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UK ring-fencing reform: *Why the ring-fence should be recalibrated, and how*

Ring-fencing was a key component of the UK's response to the financial crisis of 2008–2009. As has been widely acknowledged, subsequent regulatory reforms in banking regulation (in particular, those relating to capital, liquidity, Total Loss-Absorbing Capacity (**TLAC**) and resolution) have largely accomplished the objectives that the introduction of ring-fencing intended to achieve. Further, the regime presents costs to the UK economy, diverts investment away from the real economy and impairs the competitive position of UK banks in international markets. This position is clearly at odds with the present UK Government's objectives on growth, as acknowledged by the Chancellor, Rachel Reeves, in her Mansion House speech on July 15, 2025.

In our view, there is therefore a strong case to be made for change. This paper seeks to identify the downsides and residual benefits of ring-fencing in the current regulatory environment, examine what a recalibration could entail, and propose a revised regime which retains those residual benefits while reducing the costs of the regime to the real economy. We believe that the revisions would improve the competitiveness of the UK banking sector and flow of funding to the real economy.

Background

Banks occupy a singularly privileged position within the UK's economy owing to their essential role in the financial system, yet the very attributes that render them indispensable are also the source of acute vulnerabilities. The inherent leverage of deposit-taking institutions, the mismatch between their short-term liabilities and longer-dated assets, and their centrality to payments and clearing systems mean that distress at any one large bank can propagate swiftly through the financial system, and imperil depositors, counterparties and ultimately the real economy. These systemic risks materialised spectacularly during the global financial crisis of 2007–2009, when the failure or near-failure of several globally active banks—including systemically important institutions in the UK—necessitated unprecedented taxpayer support, revealed deficiencies in existing prudential and resolution frameworks, and exposed the problem of the implicit guarantee that certain firms were "too big to fail".

The crisis prompted an extensive domestic and international policy response. At the international level, the Basel III framework introduced more stringent capital, liquidity and leverage standards. In Europe, legislators adopted extensive amendments to the capital requirements framework and introduced, and subsequently amended, the Bank Recovery and Resolution Directive. Within the UK, the Government judged that more fundamental structural reform was necessary to restore market discipline and ensure the continuity of critical economic functions without recourse to public funds. Consequently, the Chancellor of the Exchequer established the Independent Commission on Banking (**ICB**) in June 2010, tasking it with considering reforms to enhance financial stability and promote effective competition. After more than a year of evidence gathering, economic modelling and public consultation, the Commission delivered its Final Report in September 2011, recommending, inter alia, the statutory ring-fencing of core retail banking activities, such as deposits and overdrafts, from non-retail activities such as investment banking and international banking. The ring-fencing regime passed into legislation in the Financial Services (Banking Reform) Act 2013 and associated statutory orders came into effect on January 1, 2019.

What's ring-fencing designed to do?

Ring-fencing is a uniquely British solution to the structural issues revealed by the crisis. The UK has a major international financial centre attached to a relatively small domestic economy. As a result, it has a large banking sector relative to GDP (over five times GDP in 2008, albeit that it has reduced somewhat since), which is relatively highly exposed to global financial markets.

Ring-fencing seeks to reduce the perceived risk of disruption in the provision of UK retail financial services arising from contagion from global financial markets by structurally separating retail banking activities from risks associated with activities conventionally conducted by international wholesale and investment banks.

Perimeter: Was ring-fencing aiming at the right target?

One question which was the subject of some debate when ring-fencing was being formulated was whether the underlying premise—that retail banking activities needed to be isolated from investment banking activities (sometimes dismissively referred to as "casino banking" post-crisis)—was the right one at all. In common with most banking crises, the crisis of 2007–2008 primarily manifested itself in the UK through losses associated with imprudent bank lending (including within the treasury function), coupled with excessive leverage. The major bank failures in the UK banking sector were of Bradford and Bingley and Northern Rock, each of which ran an operating model strikingly close to that of a ring-fenced bank.

How ring-fencing works

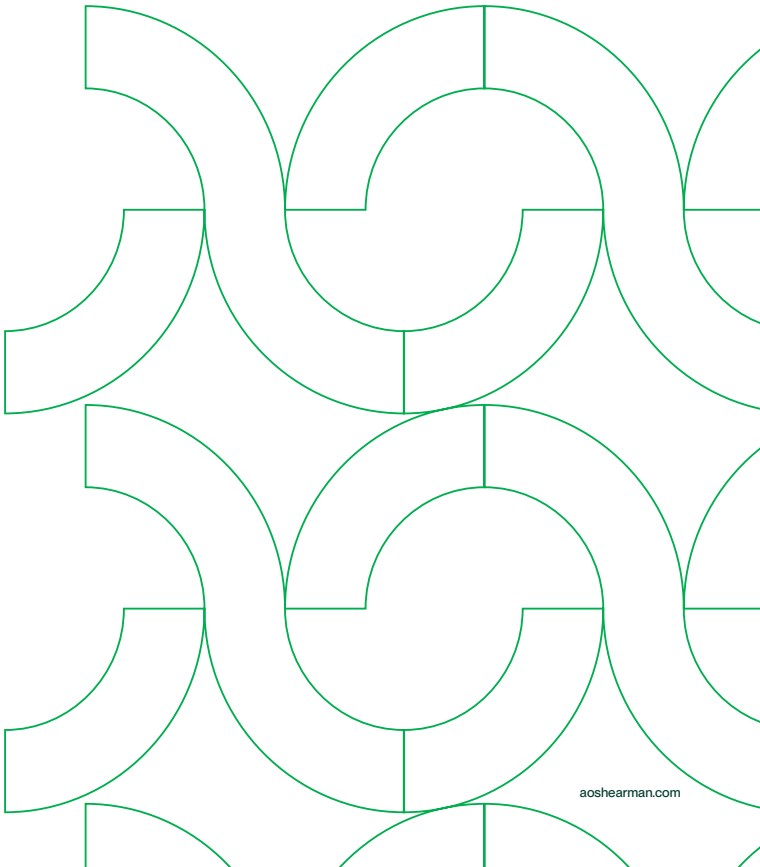
Architecture—perimeter and height

At its core, ring-fencing reflects a policy decision that certain retail banking activities ("core deposit activities"[1]), when engaged in at sufficient scale to pose systemic risk to the UK (currently a threshold of GBP35 billion[2] of core deposits), should be isolated from risks associated with activities conventionally conducted by international wholesale and investment banks ("prohibited activities"[3]). Isolation is achieved by housing mandated activities in a separate legal entity (ring-fenced bank) within an in-scope group. Prohibited activities (primarily, in broad terms, proprietary dealing in investments and incurring exposures to other financial sector entities—so-called "relevant financial institutions", or RFIs) may not be carried on by a ring-fenced entity; an in-scope banking group which wishes to conduct prohibited activities must do so through a non-ring-fenced bank. (In practice, banking groups have multiple operating legal entities, including banks and non-banks. The perimeter rules extend to non-bank entities within an in-scope group too, resulting in the major UK banks having ring-fenced subgroups (including one or more ring-fenced banks) in wider, non-ring-fenced, groups).

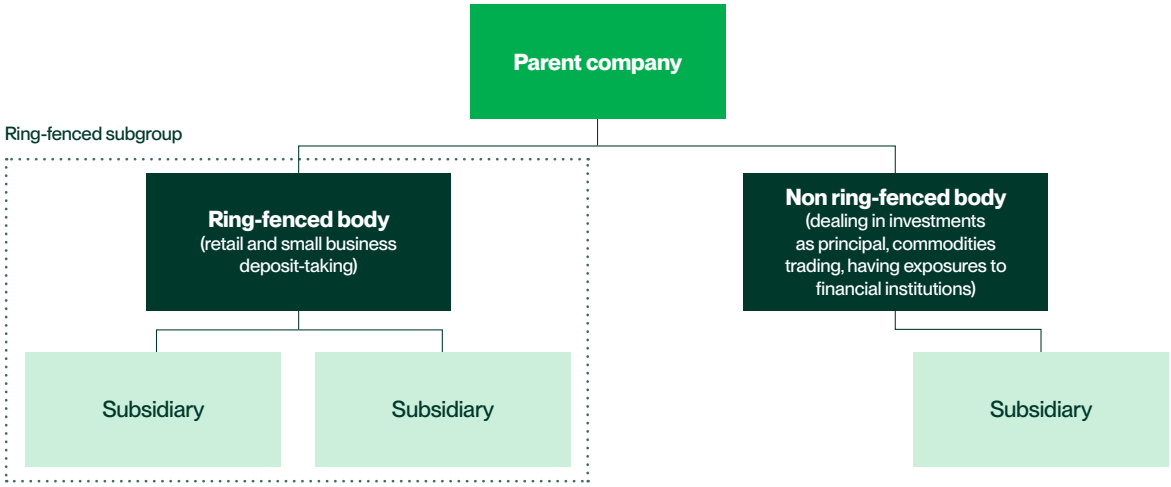
The concepts of "mandated" and "prohibited" activities determine the "perimeter" of ring-fencing, as they determine what activities must take place within, or outside, the ring-fence. The perimeter is defined in statute.[4] Until February 2025, the perimeter was also territorial, with ring-fenced banks (and their subgroups) unable to have branches, subsidiaries or participations outside the UK and EEA.[5]

As the legal structural separation of activities does not of itself fully isolate the ring-fenced bank from risks associated with prohibited activities, including those undertaken within its wider group, the regime also includes "height" rules designed to ensure that a ring-fenced bank/subgroup is able to operate at a sufficient level of independence from the wider group. Responsibility for the "height" rules is delegated to the PRA, which is given an operational objective of discharging its general functions in a way which (broadly) ensures the continuity of "core services" (deposits, payment services and overdrafts)[6] provided by ring-fenced bodies, and is obliged to make 'height' rules for "group ring-fencing purposes".[7] The "height" rules impose standalone governance, financial (capital, large exposures and liquidity), operational and reporting requirements on ring-fenced banks (and ring-fenced subgroups) to give assurance that they could continue to operate notwithstanding insolvency of (or within) the wider group.

To further reinforce the resilience of ring-fenced banks (and their subgroups), the PRA also applies a regulatory capital surcharge (the other systemically important institutions (OSII) buffer), requiring ring-fenced banks (subgroups) to maintain a risk-weighted asset (and in some cases a leverage) capital buffer as specified by the PRA.[8]



A RING-FENCED BANKING GROUP—EXAMPLE CORPORATE STRUCTURE



Activities that can be performed by either:

- Deposit-taking for large corporates, building societies and other RFBs
- Having exposure to building societies and other RFBs
- Lending to individuals and corporates
- Holding own securitisations
- Trade finance
- Payment services
- Hedging liquidity, interest rates, currency, commodity and credit risks for itself
- Selling simple derivatives to corporates, building societies and other RFBs

International comparators

The UK ring-fence regime is unique. Structural separation is a feature of some banking markets—in particular, the U.S.—while prohibiting FDIC insured deposits from being used to fund investment banking activities does not prevent U.S. banks from having exposures to the financial sector. The EU looked at introducing structural reform via the Liikanen Report of 2012 but ultimately did not progress it.[9] France and Germany each introduced a restriction on banks engaging in proprietary trading. Switzerland has no formal ring-fencing regime but as a supervisory matter encouraged its local systemic banks to subsidiarise their domestic banking business locally.

How has ring-fencing changed the UK banking sector?

As a result of the introduction of ring-fencing, affected UK banks were required to undergo ring-fencing projects which, for the major UK banks,[10] involved bifurcating their business across the ring-fence. The major UK banks therefore undertook substantial restructuring programmes in the run-up to implementation, and now run separate ring-fenced and non-ring-fenced franchises. The split has had a number of consequences for the UK banking sector, its clients and the real economy.

Narrowing the investment of retail deposits

The regime reshaped how the UK retail banking system channels retail savings into investment. Ring-fencing affects this in two ways: first, by prohibiting redeployment of retail savings into prohibited activities; and secondly, by causing affected banks to split their service offerings in a way which has resulted in large corporate customers being serviced in the non-ring-fenced bank, while smaller customers are serviced in the ring-fenced bank. This has had a number of consequences.

Funding prohibited activities

It is a design feature of the regime that core deposits are prevented from funding prohibited activities. Ring-fenced banks cannot engage in prohibited activities and generally cannot invest in entities which do so (albeit that they may incur small exposures across the ring-fence under the height rules).

Further, how core deposits flow into permitted activities depends on the choices which each affected institution had to make as to how it drew up its operating model under the ring-fencing regime. In practice, most of the affected banking groups bifurcated their customer base to service larger commercial banking customers from the non-ring-fenced bank, with small and medium-sized customers (other than relevant financial institutions) being serviced from the ring-fenced bank.

The narrowing of the investment of the proceeds of core deposits has had a number of consequences for the UK market:

- At its most straightforward, ring-fenced bank deposits are by design not funding non-ring-fenced bank activities, and are funding larger corporate customers less than would otherwise be the case. Ring-fenced banks have a large, high-quality, "sticky" retail deposit base which is unavailable outside the ring-fence. The trapping of funding in the ring-fence creates a liquidity surplus in ring-fenced banks, and a corresponding liquidity deficit in non-ring-fenced banks which needs to be eliminated by obtaining liquidity from third parties.[11] The inability of non-ring-fenced banks to access funding across the ring-fence:
  - creates additional liquidity costs for in-scope groups, which must maintain separate liquidity buffers and access liquidity elsewhere;
  - increases the cost of funding for NRFBs given greater funding costs;[12] and
  - puts NRFBs at a competitive disadvantage relative to their more integrated international competitors (including those operating in the UK retail banking market under the GBP35bn threshold) which can (and do) deploy UK retail deposit funding more profitably across their franchise.
- The prohibited activities include a number of categories of investment in the real economy. In particular, although there has been some recent liberalisation, ring-fenced banks are highly constrained in their ability to acquire and hold shares. By way of example, all of the in-scope shareholders in the Business Growth Fund (the UK venture capital fund established and owned by the major UK banks following the crisis) hold their shares outside the ring-fence, notwithstanding the obvious alignment with their retail bank franchises. (Recent liberalisation to permit investment in SME funds does not permit migration into the ring-fence pending changes to the height rules discussed below).

Geographic concentration

The ring-fenced banks are overwhelmingly domestically focussed (as noted above they have until earlier this year been unable to have non-EEA presences and, in practice, they have limited non-UK business and exposure).[13]

Sectoral concentration

The combination of high capital requirements and the limits noted above have resulted in a high level of concentration in UK mortgage lending.[14]

Capital

As noted above, ring-fenced banks are subject to the OSII buffer, a ring-fence-specific capital buffer.[15] The amount of Tier 1 capital attributable to the buffer across the affected banks runs into billions for each bank.[16] This represents a drag on investment for the UK banking sector. Some ring-fenced banks are also subject to additional leverage ratio buffer requirements.

Implementation costs

Implementation took four to five years and is reported to have cost roughly GBP2.9bn.[17]

Cliff-edges and competition

For some UK challenger banks whose deposit balances were under the ring-fencing threshold, the costs of running through the ring-fencing threshold created a "cliff edge" effect—the costs of ring-fencing have been too great to justify growth of their business through the threshold.[18]

Similar considerations apply to international banks looking to take deposits in the UK at scale. Over the threshold, the application of standalone prudential rules would dramatically reduce their ability to deploy UK deposit funding efficiently around their groups. Further, in addition to the implementation costs and ongoing restrictions on capital allocation required by the prohibited activities restriction, other knock-on effects exist—because the regime applies to all of their UK activities, exceeding the threshold affects their other operations in the UK. Ring-fencing has effectively capped their UK activities.

We are aware of at least four UK banking businesses which have capped the growth of their core deposit base to avoid breaching the ring-fencing threshold—depriving UK consumers of competition for their deposits (and, potentially, growth and innovation in retail banking services in the UK).

Client experience

Because the regime permits either side of the ring-fence to service commercial banking customers which are neither core depositors nor RFIs, there is some flexibility inherent in the regime as to whether an in-scope institution chooses to service commercial banking customers from the ring-fence, the non-ring-fence, or both. Each in-scope group has created its own target operating model, allocating clients between the ring-fence and non-ring-fence banks within its group. All of these models involve discontinuities and inefficiencies for clients as they go through the growth cycle. Migration across the ring-fence, or accessing services across the ring-fence, involves duplication of account-opening requirements (including KYC requirements) and often changes to customer relationship management. Clients will migrate across the ring-fence where they grow beyond the size prescribed by the bank's operating model, or (more rarely) where they change status from non-RFI to RFI status or vice versa, and will access services across the ring-fence where they are ring-fence clients requiring access to services (derivatives, insurance or asset management) not offered from within the ring-fence. The five biggest banks, which all have RFB subgroups, supplied around 63% of SME bank lending (excluding overdrafts) in 2014; in 2023, their market share had declined to 41%. Other providers, such as challenger banks, specialist banks and non-bank lenders, have increased their market share.[19]

Operational inefficiencies

The ongoing costs of ring-fencing are estimated at GBP1.5bn per year.[20] Maintaining separate banks with standalone governance and operational infrastructure adds a layer of costs which puts in-scope institutions at a competitive disadvantage to their international peers.

Other limitations of ring-fencing

There are several areas where the ring-fencing regime has been less successful in achieving its aims.

Issues identified by the Skeoch Review

The Skeoch Review identified the following:[21]

Ring-fencing has not increased the resilience of less complex banks: Less complex banks typically had a straightforward and transparent business model that was already easy to supervise prior to the introduction of ring-fencing. Some of these less complex banks have little to no activity outside the RFB, and therefore the bifurcation of their business creates complexity and compliance burdens for little to no increase in stability. For a similar reason to why building societies are excluded from the scope of the ring-fencing regime, there is no benefit in structurally separating banks that do not conduct prohibited activities. Ring-fencing was intended to reduce the complexity or risk associated with the RFB; if a bank's activities would exclusively fall within the RFB anyway, then ring-fencing does not reduce risk for that bank, meaning that ring-fencing does not achieve its primary objective.

Ring-fencing enhances the resilience of RFBs to the detriment of the resilience of NRFBs: The key purpose of ring-fencing was to isolate RFBs from shocks in the rest of the financial system (including in their own groups). As a result, the regime prioritises the RFB over the same group's NRFB or other group companies, since at the time of the regime's development the provision of deposit-taking and lending to consumers was deemed to be most critical. As such, from a resilience perspective, ring-fencing robs Peter to pay Paul, leaving NRFBs at greater risk than they otherwise would be. As many of the services provided by NRFBs are also critical to the real economy, the reduction in NRFB resilience is a negative for UK financial stability.

Parallel and subsequent changes to bank regulation resolved the "too big to fail" issue: Most importantly, ring-fencing was designed and legislated for at a relatively early stage in the post-crisis reforms. The other reforms have largely achieved the objectives for which ring-fencing was designed.

Although it did not come into effect until 2019, the ring-fencing policy was largely developed in 2011 through to 2016. It proceeded in parallel with a very large number of other changes to banking regulation, with overlapping aims—to enhance the resilience and resolvability of individual institutions and the wider financial system. Principal among these were enhanced capital rules under Basel III, improving the quality and quantum of capital and introducing a leverage ratio; reforms to liquidity regulation, including the introduction of the liquidity coverage ratio and net stable funding ratio; the implementation and enhancement of recovery and resolution planning requirements under the UK Banking Act 2009 and EU Bank Recovery and Resolution Directive 2014/59; the adoption in the UK of resolution strategies entailing UK banks operationalising "clean holding companies" to issue and internally downstream TLAC following the FSB standards on TLAC, BRRD, UK Bank Recovery and Resolution Order 2016 and Bank of England policy on resolution; operational continuity requirements under the PRA Operational Continuity Rules, and the adoption of service company models by three of the four major UK clearing banks to isolate operational infrastructure from the risk of failure of their operating banks; and risk management, clearing and margining requirements for derivatives under the European Market Infrastructure Regulation, substantially reducing the counterparty risk profile of the UK non-ring-fenced banks. All of these had as their objective the enhancement of the resilience and/or resolvability of UK banks generally, and all benefit the stability of ring-fenced and non-ring-fenced banks alike.

The effect of these changes, in the view expressed by Mark Carney, then Governor of the Bank of England, in 2018 was that "[w]ith enhanced resolution powers and planning, the Bank of England now has the ability to resolve failing banks".[22] Further subsequent changes have further enhanced the resilience and resolvability of the sector, including the introduction of the Bank of England Resolution Assessment Framework operational resilience rules. The final raft of UK prudential changes implementing Basel 3.1 are awaiting finalisation.

Appendix 1 lists out the parallel and subsequent reforms and identifies how the relevant change dovetails with the objectives of ring-fencing.

A key aim of ring-fencing was to reduce the implicit government guarantee (the notion that creditors assume the Government will bail out large banks, which lowers the borrowing costs and encourages the bank to undertake higher levels of risk-taking). As the Skeoch report acknowledges, while evidence shows that the value of this guarantee significantly declined since the global financial crisis (from around GBP45bn in 2010 to less than GBP5bn at the end of 2016), both the Bank of England and the Financial Stability Board have identified resolution regimes as the main factor in reducing the implicit guarantee, with credit rating agencies also attributing improvements to these regulatory changes rather than to ring-fencing.[23]

Other issues

We would add a number of more technical weaknesses or difficulties associated with the regime.

The RFI definition is over-complex, too wide, difficult to operationalise and not reflective of risk to the RFB or the system

A core component of the perimeter of the ring-fence is the restriction on incurring exposures to RFIs. The definition of the term RFI remains highly technical, complex, hard to operationalise and in some respects counterintuitive. The Financial Markets Law Committee has raised a number of issues of legal uncertainty with the definition,[24] but of more concern are the practical limitations imposed by the apparently arbitrary scope of the definition. As particular examples:

- investment firms which only deal as agent are within the scope of the definition, and hence "offside" as clients for ring-fenced banks or membership of ring-fenced subgroups, while regulated non-bank mortgage lenders and consumer credit firms, which assume risk as principal, are outside the scope. It is unclear why a firm which deals as agent, and hence does not take proprietary risk in financial markets, presents risks which merit prohibition; and
- SPVs which are not structured finance vehicles are not RFIs, making it straightforward to structure around the RFI prohibition (we note that we have not seen RFBs seeking to structure around the ring-fence in this way).

The prohibition on dealing as principal in investments is over-wide

The prohibition on dealing as principal in investments is intended to implement a policy decision that ring-fenced bodies should not engage in proprietary dealing. We see merit in the policy, but the prohibition in the legislation is over-wide, preventing ring-fenced banks from engaging in non-risk-taking intermediation (riskless principal dealing to meet retail client demand).

The perimeter makes it difficult for major UK banking groups to offer a comprehensive private banking service

Private banking typically involves the provision of an array of services, including deposits, loans, payment services and investment services. Notwithstanding the possibility for non-ring-fenced banks to take deposits from high net worth individuals (Article 2(2(d)) RFBCAO), the major UK banks have placed private banking services within the ring-fence. Private banking typically involves a high degree of integration between the provision of banking and investment services, and, in particular, credit to support investment portfolios. The major UK banks currently have to split the two across the ring-fence. The splitting of services across the ring-fence is inherently frictional given the separate governance of either side of the ring-fence, and increases the cost of servicing clients as any cross-ring-fencing services (e.g., distribution of non-ring-fenced affiliates' investment services) utilised have to be charged at arm's length. Further, given the obvious undesirability of running private banking services in this way, those UK groups which have foreign private banking franchises have left them outside the ring-fence, resulting in considerable inefficiencies in effectively running separate private banking businesses on either side of the ring-fence.

The perimeter also makes it challenging for major UK banking groups to offer wealth management services

For similar reasons, wealth management services are also difficult to offer across the ring-fence. We have acted on several aborted efforts to acquire wealth management businesses which have failed due to the need to be able to demonstrate that the target is ring-fence eligible—i.e., that it does not undertake activities which a ring-fenced bank or affiliate cannot.

Where does this leave ring-fencing?

The cost-benefit analysis of ring-fencing was conducted in 2013.[25] Were ring-fencing to be proposed now, we consider it questionable whether a cost-benefit analysis would demonstrate sufficient benefit to justify the initial and ongoing costs of the regime.

Repeal or reform?

There have been conflicting industry calls to repeal or retain the regime.[26] While we see the case for repeal, we understand repeal is not on the table as an option. This being the case, we consider that there is significant scope to reform the current regime to reduce the costs and downsides of the existing regime—creating a middle ground between the calls to repeal or retain the regime.

Approach to the middle ground

When approaching how to find the "middle ground" approach to ring-fencing, we should begin by acknowledging the progress made by the subsequent reforms. In particular, we accept the proposition (advanced by Mark Carney) that the issue of "too big to fail" has been addressed and that the prudential and resolution reforms have resulted in UK firms that are already resilient to the risk of failure and resolvable if they do fail. However, it is equally important to accept that, given the significance of major UK banks and their criticality to the UK economy, there is no room for error in their regulation.

Therefore, the approach should focus on identifying areas where gaps remain, especially those highlighted by recent bank failures, and retain aspects of ring-fencing that provide clear resilience and/or resolvability benefits, provided their costs are justified by the financial stability benefits they bring.

Remaining benefits of the regime

The Skeoch Review enumerated the benefits of ring-fencing as follows:[27]

1. Creating distinct retail deposit-taking entities that are well capitalised and liquid

While it is difficult to directly quantify the contribution of the ring-fencing regime towards the resilience of retail banking, given that, where other reforms were designed to improve resilience, ring-fencing has contributed towards the resilience of retail banks by the creation of separate legal entities.

2. Enabling easier supervision of RFBs in large, complex groups

The PRA has indicated that RFBs are now easier to supervise. This is largely due to their simpler and more transparent business models and product offerings, as well as their separate governance structures. These factors have contributed to a more straightforward and effective supervisory environment for RFBs.

3. Making it easier to carve out the RFB during a crisis

In the event the failure of a banking group were attributable to the NRFB, ring-fencing has made it easier to carve out the retail component of a failed bank, thereby making it easier to protect the retail element of the bank in the long term.

Having been subsequently through the Credit Suisse failure, we would add a further benefit:

4. Creating banks isolated from the risks that foreign assets, liabilities and operations can pose to successful resolution

Domestic banks are not just easier to supervise than global banks, they are also easier to resolve. Resolution is a relatively new discipline supported in many jurisdictions by novel laws which are not wholly tested by cross-border resolution action. Conflict of law risks can loom large where a successful resolution relies on cross-border dependencies. In the failure of Credit Suisse in 2023, one of the significant factors that appears to have confounded the implementation of the resolution plan of the bank was the dependency on foreign law rights or procedures (in Credit Suisse's case, the need for exemption from registration requirements under U.S. law) which transpired to be (apparently) unavailable.[28] Having domestic banks which are isolated from such risks can reinforce the certainty of successful resolution.

What could a middle ground approach look like?

Retaining the benefits of the existing framework

In an environment in which UK banks are both more resilient and resolvable, the purpose of the ring-fence should be to act as a safety mechanism in case the wider group gets into serious financial trouble, to ensure the continuity of its services. If the wider group fails or faces a crisis, the RFB can be protected and continue to operate, ensuring that customers' deposits and basic banking services are safeguarded. This makes it easier for regulators to manage the group, reduces the risk to ordinary depositors and helps maintain confidence in the banking system.

The benefits identified above would be reflected in continued requirements for:

(a) legal entity separation: keeping large banks' deposit franchises in a separate bank (and, where relevant, subgroup) with standalone (and where relevant sub-consolidated) capital, loss-absorbing capacity, liquidity and reporting is clearly helpful as that is the primary source of the remaining benefits cited above, and (critically) gives a fallback if the resolution strategy of the group fails

(b) perimeter restrictions: keeping RFBs away from activities that make them harder to resolve (a recalibrated perimeter); and

(c) height restrictions: measures to ensure that an RFB is not at undue risk on the resolution of the wider group.

The model would continue to be predicated on the existence of a separate, standalone UK retail bank (or banks). Crucially, the separate entity(ies) would be legally distinct from the larger banking group. The idea is to continue to have a relatively simple, easily supervised entity that holds the most sensitive and important parts of the bank's UK business—primarily deposits from retail customers. The maintenance of a separate legal entity facilitates a straightforward carve-out in times of crisis and helps to keep the ring-fenced activities distinct from other structures.

At the same time, a revised approach would recognise the lower risk profile that cross-ring-fence UK dependencies now give rise to under the resolution framework, and leverage synergies across the group in delivering competitive advantage, including sharing funding intra-group, that are currently prohibited under the ring-fencing regime. As a result, the UK banking sector would be better positioned to unlock investment within the UK and compete more effectively with international counterparts.

Bringing the ring-fencing objectives up to date: from ex ante separation to separability

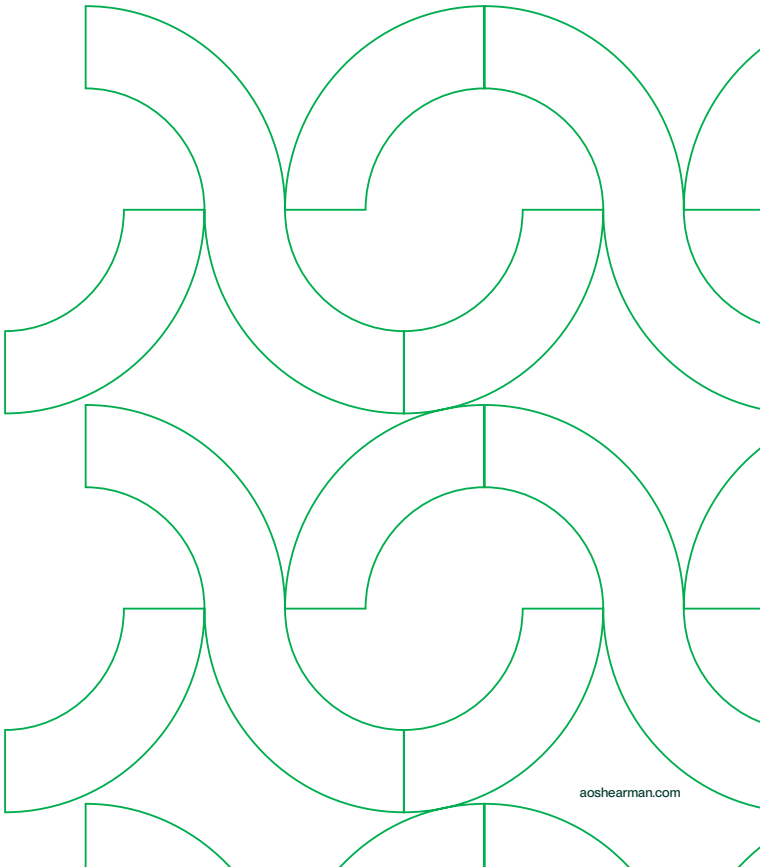
The middle ground approach would therefore continue to involve a ring-fence, but one whose objectives reflect the greater resilience of individual banks and the wider financial system, and the new paradigm for bank resolution.

In our view, the developments in bank resolution discussed above mean that the question which the ICB sought to address in making post-crisis policy is no longer the right one. In a world in which resolution was not assured and bank failure occurred on an entity-by-entity basis, there was a clear need to isolate societally critical functions from the wider group in order to preserve continuity of services. This drove the decision to include ring-fencing height objectives that anticipate preserving a ring-fenced bank from risks associated with insolvency of non-ring-fenced affiliates.[29]

By contrast, in the present environment, the advent of resolution means that banks are resolvable and have group resolution strategies. As a result, the threshold of isolation from the risk of insolvency of an affiliate is simply irrelevant—there is simply no prospect of an NRFB or bank holding company being put through insolvency proceedings. A threshold based on resolution is instead the right policy approach. This being the case, the right test is instead how to make core services continue notwithstanding failure of one or more entities outside the ring-fence.

This change in test is highly significant. Resolution has very different attributes from insolvency, including the maintenance of going-concern status and powers of the resolution authorities to continue the provision of services from an entity in resolution. Those attributes should flow back into greater flexibility to permit the deployment of funding, and sharing of non-financial assets, across the ring-fence, on the basis that the ring-fenced bank (or subgroup) needs only to be separable from the wider group on failure of one or more entities within the wider group. Ex ante separation is not justified where resolution tools and powers can achieve the same end at lower cost.

A related issue is the expectation that the ring-fence be independent from the wider group. The group ring-fencing objectives include independence of decision-taking.[30] This poses some awkward questions in practice for ring-fenced banks given the obvious tension with parent-subsidiary relationships with non-ring-fenced parents and wider regulatory expectations around common risk management and policies around a group. In practice, ring-fenced bodies need to be able to implement the group business plan and policies (a point recognised by Andrew Bailey at an early stage in the discussions of governance of ring-fenced bodies),[31] but also be capable of independent decision-taking in the event of stress within the group. The right test is demonstrable ability to act with independence under stress, not to act independently at all times. (This approach is broadly consistent with that of the Bank of England's Resolution Assessment Framework, save that independence of governance would need to apply not only in resolution of the ring-fenced body but also in the event of stress in the wider group).



A revised perimeter

Following on from the issues identified above, we see a case for liberalising the perimeter as follows.

RFI definition

The RFI definition should be narrowed to exclude investment firms which only deal as agent and those which deal as riskless principal with retail clients. This would deal with the wealth management issues discussed above.

Dealing as principal in investments

The prohibition on dealing as principal in investments should be narrowed to cover only genuine proprietary dealing. In practice, a *de minimis* limit on trading book activity within the ring-fence would achieve this end without giving rise to the major operational lift involved in assessing principal dealing activities against the various exclusions that banks have to bear today.

Private banking—core deposits

In order to compete in the private banking market effectively, affected groups should be given the opportunity to reunite their private banking franchises. This would require careful consideration of the core deposit threshold, preferably following discussion with the affected banks as to their current approach to eligibility for private banking services.

Revised height rules

As discussed above, current ring-fencing policy seeks to isolate the ring-fenced bank (subgroup) from the wider group of which it forms part: (i) financially; (ii) operationally; and (iii) in terms of decision-taking and governance. In this section we suggest how they should be recalibrated in light of the change to the group ring-fencing purposes test discussed above.

Financial height

Any discussion on an appropriate level of cross-ring-fence funding that should be permitted needs to take into account the probability of default—a function of the resilience of the group and the NRFB and likelihood of default on failure, and the loss given default—which would be determined by the treatment of claims of the RFB on the NRFB in resolution.

As to probability of default, the major UK headquartered banking groups now are all highly capitalised. Moreover, their operating banks are supported by group (or subgroup) resolution strategies that involve the issuance of own funds and structurally subordinated senior non-preferred ("bail-inable") external debt by a "clean" holding company outside the ring-fence subgroup. Most of those own funds and bail-inable debt are downstreamed to meet the requirement for internal own funds and eligible liabilities at the operating bank level, with any excess left at the upper (holding company) tier available to recapitalise the operations of the RFB and/or NRFB if difficulties arise.

Currently, the Bank of England policy on MREL (consistent with the FSB Key Attributes for Resolution regimes) requires internal TLAC equal to 75% to 90% of the external TLAC requirement to be downstreamed into the RFB and NRFB, respectively. Excess parent recapitalisation value is available to be deployed into either side of the ring-fence in the event of failure. The greater the segregation of available recapitalisation value in a holding company of a group, the greater the flexibility for the UK authorities to direct that recapitalisation value where necessary on failure—including, in extremis, preferring the position of the RFB over the NRFB. Importantly, for UK-headquartered groups and subgroups, the available pool of available recapitalisation value (both in the operating banks and at holding company level) remains under the sole control of the UK authorities in a resolution scenario.

Under the group resolution strategy, the internal TLAC issued by a failed operating bank will be bailed in contractually to recapitalise the bank, avoiding insolvency, and if necessary the holding company will be put into resolution. At a solo level, the group resolution plan, if exercised successfully, therefore avoids insolvency or resolution at the operating bank level—meaning that cross-ring-fence claims would not default on or following execution of the resolution strategy.

Group resolution strategies reduce the probability of default very substantially, but do not eliminate it. It is in principle possible, though exceptionally unlikely, that the group plan could be ineffective where the group had sustained losses so great that bail-in would not recapitalise the failed operating bank(s) to viability. Were this to be the case, then resolution powers would be exercised at the relevant failed operating bank(s). This is an important consideration for the height rules. As discussed above, resolution provides flexibility to the authorities in dealing with the failed bank's claims to preserve intragroup claims of a ring-fenced bank in a way that insolvency does not.

A detailed treatment of resolution is outside the scope of this paper, but the overwhelming likelihood is that a solo operating bank resolution would be through bail-in or a "good bank bad bank" split through the exercise of partial transfer of powers.

(a) On bail-in as part of resolution proceedings for the group, senior intra-resolution group claims are excluded from bail-in (section 48B(8)(k) Banking Act 2009)—meaning cross-ring-fence claims could not be bailed in. This would result in no loss to the ring-fenced bank. If bail-in at the NRFB occurred following resolution at the parent level, and there was no longer a resolution plan for the group, then claims would in principle fall to be bailed in but could be excluded from bail-in at the discretion of the Bank of England under section 48B(10) of the Banking Act. The section permits exclusion inter alia where the Bank is satisfied that the exclusion is necessary and proportionate to avoid giving rise to widespread contagion.[32]

(b) On a break up of the bank through the exercise of partial property transfer powers, the question of whether the RFB's claim would bear losses would be for the resolution authority, which would have the power to preserve claims by leaving them with the "good bank", or causing them to bear losses by leaving them with the "bad bank".

Accordingly, the probability of default of an affiliated NRFB is lower than in 2011, given the intervening changes in capital rules; and an RFB's loss given default associated with the (very unlikely) resolution of the NRFB is either zero if bail-in occurs when the RFB is part of the resolution group, or zero or a higher number at the discretion of the resolution authority otherwise.[33]

In light of the greater resilience of the banking sector, the much-reduced risk of losses accruing to an RFB in resolution, and the stability benefits for NRFBs associated with cross-ring-fence funding, there therefore appears to be a strong case for liberalising the height rules to permit funding across the ring-fence where the UK authorities have full control over the resolution of both the RFB and the relevant NRFB. A large exposures exemption (and 0% risk-weighting, consistent with the Core UK Groups regime) permitting exposures equal to the available TLAC at the top of the group available to the Bank of England to recapitalise the RFB under the group strategy would enable ring-fenced banks to support financing across the ring-fence safely, on the basis of the availability of group-level recapitalisation value to support all losses in resolution.

Operational height

Operational height requirements cause significant duplication of resources. For the same reasons as discussed above, separation of operational resources is no longer necessary to the resilience or resolution of an RFB, provided that any resource is within the group and available on resolution.

Under the resolution framework, the BoE can effectively direct and control resources in resolution to preserve continuity to affiliates (or former affiliates) within a banking group. As a result, there is no longer any need for operational resources to be duplicated within a resolution group, provided that the necessary resource can be identified and deployed in resolution to support the RFB. PRA Rule 9 should therefore be amended to permit services from non-ring-fenced bodies that are within the resolution group as well as group services entities and ring-fenced affiliates.

Governance

The independent decision-taking requirements (Section 3.1.3 of the Ring-fenced Bodies Part) only come into play in practice in a crisis. The RAF now provides for contingency planning against governance in resolution. The ring-fencing governance requirements are therefore largely redundant and should be removed (perhaps with some supplement to the RAF to reinforce independence of ring-fenced management not only in the RFB's own resolution, but also in the event of resolution within the wider group). On the same basis, the existing rules applying committee requirements (Chapters 5–8) seem unnecessary to the resilience or resolvability of a ring-fenced group and could safely be replaced by requirements for the appropriate capabilities in stress.

Capital

There is a wider debate to be had about the calibration of capital following the numerous changes post-ICB, which is beyond the scope of this paper. The role of the OSII buffer is part of that wider debate.

Conclusion

The above reforms to the UK ring-fencing regime would not be a rollback of the post-crisis reforms, but rather recalibration to reflect the prevailing environment. We think that such reforms would have a positive impact on the ability of the UK's largest banks to foster growth in the wider UK economy without the risk of detriment to their resilience or to wider financial stability.

Appendix 1

The statutory ring-fencing regime introduced by the Financial Services (Banking Reform) Act 2013 and embedded in the PRA Rulebook is designed to ensure that critical retail and SME banking services remain insulated from the shocks that may emanate from a universal banking group's riskier wholesale and trading activities. The objectives of the ring-fencing regime—namely the protection of continuity of core services, the reduction of the implicit taxpayer subsidy, the facilitation of orderly resolution, and the promotion of competition—operate as the benchmark against which the coherence of wider post-crisis regulatory reforms may be assessed. Each of the six regulatory initiatives identified dovetails with and amplifies these statutory objectives in the following ways.

First, the elevation of both the quality and quantum of capital under Basel III, reinforced by the introduction of the leverage ratio, directly supports the resilience of NRFBs whose business models entail higher earnings volatility and market risk. By compelling banking groups to hold substantially greater common equity and loss-absorbing instruments against the aggregate balance sheet, and by constraining excessive balance-sheet expansion through the leverage ratio, Basel III materially reduces the probability of failure of the NRFB. Where a group is ring-fenced, the improved capitalisation of the NRFB diminishes the likelihood that problems in the wholesale or investment bank will propagate stress to the RFB, thereby fulfilling the statutory objective of shielding the RFB from external contagion. In addition, the leverage ratio limits incentives for the NRFB to accumulate large positions that, if under pressure, could trigger group-wide funding problems, again protecting the continuity of core services provided within the RFB.

The liquidity coverage ratio (**LCR**) and net stable funding ratio (**NSFR**) reforms create complementary lines of defence against short-term and structural funding stress. The LCR obliges both RFBs and NRFBs to pre-fund a 30-day market-wide liquidity shock with high-quality liquid assets, while the NSFR forces the NRFB to maintain a stable funding profile by ensuring that banks have enough reliable funding to cover their assets over a one-year period. By mitigating reliance on wholesale funding, these measures curtail the transmission channel through which liquidity stress in the NRFB could otherwise force the group to upstream liquidity from the RFB.

The recovery and resolution planning obligations under the UK Banking Act 2009 enable authorities to effect orderly resolution without recourse to public funds. The statutory tests embedded in resolvability assessments require banks to demonstrate the separability of their critical functions and to evidence that intra-group service level agreements, financial dependencies and booking models do not frustrate resolution execution. The ring-fencing regime imposes a pre-emptive structural separation that simplifies such planning by delivering a distinct entity whose core services can be maintained as a going concern or transferred with minimal disruption. Conversely, the iterative supervisory scrutiny inherent in recovery and resolution planning is a more refined approach to the ring-fence's legal, operational and financial independence.

Bail-in is the Bank of England's preferred resolution strategy for the largest UK firms, including all ring-fenced banks. For most bail-in firms, there is a single-point-of-entry resolution strategy centred on a "clean" holding company, mandated by the Bank Recovery and Resolution Order 2016, which complements ring-fencing by ensuring that loss-absorbing capacity is issued externally at the holding-company level and internally downstreamed to operating subsidiaries, including the NRFB and the RFB, in the form of contractual instruments that can be written down or converted without triggering cross-default. This architecture preserves the legal and financial independence of the RFB by preventing it from being the issuer of bail-inable debt to third-party investors, and it means the resolution authority imposes losses on shareholders and creditors at the parent holding company level while leaving the RFB solvent and operational. As a result, the resolution mechanism protects an entity providing core services.

The PRA's Operational Continuity in Resolution (**OCIR**) rules, informed by FSB guidance, require systemically important banks to demonstrate that group-wide critical shared services—IT, payments infrastructure, trade processing, treasury and key staff—can continue during resolution. Three of the four largest UK clearing banks have responded by transferring these functions into dedicated service companies that provide them to both the RFB and NRFB on arm's-length, enforceable contracts. This model ensures that a failure within the NRFB cannot precipitate the sudden withdrawal of essential services to the RFB, thus safeguarding the ring-fence objective of uninterrupted availability of core banking services to households and SMEs. At the same time, OCIR enhances the credibility of the Bank of England's preferred resolution strategy by giving the authorities operational levers to maintain service continuity, thereby dovetailing operational resilience with structural separation.

Finally, the European Market Infrastructure Regulation (**EMIR**) mandates central clearing of standardised OTC derivatives, bilateral margin requirements for non-cleared trades and robust risk-mitigation techniques. NRFBs are the principal users of complex derivatives for market-making and client facilitation, activities that generate substantial counterparty credit exposures and pro-cyclical liquidity demands. By forcing these exposures through CCPs or collateralised bilateral frameworks, EMIR decreases the probability that a counterparty default will generate sudden, uncollateralised losses that could cascade from the NRFB to the wider group. The discipline of variation and initial margin additionally limits the NRFB's capacity to fund market activities with unstable short-term repo or prime-brokerage borrowings that, under stress, might prompt liquidity extraction from the RFB. The EMIR construct therefore limits the possibility that the NRFB would undermine the stability of the RFB.

In aggregate, the above reforms go beyond the ring-fencing regime to create concentric layers of defence—capital, liquidity, loss-absorption, operational resilience and counterparty risk mitigation—each calibrated to close the channels through which financial distress in investment-banking operations might contaminate the core retail bank.

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Footnotes

1. The legislation uses the terminology "core activities", "core services" and "core deposits". The term "core deposits" captures deposits held with a UK deposit-taker in a UK account from individuals and corporates. Exclusions exist for certain high net worth individuals (permitting private banking in the non-ring-fence) and high net worth organisations (Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014).
2. Changed from GBP25bn in February 2025.
3. We have used the term "prohibited activities" as a catch-all for the activities a ring-fenced bank cannot undertake. The legislative framework in fact describes two categories: excluded activities (in broad terms, dealing as principal in investments, set out in section 142D FSMA) and prohibitions, empowered by section 142E FSMA and set out in the Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014. In addition to "mandated activities" and "prohibited activities", there also exists a third, residual, category of "permitted" activities (such as commercial lending) which may be undertaken within and/or outside the ring-fence—we refer to these in this paper as "permitted activities".
4. Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014.
5. The regime was introduced while the UK was still part of the European Union and it was considered contrary to EU law to have a narrower geographic perimeter.
6. Section 2B FSMA.
7. Section 142B FSMA.
8. The capital buffer required from January 1, 2025 is set out here: https://www.bankofengland.co.uk/prudential-regulation/publication/2023/november/osii-buffer-rates-for-ringfenced-banks-and-large-building-societies.
9. High-level Expert Group on reforming the structure of the EU banking sector, Final Report, October 2, 2012, https://finance.ec.europa.eu/document/download/e30ae267-9b3a-4be5-a3fb-4e268e7b6d67_en?filename=liikanen-report-02102012_en.pdf.
10. Barclays, HSBC, Lloyds, NatWest and Santander: see https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/authorisations/which-firms-does-the-pra-regulate/2025/list-of-ring-fenced-bodies.pdf. Santander is unique in being a foreign-owned group which is within the regime. Virgin Money was in scope until it was acquired by Nationwide Building Society on October 1, 2024.
11. The Ring-fencing and Proprietary Trading Independent Review Final Report (the Skeoch Review), page 11, https://assets.publishing.service.gov.uk/media/6230b687e90e070ed9432345/CCS0821108226-006_RFPT_Web_Accessible.pdf. The excess liquidity above internal liquidity targets held by the five largest RFBs was GBP120bn as of September 2021.
12. Skeoch Review, page 65. The additional cost of funding for NRFBs was an accepted cost of the ring-fencing regime in advance of the legislation being passed. At the time of the Skeoch Review, wider macroeconomic conditions (e.g., low bank rate and quantitative easing) had limited the actual impact on NRFBs' cost of funding, which is likely to have changed in the years since.
13. Skeoch Review, pages 78–79.
14. Skeoch Review, page 44. UK retail mortgages constituted more than 80% of RFBs' lending at the time of the report.
15. Building societies over a certain threshold must also maintain an OSII buffer.
16. For example, GBP3.82bn for Lloyds Banking Group (see Pillar 3 disclosures, https://www.lloydsbankinggroup.com/assets/pdfs/investors/financial-performance/lloyds-bank-plc/2025/q1/2025-lb-q1-pillar-3.pdf).
17. Skeoch Review, page 14.
18. Annual aggregate ongoing cost of GBP1.5bn, Skeoch Review, page 14.
19. British Business Bank (2024), "Small business finance markets 2023/24", pages 29–30, https://www.british-business-bank.co.uk/sites/g/files/sovrnj166/files/2024-03/small-business-finance-market-report-2024.pdf.
20. Skeoch Review, page 82.
21. Skeoch Review, pages 37–38.
22. Mark Carney, "New Economy, New Finance, New Bank", June 21, 2018, available at: https://www.bankofengland.co.uk/-/media/boe/files/speech/2018/new-economy-new-finance-new-bank-speech-by-mark-carney.pdf.
23. Skeoch Review, page 38.
24. Report: "UK Bank Ring-Fencing Legislation", November 2021 (https://fmlc.org/wp-content/uploads/2021/11/Final-FMLC-Bank-Ring-Fencing-Paper-1.pdf); Response: "A smarter ring-fencing regime", Consultation on near-term reforms (https://fmlc.org/wp-content/uploads/2024/04/FMLC_Response_A-smarter-ring-fencing-regime-Consultation-on-near-term-reforms.pdf).
25. HM Treasury and Department for Business, Innovation and Skills, "Banking reform: draft secondary legislation", July 2013, available at: https://assets.publishing.service.gov.uk/media/5a74dd6ae5274a3cb2867cdf/PU1488_Banking_reform_consultation_-_online-1.pdf.
26. In April 2025, the chief executives from four of Britain's largest banks (HSBC Holdings, Lloyds Banking Group, NatWest Group and Santander UK) wrote a letter to the Chancellor of the Exchequer asking for the ring-fencing regime to be abolished in the UK. Other key stakeholders believe that it is wrong to call for the removal of the ring-fencing regime. Andrew Bailey, Governor of the Bank of England, has warned that removing the ring-fencing rules would make mortgages and other types of loan more expensive. This is because banks might use money from retail deposits for investment banking or for activities outside the UK, instead of lending to UK households and small businesses. As a result, loans in the UK could become more expensive and harder to get. The Chief Executive of Barclays has also stated his support for the existing regime.
27. Skeoch Review, pages 34–36.
28. See section 1.4 of "2023 Bank Failures: Preliminary lessons learnt for resolution", FSB, October 10, 2023, available at: https://www.fsb.org/uploads/P101023.pdf.
29. The expectation that ring-fenced bodies should be isolated from risks in the wider group finds its way into the legislative framework through the "ring-fencing purposes" in section 142H(3) FSMA, which are: (a) ensuring as far as reasonably practicable that the carrying on of core activities by a ring-fenced body is not adversely affected by the acts or omissions of other members of its group; (b) ensuring as far as reasonably practicable that in carrying on its business a ring-fenced body—(i) is able to take decisions independently of other members of its group, and (ii) does not depend on resources which are provided by a member of its group and which would cease to be available to the ring-fenced body in the event of the insolvency of the other member; (c) ensuring as far as reasonably practicable that the ring-fenced body would be able to continue to carry on core activities in the event of the insolvency of one or more other members of its group". Subsections (3)(b)(ii) and (3)(c) establish an expectation of the ability to carry on notwithstanding the insolvency of one or more members of the wider group.
30. Section 142H(43)(b)(i).
31. Speech by Andrew Bailey, "Progress on prudential regulation and three areas to complete", October 2015, available at: https://www.bankofengland.co.uk/-/media/boe/files/speech/2015/progress-on-prudential-regulation-and-three-areas-to-complete.pdf.
32. Section 48B(12)(c): "that the exclusion is necessary and proportionate to avoid giving rise to widespread contagion, in particular as regards protected deposits held by natural persons or micro, small and medium-sized enterprises, which would severely disrupt the functioning of financial markets, including financial market infrastructures, in a manner that could cause a serious disturbance to the economy of the United Kingdom".
33. We note that "no creditor worse off" considerations would arise on the exercise of discretion to exclude RFB claims from bail-in; these are beyond the scope of this paper.