
BY CHARLES RANDELL

In an article to be published in the September issue of the Butterworths Journal of International Banking and Financial Law, Slaughter and May partner Charles Randell comments on the Government's White Paper on implementing the recommendations of the Independent Commission on Banking (ICB). He notes that, in general, the White Paper follows the ICB’s recommendations, but in a number of important areas the Government has stopped short, including:

• a concession that ring-fenced banks should be able to sell "simple derivatives" to their customers;
• no requirement that ring-fenced banks should make disclosures as if they were separate listed entities;
• no requirement that large UK banks should be subject to a tighter leverage limit than required by Basel III;
• relaxation of the ICB’s recommendation that UK headquartered banking groups should be subject to a primary loss-absorbing capacity requirement at the group level of at least 17% of risk weighted assets ("RWAs"), allowing the non-EEA assets of a banking group to be exempted from this calculation if the group can establish that its non-EEA activities are resolvable;
• no requirement that the primary loss-absorbing capacity of a UK banking group should be increased by a "resolution buffer" of up to an additional 3% of RWAs if it is considered difficult to resolve; and
• in general, few specific commitments to implement the ICB’s competition recommendations.

Both Sir John Vickers and Martin Wolf of the ICB have reiterated their belief that a tighter leverage ratio should be imposed, and Martin Wolf has expressed concerns that allowing ring-fenced banks to offer "simple derivatives" may lead to the ring fence becoming "almost totally permeable". These criticisms are likely to be further fuelled by fallout from the revelations over the determination of LIBOR, which have reignited debate over whether retail and investment banking activities should be allowed to co-exist within the same group, or should be separated completely.

At the same time, developments in Europe have highlighted the limits to the Government’s ability to legislate in this area. These limits became apparent in the European negotiations over implementation of the Basel III capital accord, where the "maximum harmonisation" approach threatened to prevent the UK from imposing the ICB’s additional equity capital and loss-absorbing capacity requirements on UK banks; it remains to be seen whether the final texts of the Capital Requirements Directive (IV) and Capital Requirements Regulation allow the necessary flexibility. The proposed EU Recovery and Resolution Directive also presents challenges for the implementation of the ICB’s recommendations. The draft Directive envisages that, regardless of the priority afforded to insured deposits, deposit guarantee schemes will rank pari passu with unsecured non-preferred claims; this would undermine the ICB’s purpose in recommending depositor preference. It would also require member states to ensure that members of a financial institution group may agree to provide financial support to other group members – a concept wholly inconsistent with the ICB’s ring-fencing proposal. Further EU proposals relating to the structure of financial institutions may result from the report of the Liikanen Group, set up by the European Commission, which is expected in October 2012.

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