Katten
KattenMuchinRosenman LLP
CORPORATE & FINANCIAL WEEKLY DIGEST

Corporate & Financial Weekly Digest

Posted at 11:24 AM on April 15, 2011 by Andrew Turner

UK Independent Commission on Banking Consults on Reform of Banking System

Co-authored by Edward Black

On April 11, the Independent Commission on Banking (ICB), established by the UK Government in July 2010, published for consultation its interim report on potential reforms to the UK banking sector. Its proposals have the twin aims of financial stability and competition.

The ICB stresses that it has not yet reached any final conclusions. Its key interim proposals are:

1. As expected, the ICB has stopped short of realizing the banks' worst fears—recommending a British version of the repealed U.S. Glass-Steagall Act and forcing a separation of ownership between investment and commercial/retail banking. However, it is recommending a form of "Glass-Steagall light"; retail banking operations can be owned by a combined, or "universal", bank, but must be ring-fenced into a separate subsidiary of the investment or combined bank.
2. Systemically important banks should hold equity capital of at least 10% (up from the 7% recommended by new EU regulations). Investment and wholesale banking operations in the UK will only have to maintain capital reserves in accordance with international norms. The criteria for qualifying as a "systemically" important bank are not yet defined.
3. Universal banking groups would be able to move capital between their investment and retail banking subsidiaries provided that each subsidiary meets its distinct capital reserve requirements at all times.
4. The ICB does not at present recommend the adoption of a UK equivalent of the "Volcker Rule."
5. Banks should issue debt which suffers some of the loss if the bank gets into trouble; the report is sketchy on the detail here but the principle is that the bank's bondholders, as well as its equity, should suffer at least some of the pain if a bank runs into trouble. The report also floats the idea of bank depositors' money ranking ahead of other debt on bankruptcy (as is already the case in a number of countries).
6. The role of the proposed organizations which will replace the UK Financial Services Authority (FSA) in due course (see the June 18, 2010, and July 30, 2010, editions of Corporate and Financial Weekly Digest) is clarified. The Financial Conduct Authority, which will be responsible for prudential and conduct supervision of banks, investment firms and exchanges, is clarified. The other regulator replacing the FSA will be the

Prudential Regulatory Authority, which will have primary responsibility for monitoring banks' balance sheets and financial soundness.

7. The UK retail banking market is perceived to suffer from a lack of competition. As it has over 30% of the UK retail market, ICB's preliminary recommendation is that Lloyds will almost certainly be ordered to sell off several hundred more branches. Other large retail banks may also be ordered to divest branches in order to promote competition.
8. The ICB notes with approval proposals to standardize and clear OTC derivatives.

The consultation stage lasts until July 4. The ICB is due to issue its final report and recommendations to the UK Government in September 2011.

Read more.

Katten Muchin Rosenman LLP
Charlotte Chicago Irving London Los Angeles New York Washington, DC