assessment of its capital demand - is the issuance of Individual Capital Guidance (ICG). The ICG will either confirm the bank’s capital demand, or as is more often the case set it at a higher level. Once the capital demand is set the bank must address the issue of capital supply, i.e. ensuring that the bank is appropriately capitalised. Although much of the capital supply mix is pre-determined by existing regulation, the ICG can also influence the make-up of the capital supply. Further detail on capital supply is set out in Appendix 2.

There are two Pillars of capital assessment – Pillar 1 which is formulaic and based on the CRR, Pillar 2A which covers risk that are not adequately covered in Pillar 1, and Pillar 2B that generates an additional capital charge based on stress testing – currently know as the Capital Planning Buffer.

CRD IV buffers come into force in January 2016[[183]](#footnote-183) and are a key regulatory intervention in building bank resilience. There are four buffers above the Pillar 1 and Pillar 2 capital charge:

* Countercyclical Capital Buffer (CCB)

The CCB applies to all banks (including RFBs). It is set by the FPC and is currently set at zero. What is interesting about the CCB is that the FPC has agreed reciprocal arrangements with other regulators to apply their CCB, such that a bank with £100m of exposure to borrowers based in Sweden must apply the Swedish regulator’s CCB.

* Systemic Buffer (SB)

The Systemic buffer is aimed at globally systemic banks, however the PRA has indicated that it intends to apply a Ring-fenced Bank buffer in this category of 1 – 3%[[184]](#footnote-184)

* Capital Conservation Buffer (CCoB)

The CCoB is a capital sum that is required to be held to protect the core capital and can be used to absorb losses without breaching regulatory capital limits

* PRA Buffer (PRA-B)

The PRA-B is intended to replace the Capital Planning Buffer (CPB) and has two components (1) a forward looking assessment component – largely following the current CPB stress testing process; and (2) a component to cover identified weaknesses in governance and / or risk management (applied using a scalar based on SREP score).

Stress testing[[185]](#footnote-185) for the forward looking assessment component of the PRA-B (and the current CPB) is based on BoE published scenarios[[186]](#footnote-186), a concurrent stress scenario, and stress scenarios that are bespoke to the firm. Concurrent stress testing allows the regulator to assess risk across the banking sector and it produced a scenario for this purpose and specified the macro-economic variables that must be used in the scenario[[187]](#footnote-187).

A key technique introduced post the financial crisis was a requirement for firms to conduct ‘reverse stress testing’[[188]](#footnote-188), in essence a stress test that pushes the bank into failure. This was followed up by both CEBS (now EBA) guidance[[189]](#footnote-189), and the Basel Committee[[190]](#footnote-190). Reverse testing is also a requirement in the CRR[[191]](#footnote-191). With the introduction of recovery and resolution planning, reverse stress testing, makes the link between the expected stress testing of business plans in the ICAAP for capital adequacy purposes, and management’s responsibility to create effective recovery and resolution plans.

Although the ICAAP assesses the capital adequacy of the firm, regulators have now put a cap on the ability of RFBs (all banks) to leverage the balance sheet by applying a leverage ratio restriction[[192]](#footnote-192). The leverage ratio is counterintuitive in that a low leverage ratio is bad and a high leverage ratio is good (see Appendix 2). The Financial Policy Committee have set the leverage ratio floor at 3%[[193]](#footnote-193), however, they have calibrated the leverage ratio to the new system of buffers[[194]](#footnote-194), so that the leverage ratio will be 3% plus the addition of a proportion of the systemic buffer (which will include an RFB buffer) and the countercyclical buffer (set by the FPC).

The outcome of the PRA SREP is Individual Capital Guidance (ICG).

## ILAAP

The Internal Liquidity Assessment Process (ILAAP) is used to assess the RFB’s liquidity profile, the liquidity risks, and the amount of current and future liquidity required to mitigate the risks, The key function of the ILAAP is to inform the Board of the on-going assessment and quantification of liquidity risks, how liquidity risks are managed and how it details the RFB’s liquidity risk governance framework. Two key factors in the ILAAP are determining the Liquidity Asset Buffer (LAB) and developing a credible Liquidity Contingency Plan (LCP).The cost of funding and liquidity should be built into the pricing products and services via transfer pricing.

The two main protections for liquidity risk are the introduction of a Liquidity Coverage Ratio (LCR) and a Nest Stable Funding Ratio (NSFR). Technical detail on liquidity regulation is set out in Appendix 3

As with the ICAAP, the ILAAP must be submitted to the PRA who will use their Liquidity Supervisory Review and Evaluation Process (L-SREP) to assess the RFB’s liquidity risk management, the appropriateness of the LAB, and the effectiveness of the LCP.

The outcome of the PRA review is Individual Liquidity Guidance (ILG).

## Recovery and Resolution Plans

The recovery and resolution debate, although currently high profile, is not new and has been addressed by the BCBS in the past[[195]](#footnote-195), and recently updated[[196]](#footnote-196). However, the financial crisis has created renewed interest with the lead taken by the FSB who carried out a thematic review and issued two guidance papers on recovery and resolution in 2013[[197]](#footnote-197), culminating in a key attributes of effective resolution regimes paper in 2014[[198]](#footnote-198). However, while the FSB guidance is influential soft law, the key requirements for the UK and RFBs are contained in the EU’s Banking Recovery and Resolution Directive (BRRD)[[199]](#footnote-199).

The BRRD is intended to:

*“....provide national authorities with common powers and instruments to pre-empt bank crises and to resolve any financial institution in an orderly manner in the event of failure, whilst preserving essential bank operations and minimising taxpayers’ exposures to losses.”[[200]](#footnote-200)*

The Recovery and Resolution Plan (RRP) is in fact two plans – a Recovery Plan, and a Resolution Pack. The Board must appoint a nominated individual to be the Board’s Recovery and Resolution Officer and this person will be the key contact for the PRA. Both the Recovery Plan and the Resolution Pack must be submitted to the PRA and kept up to date. The PRA must be promptly notified if there are any changes. Additional detail on recovery and resolution is set out in Appendix 4.

The Recovery Plan is a key tool to identify options to recover financial strength and viability under severe stress. The objective is to identify Early Warning Indicators (EWIs) from the ICAAP and ILAAP that would trigger pre-considered credible recovery options that can be implemented quickly under a range of firm-specific and market wide stress scenarios, addressing both liquidity and capital shortfalls. Recovery planning is a logical extension of the processes for managing capital and liquidity under stress. However, it will usually require additional analysis around more extreme responses, for example, core asset disposals, and radical de-risking that may cause franchise damage.

The Resolution Pack is to support a plan that comes into effect when recovery is no longer a viable option and the bank has failed or is likely to fail. The Pack is predominantly a compendium of information that allows the regulator to plan for an orderly resolution. Although the Pack must be submitted to the PRA, the legislation gives powers to the BoE and / or HM Treasury to participate in and / or lead an orderly winding-up, a sale of the RFB, or manage the RFB for a period and either re-structure it for sale or re-launch.

The BoE (the Resolution Authority) has four resolution options:

* A sale of business tool[[201]](#footnote-201)
* A bridge institution tool[[202]](#footnote-202)
* An asset separation tool[[203]](#footnote-203)
* A bail-in tool[[204]](#footnote-204)

A key factor in the bail-in tool is that there is something to bail-in. The FSB have introduced the concept of Total Loss Absorbing Capital (TLAC) for globally systemic banks. In the EU the BRRD has introduced a similar equivalent for all banks, but calibrated to their risk profile, known as Minimum Requirement for own funds and Eligible Liabilities (MREL)[[205]](#footnote-205).The EBA have consulted on pan EU level detail and the BoE as Resolution Authority will be consulting on the detail as it applies to the UK later this year. The requirement to hold MREL commences on 1st January 2016.

## Part VII Transfer

The mechanism in Part VII of FSMA 2000 was a new innovation for bank transfers. Prior to this there had been no statutory procedure for doing transfers of bank business. Pre FSMA 2000 such a transfer usually required a private Act of Parliament. As this amounted to a contractual variation (in essence a novation of contracts by replacing one bank as contracting party with the other), when combined with Parliament’s reluctance to interfere in the business affairs of individuals, these were difficult to obtain[[206]](#footnote-206).

The Part VII transfer is a transfer of the assets and liabilities (although it could be a transfer of just assets) from one bank to another, and in the case of RFBs that are part of a group from the parent bank, or other subsidiaries of the parent, to the new RFB. Some banks will be transferring assets and liabilities from a number of subsidiaries into the RFB. This can be very irritating for customers getting a new bank, new sort-codes, new accounts, new cards and other banking essentials. It is very important that communication is managed properly as customers have to be notified in advance[[207]](#footnote-207) and may decide to take unilateral action and bank somewhere completely different,

The banking transfer scheme will not be effective[[208]](#footnote-208)unless it has been sanctioned by the High Court (the court)[[209]](#footnote-209). The court, before deciding to sanction the scheme must be satisfied as to two things:

* Certificate of adequate resources issued by the PRA[[210]](#footnote-210)
* That the firm is authorised to conduct the business that is being transferred.

The FSBRA 2013 has made appropriate amendments to Part VII to cater specifically for RFB transfers[[211]](#footnote-211).

# Analysis

It can be seen from the preceding that much has been done since the financial crisis to improve the resilience of the banking system. The majority of these improvements, e.g. capital buffers; MREL, the introduction of the LCR and NSFR apply to all banks and not just RFBs. However, the purpose of RFBs was not just to improve the resilience of UK banking but to ensure that if such circumstances were to arise again that the government would be in a position save the banks that are critical to the effective functioning of the economy.

Whilst it is clearly right to focus on the banks that support the national economy (both personal customers and SMEs that generate employment), the Independent Commission on Banking with a mandate focussed on structural reform is not sufficient to resolve the malaise that is at the root cause of retail banking in the UK. It will treat a symptom but on its own it is not enough. This may have been recognised in the hindsight of our political leaders when shortly afterwards they decided to se up a further review with the Parliamentary Commission on Banking Standards.

Although both Barclays and HSBC have come out very strongly in arguing against ring-fenced banking, arguing that much of the new regulation that is now in place has solved the symptom and that the need for RFBs should no longer be a key objective. This is a very narrow view and fails to recognise that the RFB could also be used as a tool to allow that bank to re-connect with its customers and fulfil the expectations of the PCBS and the BSB.

Some commentators (e.g. Sir David Walker) have argued that that so much has been done to ensure the resilience of the banking system that the need for ring-fencing is redundant. Sir David is wrong in his assessment. Applying a traditional probability impact approach, it is true to say that all of the regulation reflected in this dissertation will contribute to reducing the probability of bank failure, however, without ring-fencing the impact remains the same. In Sir David’s case, the probability of Barclays failing has been reduced, however, were it to fail tomorrow the government, if circumstances required, would not be able to rescue the part that supports the national economy and would still have to rescue the whole of Barclays at great cost to the taxpayer. Post implementation of the RFB provisions the bank will be easier to resolve, and a government rescue of the critical part only will be possible.

In addition the position put forward by Sir David, takes a very narrow view of RFBs only looking at the prudential benefits. Given the amount of money that Barclays spent commissioning the Salz review[[212]](#footnote-212) and acknowledging that the bank (and many other banks) needed to change its culture – it is important to recognise that retail banks and investment banks require different cultures to reflect their respective relationship and transaction approaches (and stop investment bank transaction driven culture seeping into retail banks).

|  |  |
| --- | --- |
| **Ring-fenced Bank** | **Investment Bank** |
| Banker – Customer Relationship | My word is my bond |
| Trust and Confidence | Knowledgeable Counterparties |
| Relationship Based | Transaction based |

RFBs that invest in re-discovering and developing the relationship driven banker-customer relationship are those that are likely to be best placed to support the national economy and less likely to find themselves in difficulty.

Whilst Vickers has outlined the structure, the PCBS expect the RFB to provide a better service to their customers and are expecting the BSB to oversee the delivery better of standards, and consequent culture change. As Ed Balls, noted:

“If the letter and the spirit of the Vickers proposals are not delivered and we do not see cultural change in our banks, full separation will be necessary:”[[213]](#footnote-213)

# Conclusion

Despite all the new regulation and the reduction in the likelihood of bank failure, ring-fenced banking must go ahead to achieve its primary purpose, which is to ensure that the government, if required, can rescue banks that are critical to the effective functioning of the economy.

A secondary purpose of increasing competition in the banking sector, and ensuring that RFBs support the economy is a much bigger task and will take a long time. This secondary purpose requires culture change, a more professional ethos in banks, and a reconnection with customers.

The RFB provides a great opportunity for banks to reconnect with their customers and support the national economy. If the banks fail to deliver this it is likely that there will be further political and regulatory intervention.

# Appendix 1 – Capital Adequacy

All banks must comply with the overall financial adequacy rule[[214]](#footnote-214), which is necessary to meet the Threshold Conditions[[215]](#footnote-215) to become a bank and remain an authorised bank.

“*A firm must at all times maintain overall financial resources, including own funds and liquidity resources, which are adequate both as to amount and quality to ensure there is no significant risk that its liabilities cannot be met as they fall due.*”

This rule addresses both liquidity adequacy (addressed in Appendix 3) and capital adequacy addressed in this Appendix. The assessment of capital is based on the Basel II[[216]](#footnote-216) methodology that introduced the three pillar approach of:

* Capital adequacy assessments by the bank concerned (Pillar 1);
* Supervisory Review and Evaluation Process (SREP) by the regulator (Pillar 2); and
* Disclosure (Pillar 3).

As set out in Appendix 3, the ILAA[[217]](#footnote-217) is the process by which the bank assesses its liquidity adequacy, resulting in a ILAAP document which is submitted to the PRA for an L-SREP resulting in Individual Liquidity Guidance (ILG). The corresponding process for capital adequacy is the ICAA[[218]](#footnote-218), resulting in an ICAAP document, which is submitted to the PRA for a SREP resulting in Individual Capital Guidance (ICG). The European Banking Authority has issued guidance on SREP methodologies[[219]](#footnote-219).

Unlike the previous regulatory regime, which was implemented by Directive, the majority of the new prudential regulatory regime for banks (including RFBs) key underlying legal source can be found in two key legal documents: (1) The Capital Requirements Directive (CRD IV)[[220]](#footnote-220); and (2) the Capital Requirements Regulation (CRR)[[221]](#footnote-221).

In the context of the three Pillar Basel approach this Appendix is predominantly focussing on the Basel Pillar 1 assessment of its own capital adequacy, i.e. the completion of its ICAAP which will be submitted to the PRA for a SREP. Somewhat confusingly, the Basel Pillar 1 assessment itself has two pillars, with the second pillar split into a Part A and a Part B, so that the Basel Pillar 1 consists of:

* Pillar 1 is a formulaic calculation of capital based on the RFBs risk exposure based on its financials, for example, assets on its balance sheet for calculating credit risk capital; and turnover for calculating its operational risk capital;
* Pillar 2A – is intended to capture risks that have not been captured (or not fully captured under Pillar 1); and
* Pillar 2B – is intended to capture risks which may arise in the bank’s five year planning period due to changes in the economic environment.

***Calculating the Pillar 1 Capital Charge***

*Credit Risk*

This will be the main risk for most RFBs, the risk that supports the maturity transformation activity that is so important for the functioning of the economy and the risk that an RFB must take on and manage if it is to make a reasonable profit and survive. There are two different methods for calculating capital to support credit risk, which were set out in Basel II[[222]](#footnote-222), and now reflected in the CRR: (1) the Standardised Approach[[223]](#footnote-223); and (2) the Internal Ratings Based Approach (IRB)[[224]](#footnote-224). The IRB is available (subject to regulatory approval) in Foundation or Advanced form – with lower capital requirements for more advanced approaches. These remain current at the time of writing, however, as part of the overall review of the regulatory architecture they are being reviewed[[225]](#footnote-225). The current requirements are set out in the CRR[[226]](#footnote-226). Using approaches other than the Standardised Approach requires a waiver from the PRA[[227]](#footnote-227).

Unless an RFB is an existing legal entity with an IRB waiver, if it wants to lower its capital charge for credit risk, it will need to apply for an IRB waiver. This used to be something that was assessed and decided by the national regulator, however, since the introduction of the CRR (a single EU prudential regulation rulebook), supplemented by additional regulation in the form of EBA Regulatory Technical Standards (RTS), the PRA is required to assess the waiver based on detailed criteria[[228]](#footnote-228).As a result of this most firms will use the Standardised Approach initially – which is based on Risk Weighting an Asset (RWA).

Following the Basel II criteria (soft law), the CRR (hard law) has set out the calculation methodology. For the core of an RFB business, the Standardised Approach would be as follows:

* a 35% risk weighting for residential mortgages (subject to a 80% loan-to-value cap – when the risk weight increases);
* a 75% risk weighting for personal lending;
* SMEs – are allowed a reduction in capital due to their importance to the economy[[229]](#footnote-229); and
* Large corporate with a rating – the risk weighting would be based on the rating of the respective companies given by a Credit Rating Agency (CRA).

In relation to large corporates, there was a loss of confidence in rating agencies during the financial crisis, and the inherent conflicts in the ratings agency business model, in particular when rating securitisations, the EU have reviewed this approach with CRAs, now regulated and known as European Credit Assessment Institutions (ECAIs). To ensure consistency of assessment, and pan-EU comparability, the EU have introduced six Credit Quality Steps (CQS), and aligned all the ECAI ratings to the CQS. In future CQS will be used for calculating exposures[[230]](#footnote-230).

Within a credit risk context RFBs must also consider Counterparty Credit Risk, and any other non-credit assets[[231]](#footnote-231). In all cases the relevant exposure is converted an RWA and the basic Pillar 1 capital charge of 8% is applied. In the mortgage example a £100m portfolio of mortgages (with LTV below 75%) would be risk weighted at 35% so that the Risk Weighted Asset would be £35m – the bank’s capital charge for the portfolio of mortgages (its asset) will be £35m by 8% or £2.8m.

*Market Risk*

The 1966 Amendment to the Basel Accord[[232]](#footnote-232) was aimed at banks that traded assets, and generally generated a lower capital requirement on the basis that the assets were available for sale, had a price set in the market, were supported by underlying liquidity, and were held in a newly introduced ‘trading book’. Assets that are held in the ‘banking book’ in the form of loans do not have these qualities, albeit that from the late 1980s a key objective of many banks, via securitisation, was to convert the assets in their banking book into something that could be traded – starting off in a relative simple way, and getting particularly complicated with synthetic securitisation, i.e. using credit default swaps to transfer risk off the balance sheet and into a special purpose vehicle, for onward selling to institutional investors.

RFBs will not be allowed to operate a trading book. Although some trading will no doubt be carried out by the RFBs treasury function, such trading should not be for profit, i.e. any trading that is done should be done for hedging purposes only, for example, hedging a portfolio of fixed interest mortgages.

*Operational Risk*

Operational risk will also be key risk for RFBs, however, unlike credit risk it is a risk that they would like to avoid as there is no profit to be made from it, and potentially serious losses, regulatory fines and damage to the RFBs reputation could occur. Operational risk is a cost of doing business.

As with credit risk RFBs will have three approaches to operational risk that they can choose from: (1) the Basic Indicator Approach (BIA)[[233]](#footnote-233); (2) The Standardised Approach (TSA)[[234]](#footnote-234); and the Advanced Measurement Approach (AMA)[[235]](#footnote-235) – again with lower capital requirements for more advanced approaches. It is possible under the AMA to obtain a reduction on the basis of insurance, subject to meeting certain requirements[[236]](#footnote-236).

The Basic Indicator, with the highest operational risk capital requirement, is mainly for banks that have very basic business models and do not have an operational risk function. Very few firms are on the Advanced Measurement Approach, which requires substantial investment in modelling capability, and regulatory approval. The majority of firms are on the Standardised Approach, and it is to be expected that the majority of RFBs will be on such an approach, except in instances where their parent may have made an investment in developing AMA, and is either an AMA bank or ready to go AMA. In any event the RFB will need to apply to the PRA for a waiver to use the AMA and will need to satisfy the criteria set out in the relevant EBA RTS[[237]](#footnote-237). Given the nature of the business of an RFB, the cost-benefit analysis of moving from TSA to AMA may not be justified.

For an RFB applying the TSA approach the Pillar 1 charge is based on the application of a Beta factor to the average of three years gross revenue of the relevant business lines[[238]](#footnote-238). For the core business of an RFB – retail and commercial – the Betas are 12% and 15% respectively[[239]](#footnote-239).

All RFBs will have the following two components to their Pillar 1 capital charge:

* Credit Risk (including Counterparty Credit Risk); and
* Operational Risk

***Calculating the Pillar 2A Capital Charge***

The purpose of Pillar 2A is to allow the RFB to assess whether the formulaic methodology used generates a reliable capital charge relative to the risk profile of the RFB.

The Pillar 2A capital charge is based on the RFBs assessment of risks that are not covered by Pillar 1, or not adequately covered by Pillar 1. They are not covered by standard calculations, and are a bespoke assessment based on the idiosyncratic risk profile of each bank. The PRA is currently reviewing its methodologies for assessing Pillar 2 capital requirements and is being more transparent about its methodologies[[240]](#footnote-240).

The EBA SREP guidance[[241]](#footnote-241), and the PRA Rulebook[[242]](#footnote-242), suggest that the following should be assessed at Pillar 2A:

* Credit and Counterparty Risk[[243]](#footnote-243);
* Market Risk[[244]](#footnote-244);
* Liquidity Risk[[245]](#footnote-245);
* Operational Risk[[246]](#footnote-246);
* Concentration Risk[[247]](#footnote-247);
* Residual Risk[[248]](#footnote-248);
* Securitisation Risk[[249]](#footnote-249);
* Business Risk;
* Interest Rate Risk in the Banking Book[[250]](#footnote-250);
* Risk of Excessive Leverage[[251]](#footnote-251);
* Pension Obligation Risk; and
* Group Risk.

The credit risk, market risk, and operational risk formulaic calculations are addressed in Pillar 1 above. Although all risks should be considered, for an RFB, the key Pillar 2A risks will be:

* Credit Risk
  + Core Credit Risk
  + Counterparty Credit Risk
  + Concentration Risk
* Market Risk
  + Interest Rate Risk in the Banking Book
* Operational Risk

Capital is not considered a good mitigant for liquidity risk, although like all risks it has underlying operational risk - ‘people, process and systems’ – which is why operational risk is such an important risk. Liquidity risk is addressed in Appendix 3.

*Credit Risk*

The PRA Pillar 2A assessment methodology is based on a comparison of Standardised Approach risk weights to a PRA produced table of IRB risk weight benchmarks. The PRA reserves the right to apply supervisory judgement for any perceived deficiency in the model. The PRA has not produced benchmarks for all portfolios due to a lack of data. The methodology is applied on an aggregate basis, e.g. if there is excess Standardised Approach capital relative to the benchmark in one portfolio (e.g. LTVs less than 50%) the excess can be applied to another portfolio where there is a deficiency (e.g. credit card exposures). The PRA will take this into consideration in the SREP.

*Counterparty Risk*

Counterparty credit risk is defined as the risk of a financial loss arising from the failure of a counterparty to meet its obligations under financial contracts. It is particularly applicable to derivatives, bonds, and other debt instruments. Most derivatives are now settled through central clearing houses (where there is a requirement to post initial and variation margin as collateral) and as such they are risk weighted at 2% in the formulaic Pillar 1 calculation, however, where the RFB has invested in bonds that are used for Repo (e.g. selling at a discount to the BoE for liquidity purposes and buying the bond back) purposes it should consider whether there is additional counterparty risk. Again, the purpose of Pillar 2A is to allow the RFB to assess whether the formulaic Pillar 1 charge is a fair representation of the risk.

*Concentration Risk*

There are four key types of concentration risk that an RFB should consider holding additional capital against:

* *Single Name Concentration* – additional capital held to cover a large unexpected loss to a large single customer;
* *Sector Concentration* – additional capital held to cover large unexpected losses in a single sector, e.g. a bank that might have a large number of commercial real estate loans;
* *Product Concentration* – additional capital held to cover large unexpected losses that result from over-exposure to a particular product; and
* *Geographic Concentration* – most RFBs will have their geographic concentration in the UK. However, all residential mortgage portfolios are excluded from geographic concentration risk assessment.

With the exception of Geographic Concentration, banks are required to calculate a (HHI)[[252]](#footnote-252) score (a measure of concentration) for all other portfolios. The PRA have developed a multi-factor capital model using a methodology for Single Name Concentration risk[[253]](#footnote-253) and a methodology for Sector Concentration and Geographic Concentration[[254]](#footnote-254). They have used these methodologies to create a range of add-ons calibrated to the HHI score for each of (1) Single Name Concentration; (2) Sector concentration risk; and (3) Geographic (international) concentration risk. For geographic concentration the PRA considers the UK separately.

The PRA will exercise a judgement where within the range the add-on should fall – working on the presumption that, in the absence of compelling reasons, it will be the mid-point of the add-on range. The add-on will be the sum of add-ons for each credit concentration risk type. The PRA will adjust if they believe it does not reflect the underlying credit risk within a portfolio.

*Interest Rate Risk in the Banking Book*

This is a form of market risk but is non-traded market risk and comes about because of the development of fixed rate products and the use of wholesale funding. There are predominantly three key risks:

* Re-pricing and yield curve risk
  + This risk arises from the timing difference between the maturity and mis-pricing of assets.
  + The main sources is term deposits and fixed rate mortgages, and the hedging strategies to manage the associated risk can give rises to mismatches in respect of re-pricing and maturity.
* Basis Risk – there are two types of basis risk
  + Bank Rate vs LIBOR
    - When the bank raises funds in the wholesale market the cost of funding will usually be priced off a LIBOR rate, whereas the pricing of customer products will usually be priced off the Bank of England’s base rate. As these rates are unlikely to move simultaneously there is a basis risk.
  + Bonds vs Swaps
    - Where the banks is holding fixed rate bonds (commercial or government) as part of its liquidity management (e.g. High Quality Liquid Asset buffer) and the interest rate risk exposure is hedged with Swaps, there is a basis risk, as like bank rate and LIBOR, bond rates and swaps do not normally move in tandem.
* Optionality Risk – this arises when the customer has the ability to influence the timing and size of the bank’s cash-flows, the two major sources for an RFB will be:
  + Pipeline Risk
    - This can arise where fixed rate pricing (e.g. for mortgages) has been agreed and hedged in advance of the customer commitment to draw the mortgage funds, or a variety of misjudgement or customer action that leads to a position where the hedging is not accurate.
  + Pre-payment Risk
    - This arises where the bank has agreed and hedged a fixed rate mortgage but the customer has the ability to repay early without compensation to the bank. Early repayment without compensation may lead to a loss in respect of the hedging arrangement. This is often covered by an early repayment charge clause in fixed rate mortgage contracts.

Operational Risk

The CRR does not require TSA firms to do scenario analysis (it is an AMA requirement[[255]](#footnote-255)), however, it has long been accepted as good practice by regulators and is expected of TSA firms as part of their Pillar 2A operational risk calculation. The PRA has recently been more open about its own Pillar 2A assessment methodologies, and expect firms to be able to provide information in a way that allows for this assessment.

The following approach applies to Category 1 firms, and to Category 2 firms depending on the level of sophistication of the firm’s risk management. This will cover many RFBs.

Firms will be required to supply the following key pieces of information to the PRA to allow them to do their assessment:

* Forecast operational risk losses, broken down between conduct and non-conduct losses and by future year; and
* Information on the operational risk scenarios the RFB have considered in their ICAAP, covering a description of such scenarios and an assessment of their impact and likelihood.

For non-conduct risks the PRA will the conduct three estimates (based on a 1 in 1,000 (99.9%) confidence level):

* Estimate 1 – an estimate based on the RFB’s forecast of expected losses (excluding conduct and legal risk) in the next year extrapolated to a 1 in 1,000 year confidence level;
* Estimate 2 – an estimate based on the average of the RFB’s five largest losses (excluding conduct and legal risk) – repeated for the previous five years with the largest loss (calibrated to 1 in a 1,000) being used; and
* Estimate 3 – the RFB’s scenarios – modelled to a 1 in 1,000 confidence level – with the five largest impacts summed and a pre-defined diversification benefit (the same for all firms) will be applied.

For the Pillar 2A Non-conduct operational risk component, supervisory judgement will then be used to determine the add-on based on:

* The quality of the RFBs Pillar 2A assessment;
* The capital ranges generated by the estimates above for non-conduct risk;
* Confidence in the RFBs scenario analysis and internal loss data;
* The quality of the firm’s operational risk management and measurement framework; and
* Peer group comparison.

For Pillar 2A conduct risk supervisory judgement will be used to determine the add-on based on:

* Supervisory judgement of the RFB’s exposure to conduct risk;
* The RFB’s largest conduct losses over the past five years;
* The level of expected annual loss for conduct risk; and
* Conduct related scenarios where potential scenarios over a shorter time horizon (e.g. 5 years) are considered.

The RFB’s Pillar 2A charge will then be the sum of (1) the capital assessment for non-conduct risk; and (2) the capital adjustment for conduct risk.

***Calculating the Pillar 2B Capital Charge***

In addition to its Pillar 1 capital charge for credit risk and operational risk and the RFBs Pillar 2A charge for credit risk, counterparty credit risk, concentration risk, interest rate risk in the banking book, and operational risk, the RFB will also be required to estimate a Pillar 2B charge.

The Pillar 2B charge is an assessment of macro-economic scenarios over the life of the business plan (the five years set out in the ICAAP). The RFB will run a PRA defined scenario[[256]](#footnote-256), and usually a scenario of its own choosing. Both scenarios will usually involve some form of recession, with a reduction in a series of macro-economic variables such as GDP, unemployment, house price inflation etc. tested against the business plan.

The stress testing forces the RFB to think about the management actions that they would take to reduce the impact of the stress. The product of each scenario in the ICAAP takes the form of: (1) a gross stress; (2) application of management actions; and (3) a net stress position.

The largest loss that needs to be absorbed in the five years of the net stress becomes the Pillar 2B charge – currently known as the Capital Planning Buffer (CPB)[[257]](#footnote-257).

The combination of the formulaic Pillar 1 capital charge, the self-assessed Pillar 2A and Pillar 2b charges constitutes the RFBs Capital Demand relative to its risk profile. It is this that is presented to the Board in the ICAAP and submitted to the PRA.

# Appendix 2 – Capital

Having determined the Capital Demand in the ICAAP risk assessment, it is then necessary to address the issue of Capital Supply and the form it must take. There are three key types of capital, which, in order of importance are: (1) Common Equity Tier 1 (CET1) – share capital and reserves (retained profit); (2) Additional Tier 1 (AT1); and (3) Tier 2.

Additional Tier 1 (AT1) instruments are debt issued by banks to build in additional resilience to the bank’s capital adequacy. They are intended to protect against the bank’s CET 1 falling below a certain level. AT1 converts from debt to equity if the CET1 ratio falls in times of stress. AT1 issuance is usually attractive to investors as it usually has a higher yield commensurate with the risk of conversion in times of stress for re-capitalisation. Tier 2 capital has a similar structure but is used after Tier 1. As part of recovery and resolution planning, there can also be bail-in debt – but this is not part of capital.

As mentioned in footnote 257, the PRA Buffer will have replaced the Pillar 2B Capital Planning Buffer and will only apply where it is in excess of the Capital Conservation Buffer (CCB) and Systemic Buffer (SB). The CCB will apply at its full 2.5% for RFBs in 2019. At the time of writing the SB has been set, and in its true form (aimed at G-SIFIs) would not apply to RFBs, however, the PRA is introducing a specific systemic buffer for RFBs in the range 1 to 3%.The PRA Buffer will not have to be fully met until 2019. 25% will need to be met in 2016 and 50% in 2017, however for RFBs in 2019 it must be met in full. The PRA Buffer must be covered by CET1 (shares and retained profit).

A Governance and Risk Management (G&RM) Scalar may be introduced where the PRA observe significant weakness in an RFBs governance and risk management. Where such a scalar is introduced, it will be covered by the PRA Buffer (and set as a scalar to the CET 1 required to cover both Pillar 1 CET 1 (4.5% of RWA) and Pillar 2A CET 1 (56% of the Pillar 2A add-on). Where a G&RM scalar is set, it is a part of the PRA Buffer that does not benefit from an offset against the other buffers. It would also constitute part of a Core Capital Planning Buffer and as such would not benefit from the transitional arrangements, i.e. it would need to be covered by 100% CET1.

Governance and risk management scalars have been around for a long time. It is possible that a new RFB will get a Governance and Risk scalar for at least the first year whilst the Board and EXCO establish themselves and are seen to work effectively in respect of their respective roles – (1) direction and oversight; and (2) management of the business respectively. In this respect RFBs can help themselves by setting out their governance effectively in the RFBs ICAAP.

The outcome of the submission of the ICAAP to the PRA, following their SREP, is the issue of Individual Capital Guidance (ICG). The ICG will inform the RFB of the amount of capital they must hold and also the quality of the capital (i.e. the mix of CET1, AT1 and T2).

As an additional safety net the PRA have a Leverage Ratio (LR)[[258]](#footnote-258). Vickers wanted the LR set at 4% allowing banks to leverage their balance sheet to 25 times capital. The LR has been set at 3% (33 times leverage) but with add-ons of 35% of the Countercyclical Capital Buffer (currently 0) and 35% of the Systemic Buffer (or RFB Buffer for RFBS) - so for many banks it will in effect be close to 4%.

|  |  |  |
| --- | --- | --- |
| A PRA Buffer assessment is applied only when the assessment exceeds the CCB and SB. However, any governance and risk scalar will be held in the PRA Buffer. | **PRA Buffer**  CET1 (if required) | **PRA Buffer**  (includes Governance & Risk scalar) |
| There is a transition period for this – 2016 (0.625%); 2017 (1.25%); 2018 (1.875%) and 2019 (2.5%). RFBs in 2019 will be required to hold the full 2.5% in CET1 | **Capital Conservation Buffer (CCB)**  CET1 |
| This has been discussed between Carney and Osborne, but HMT has yet to designate (most likely the FPC). As RFBs will not be internationally systemic (G-SIFI) it should not apply. However, the PRA has proposed a Ring-fenced Bank buffer, which when implemented will range from 1 – 3%. | **Systemic Buffers (SB)**  CET1 (if required) |
| If set this must be held as CET 1  Note: that for exposures in other EEA states the CCB for the relevant State must be used. | **Countercyclical Capital Buffer**  Set by the FPC – reviewed quarterly – currently set at 0% | |
| Aligned to Pillar 1 proportions (from Jan 2015) | **Pillar 2A (same proportions as Pillar 1)**  25% of Pillar 2A charge - T2  19% of Pillar 2A charge - AT1  56% of Pillar 2A charge - CET1 | |
| Current Pillar 1 requirements | **Pillar 1**  2% of RWAs - T2  1.5% of RWAs - AT1  4.5% of RWAs - CET 1 | |

# Appendix 3– Liquidity Adequacy

**Note:** Although references to BIPRU are correct at the time of writing, the PRA Liquidity Regime is being replaced on 1st October 2015 with the liquidity provisions from the CRR supported by EBA RTS. However, the principles remain the same.

The RFB must comply with the Overall Liquidity Adequacy Rule (OLAR) which states that:

*A firm must at all times maintain liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as the fall due.[[259]](#footnote-259)*

For the purposes of OLAR the RFB must also ensure that its liquidity resources contain a buffer of high quality unencumbered resources and maintain a prudent funding profile[[260]](#footnote-260). In addition the RFB cannot anticipate resources that might be made available from the BoE[[261]](#footnote-261).

Following the run on Northern Rock in 2007[[262]](#footnote-262)the FSA implemented a major overhaul of the regulator’s approach to liquidity introducing the requirement for bank’s to produce an Individual Liquidity Adequacy Assessment[[263]](#footnote-263). The provisions were contained in the BIPRU section of the FSA Handbook. The FSA provisions address, in particular, liquidity adequacy[[264]](#footnote-264), liquidity risk management[[265]](#footnote-265), stress testing and Contingency Funding Plan (CFB)[[266]](#footnote-266), and the Liquid Asset Buffer (LAB)[[267]](#footnote-267). The PRA set out the major liquidity risk drivers (the EBA SREP guidelines and some additions) firms should assess and monitor[[268]](#footnote-268):

* Retail funding risk;
* Wholesale secured and unsecured funding risk;
* Risks from funding diversification;
* Off balance sheet liquidity risk;
* Risks arising from the firm’s funding tenors
* Risks associated with the firm’s credit rating
* Funding risks resulting from estimates of future balance sheet growth
* Franchise-viability liquidity risk;
* Intra-day liquidity risk;
* Marketable assets risk;
* Non-marketable asset risk;
* Internalisation risk.

Given the nature of RFB’s and their domestic focus the list excludes cross-currency risk and the risk associated with transferring liquidity resources across sectors, entities and countries, nevertheless, the list is not exhaustive and each firm should prioritise a list of liquidity risk relative to their strategic focus and business model.

Although, with all the regulatory change that is occurring, the liquidity regime is also changing[[269]](#footnote-269), however, it is more a change of labels than substantive process, and reflects an international harmonisation of liquidity standards – Basel III[[270]](#footnote-270), and EU harmonisation based on the provisions of CRD IV and the CRR.

A key factor in reducing the risk of a run on an RFB is the changes to the safety net for customers that is provided by the Financial Services Compensation Scheme (FSCS). At the time of the Northern Rock run, the scheme covered one hundred percent of the first £2,000, and ninety percent of the next £33,000. On the 1st of October 2007 this was increased to one hundred percent of the first £35,000, and on 7th October 2008 the sum covered was increased again to £50,000, and today it stands at £85,000[[271]](#footnote-271). In addition the FSCS has taken to advertising on both radio and television to ensure that the general public area aware that in the majority of cases their money is safe.

Base1 III[[272]](#footnote-272) introduced two new key liquidity ratios.

* The Liquidity Coverage Ratio (LCR)

The LCR is intended to encourage firms to be able to deal with a 30 day liquidity crisis (based on a severe but plausible liquidity stress scenario) without having to resort to the use of central bank facilities. This, in essence, requires the RFB to have a liquid asset buffer of high quality unencumbered assets that can be very quickly converted into cash to meet liquidity needs for a 30 day time horizon. The formula[[273]](#footnote-273) is:

Stock of high-quality liquid assets

----------------------------------------------------------------- >/= 100%

Total net cash outflows over the next 30 calendar days

The LCR is being phased in between 1st October 2015 and 1st January 2018[[274]](#footnote-274), however, the UK, at the request of the Financial Policy Committee[[275]](#footnote-275), has increased the phase percentages above those required by the CRR. This will only affect RFB’s that are authorised before the 1st January 2018 (albeit that they will not be RFBs until 2019).

* The Net Stable Funding Ratio (NSFR)

The NSFR is complementary to the introduction of the LCR in that it is intended to encourage firms towards more stable long term funding of assets and business activities. Stable funding is defined as funding expected to be stable over a one year time horizon under conditions of extended stress. The formula[[276]](#footnote-276) is:

Available amount of table funding

------------------------------------------- >100%

Required amount of stable funding

In the event that an RFB cannot meet its LCR, or does not expect to meet its LCR, in addition to providing a restoration plan, it must submit daily liquidity returns to the PRA[[277]](#footnote-277).

The FSA’s assessment methodology classified deposits into Type A deposits (less sticky – more likely to withdraw) and Type B deposits (sticky – less likely to withdraw)[[278]](#footnote-278). This will be reviewed and a possible new categorisation could be:

* Stable – below the FSCS limit;
* Less Stable – above the FSCS limit; and
* High Outflow – deposits in excess of a given sum (dependent upon the average firm balance, e.g. £200,000).

The FSA proposed three stress tests for liquidity[[279]](#footnote-279), all of which were confirmed in the subsequent policy statement[[280]](#footnote-280) and have now been part of liquidity risk management practice for a number of years – the stress tests are:

* An Idiosyncratic stress (i.e. specific to the RFB);
* A Market-Wide stress (a systemic stress); and
* A Combined stress (combining both of the above).

This requirement to carry out these three stresses has been carried forward into the new PRA Rulebook[[281]](#footnote-281). In developing the RFB’s Liquidity Contingency Plan (LCP)[[282]](#footnote-282) the plan should clearly set out the RFB’s strategy for addressing liquidity shortfalls in stressed conditions.

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In addition to the three tests above the firm is required to conduct a reverse stress test – a stress test to the point at which the bank would fail[[283]](#footnote-283).

Under BIPRU the firms’ were required to hold a Liquidity Asset Buffer – in the new regulations this is known as holding High Quality Liquid Assets (HQLA) and is likely to become known as the HQLA buffer. As part of the firm’s Enterprise Wide Risk Management Framework, the firm must have a Liquidity Risk Appetite (and a Funding Risk Appetite) that has been agreed by the Board. The Liquidity Risk Appetite should be defined in terms of survival days – survival days using the HQLA (30 Days), and survival days using the HQLA and the Bank of England Discount Window Facility (DWF):

* Cash held in the firm’s BoE Reserve Account;
* Pre-positioned assets at the Bank’s DWF; and
* Repo facilities – and an understanding of the ‘haircuts’ (reduction in value) applied.

Normally the CFO is responsible for liquidity management, although the work will usually be carried out by the bank’s treasury function. The Treasury functions in RFBs should be ‘not for profit’ treasury functions and solely charged with managing the banks funding hedging and liquidity. Two key things that the Treasury function need to do:

* Liquidity forecasting – the equivalent of cash forecasting in a normal corporate, i.e. understand the daily weekly, and monthly inflows and outflows of cash;
* Transfer pricing[[284]](#footnote-284) – this approach allows for the attribution of risk and associated costs of both funding and liquidity to business lines and their products. Lending has both a funding cost and liquidity cost, and correspondingly deposits have an internal funding reward.

The PRA is currently migrating to a standardised EU reporting system known as COREP which will include a full suite of liquidity returns (to replace the existing FSA legacy suite). This suite will include the additional liquidity monitoring metrics mandated by the EBA. The RFB reporting systems must be capable of producing daily return on day one to ensure that in the event of not meeting LCR it can comply with its regulatory obligations[[285]](#footnote-285).

Currently firms are allowed to apply for an intra-group liquidity modification. The CRR[[286]](#footnote-286) allows for a permission that has an effect equivalent to an intra-group liquidity modification. Given the expectation of an RFB to be ring-fenced it is reasonable to assume that this permission will not be available to RFBs.

Once the RFP has submitted its ILAAP, the PRA will apply the Liquidity Supervisory Review and Evaluation Process (L-SREP)[[287]](#footnote-287). In addition to assessing the quantitative requirements the L-SREP will a look to establish that the firm has a Board approved liquidity risk appetite and funding risk appetite that are appropriate for the business and communicated to the relevant business lines[[288]](#footnote-288), and examine that the firm has appropriate

‘*governance, strategies, policies, systems and processes, transfer pricing, qualitative management, funding diversification, market access, and funding plans in order to identify, measure, manage and monitor liquidity risk over meaningful time horizons*’[[289]](#footnote-289).

The outcome of the L-SREP is that the PRA will issue liquidity guidance advising two things:

* the amount and quality of liquid assets (the HQLA) that the firm is required to hold to support the firm’s liquidity risk management; and
* a prudent funding profile for the firm.

Following the Basel three pillar approach, the ILAAP is a Pillar 1 assessment that the firm uses to establish its liquidity profile and appropriate HQLA, the L-SREP is the regulator’s Pillar 2 assessment leading in most cases to some add-ons for liquidity. This leaves Pillar 3 which focuses on disclosure. There is an increasing expectation that firm’s will disclose more about their risk management to allow market participants have a better understanding of the risk profile of firms[[290]](#footnote-290). An LCR disclosure template has already been designed[[291]](#footnote-291) and, from a market discipline perspective, we are likely to see further disclosure required.

# Appendix 4 – Recovery And Resolution

The FSB led the charge on Recovery and Resolution in the immediate aftermath of the financial crisis and published a number of papers on recovery[[292]](#footnote-292). The EU have implemented the Bank Recovery and Resolution Directive, which establishes the PRA as the ‘competent authority’ for Recovery and the Bank of England as the ‘resolution authority’ for resolving banks that are no longer recoverable[[293]](#footnote-293).

A key plank of both recovery and resolution is the ability to bail-in debt. One of the recommendations of the ICB was the introduction of Permanent Loss Absorbing Capacity (PLAC). This has now been super-ceded by the FSB’s Total Loss Absorbing Capacity (TLAC) and the EUs Minimum Requirements for own funds and Eligible Liabilities (MREL).

TLAC is a Financial Stability Board expectation and aimed at Globally Significant Banks (G-SIBs). MREL is the equivalent EU requirement as set out in the Bank Recovery and Resolution Directive (BRRD). Both TLAC and MREL aim to achieve the same thing – ensure that shareholders and creditors bear losses in situations of resolution.

TLAC expects a Pillar 1 of 16-20%, with a discretionary additional Pillar 2 component and only applies to G-SIBs. MREL will apply to all banks in the EU, with the BBRD starting point based on an estimated reference level at 10% of total liabilities. MREL is scheduled to be implemented on 1st January 2016. TLAC is not intended to be implemented until 1st January 2019 and is unlikely to apply to RFBs, however MREL will apply to all RFBs

The EBA have recently consulted[[294]](#footnote-294) on how MREL should be adapted to reflect the resolvability, risk profile, systemic importance and other characteristics of each institution. Consultation closed on 27th February and went to the European Commission as a Regulatory Technical Standard (RTS) in July, after which it will become a Regulation and be legally binding in the UK. MREL will be set by the ‘Resolution Authority’, which in the UK is the BoE and not the PRA. The BoE have indicated that they will issue a separate Policy Statement on MREL later this year.

The key objective of MREL is to ensure that there are enough own funds and eligible liabilities to absorb losses and contribute to re-capitalisation. The EBA have set out six criteria for the BoE to use in assessing the application of MREL:

1. The need to ensure that losses are absorbed – the BoE should ensure that losses equal to capital requirements (including buffers and leverage requirements) can be absorbed by the RFB;
2. The BoE should determine the amount of re-capitalisation which would be required to implement the preferred resolution strategy identified in the resolution planning process:
   1. Creates a link between MREL and the capital ratio (including any leverage ratio requirement that has been applied) necessary to comply with the conditions for authorisation;
   2. The need to ensure sufficient confidence in the RFB, i.e. how much is needed to restore the capital buffers.
3. Need to ensure that MREL is sufficient even if the resolution plan envisages that certain classes of liabilities are excluded from contributing to loss absorption or re-capitalisation by the BoE in order to ensure a successful resolution;
4. The BoE must take account of the extent to which the Deposit Guarantee Scheme could contribute to the financing of the RFBs resolution;
5. The BoE must take account of the size, business model, funding model, and risk profile of the RFB (most likely to be based on the SREP score of 1 – 4);
6. The BoE to take account of the potential adverse effects on financial stability of the failure of the RFB.

The figure for 1 above is calculated by translating the RFBs overall requirement [£x] into the equivalent percentage of total liabilities and own funds [£x]. If the RFBs overall capital requirement (Pillar 1, Pillar 2, and buffers) was 10.5% and the RFBs total RWAs were equal to 35% of total and own funds, the RFBs MREL loss absorption component would be 3.675% of total liabilities and own funds:

Total liabilities and own funds = 1,000

RWAs (1,000 \*35%) = 350

Capital would be RWAs \*overall capital requirement (350\*10.5%) = 36.75

MREL loss absorption – 36.75 \*10% = 3.675%

Having established the MREL loss absorption amount, the BoE then have the flexibility to use the other five criteria to adjust this amount:

* For 2 the EBA consultation notes that where the resolvability assessment determines that it is feasible and credible to liquidate the bank the recapitalisation amount will be zero (a full bail-in approach based on the above would add another 3.7% of total liabilities and own funds);
* For 3, some liabilities are not eligible for inclusion[[295]](#footnote-295), and the BoE also has the power to exclude in some cases[[296]](#footnote-296);
* For 4, subject to limits, the Deposit Guarantee funds (FSCS) can be used in resolution[[297]](#footnote-297) and can lead to a reduction in MREL;
* For 5, the BoE (the Resolution Authority) and the PRA (the Competent Authority) should be aligned;
* For 6, the nature of the RFB and its impact on the economy should be taken into account.

A final consultation paper on MREL from the BoE is awaited at the time of writing.

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255. CRR Articles 321 and 322. [↑](#footnote-ref-255)
256. See footnote 186. [↑](#footnote-ref-256)
257. It should be noted that although banks will still be required to run these scenarios and stress tests, the system of buffers is changing with the introduction of the Systemic Buffer and the Capital Conservation Buffer. When the CPB exceeds these buffers in the future it will be known as the PRA Buffer. [↑](#footnote-ref-257)
258. CRR Article 429. [↑](#footnote-ref-258)
259. PRA Rulebook ILAA 2.1 [↑](#footnote-ref-259)
260. PRA Rulebook - ILAA 2.2(1) [↑](#footnote-ref-260)
261. PRA Rulebook - ILAA 2.2(2) [↑](#footnote-ref-261)
262. See footnote 14. [↑](#footnote-ref-262)
263. FSA Policy Statement 9/16 ‘Strengthening Liquidity Standards, October 2009. [↑](#footnote-ref-263)
264. BIPRU 12.2 (Note: BIPRU 12 will be withdrawn on 1st October 2015 and replaced by the liquidity risk requirements of the CRR and the PRA Rulebook). [↑](#footnote-ref-264)
265. BIPRU 12.3 [↑](#footnote-ref-265)
266. BIPRU 12.4 [↑](#footnote-ref-266)
267. BIPRU 12.7 [↑](#footnote-ref-267)
268. PRA Rulebook – ILAA 11.5 [↑](#footnote-ref-268)
269. PRA ‘Consultation Paper 27/14, CRD IV: Liquidity’ (2014). [↑](#footnote-ref-269)
270. BCBS‘ Basel III: International framework for liquidity risk management standards and monitoring’ (2010). [↑](#footnote-ref-270)
271. Recently reduced to £75,000 based on a prescribed review of the GBP / EUR exchange rate. [↑](#footnote-ref-271)
272. See footnote 270. [↑](#footnote-ref-272)
273. See footnote 270, p3; CRR Article 412. [↑](#footnote-ref-273)
274. CRR Article 412(5) [↑](#footnote-ref-274)
275. Bank of England, Record of the Financial Policy Meeting, 18 June 2013, page 2. [↑](#footnote-ref-275)
276. See footnote 270, p25; CRR Article 510. [↑](#footnote-ref-276)
277. CRR Article 414 [↑](#footnote-ref-277)
278. For Wholesale - BIPRU 12.5.16(4), and for Retail – BIPRU 12.5.21(3). [↑](#footnote-ref-278)
279. FSA ‘Consultation Paper 08/22 ‘Strengthening Liquidity Standards, December 2008. [↑](#footnote-ref-279)
280. FSA ‘Policy Statement 09/16, Strengthening liquidity standards’, October 2009. [↑](#footnote-ref-280)
281. PRA Rulebook – ILAA 11.4 [↑](#footnote-ref-281)
282. PRA Rulebook – ILAA 12.1 (replaces the BIPRU Contingency Funding Plan). [↑](#footnote-ref-282)
283. See footnote 188. [↑](#footnote-ref-283)
284. PRA Rulebook – ILAA 6.1 [↑](#footnote-ref-284)
285. CRR Article 414 [↑](#footnote-ref-285)
286. CRR Article 8 [↑](#footnote-ref-286)
287. See footnote 182. [↑](#footnote-ref-287)
288. PRA Rulebook – ILAA 4 [↑](#footnote-ref-288)
289. See footnote 269, para 5.23. [↑](#footnote-ref-289)
290. Enhanced Disclosure Taskforce ‘Enhancing the Risk Disclosure of Banks’, 29th October 2012. [↑](#footnote-ref-290)
291. BCBS ‘Liquidity Coverage Ratio disclosure standards’, January 2014. [↑](#footnote-ref-291)
292. See footnote 197. [↑](#footnote-ref-292)
293. See footnote 199. [↑](#footnote-ref-293)
294. EBA ‘Final Draft Regulatory technical standards on criteria for determining the minimum requirement for own funds and eligible liabilities under Directive 2015/59/EU (2015). [↑](#footnote-ref-294)
295. Article 44(2) BBRD [↑](#footnote-ref-295)
296. Article 44(3) BRRD [↑](#footnote-ref-296)
297. Article 109 BRRD [↑](#footnote-ref-297)