Aligning the ring-fencing and resolution regimes: Positive Money submission

Positive Money welcomes the opportunity to respond to HM Treasury's Call for Evidence on aligning the ring-fencing and resolution regimes.

We are a not-for-profit research and campaigning organisation, working towards reform of the money and banking system to support a fair, democratic and sustainable economy. We are funded by trusts, foundations and small donations.

7. Considering the above criteria and the materiality of the regime's benefits and costs, do stakeholders have any initial overarching views on the long-term future of the ring-fencing regime?

We support the full retention of the ring-fencing regime and would strongly oppose any disapplication. Ring-fencing by no means fully protects the public from banking crises, but it is vitally important for consumers to have confidence that their deposits are protected from losses in banks' investment banking activities.

The scale of leverage in banks' positions mean that even very small changes in values could expose customers to losses. For instance, Barclays has a derivatives exposure of more than £21 trillion - around ten times UK GDP.[1] Of course many of these exposures will be mostly offset, but a loss of just 0.32% would be enough to wipe out Barclays' total equity (£69.2bn) and expose depositors to losses. Minimum leverage ratios of just 3.25% mean that, more generally, modest losses have the potential to wipe out UK banks' equity, especially given that capital strength may be exaggerated by banks using their own models for risk-weighting. As of November 2022, the ratio of equity to assets for UK banks was just 5.1%,[2] significantly lower than levels seen in many other European countries.[3] The market value of equity for UK banks has also been below its book value in recent years, suggesting a lack of faith in the quality of banks' assets.[4] These low levels of capital make any disapplication of ring-fencing particularly inappropriate.

Given such high levels of leverage, banks rely on a state-guaranteed deposit base in order to gain the confidence of investors. Disapplying ring-fencing would further subsidise banks' activities, as they would be able to use the size of their balance sheet and state-guaranteed customer deposits to support their investment banking activities. Banks with large retail deposit bases would enjoy much increased competitive advantages in trading, as a result of the government guaranteeing their liabilities, as well as from the size of the collateral they are able to offer, which could hurt the development of market entrants.

Disapplying ringfencing could also risk facilitating 'tiering' within the money and payments system, where deposits issued by non-ring fenced banks are not considered as safe.

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[1] Barclays PLC - Annual Report - 2022

[2] https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2022/fpc-core-indicators-december-2022

[3] Leverage ratios for European banks 2022 | Statista

[4] https://thedocs.worldbank.org/en/doc/645751560353055405-0130022019/original/FRBWBIMFConferenceKeyNoteSirJohnVickersJune62019.pdf

Furthermore, there may be undue confidence in the ability of resolution regimes such as 'bail-ins' to act as an alternative to ring-fencing. In the few cases where bail-ins have been tested, there has been significant issues that may have exacerbated financial instability. For instance, during the Cypriot banking crisis of 2013, a haircut was imposed on uninsured depositors in order to bail-in banks, which undermined confidence in the safety of deposits and fuelled financial contagion.[5] More recently, in the case of the failure of Credit Suisse, there was controversy when holders of the bank's AT1 contingent convertible ('CoCo') bonds, which convert from debt to equity in order to bail-in the bank, saw their bonds written down before shareholders took losses, despite traditional convention for bondholders to take priority over shareholders. This uncertainty caused the price of other banks' AT1 bonds and shares to fall.[6]

We echo the concerns expressed by the architects of the post-2008 regulatory regime, such as Sir John Vickers and Sir Paul Tucker.[7] Vickers, in particular, has warned that ring-fencing not only 'helps protect citizens from banking Armageddon' but also helps impose different governance structures and organisational cultures for retail banking and investment arms, which are fundamentally different businesses.

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[5] Failing banks, bail-ins, and central bank independence: Lessons from Cyprus | CEPR
[6] European banks default-risk indicator jumps, AT1 bonds fall | Reuters
[7] UK financial regulation architects warn against scrapping 'ringfencing'