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Will Paige

Overhaul of UK banking rules could expose sector to more risk

Article

The news: The UK government has laid out plans to reform the country's banking sector and "turbocharge growth" through a series of major changes to existing regulations.

Chancellor of the Exchequer Jeremy Hunt unveiled the Edinburgh Reforms of financial services—over 30 regulatory reforms aiming to "repeal and replace hundreds of pages of burdensome EU retained laws."

The big talking points: Here are the most significant changes unveiled for UK financial services.

1. **Ring-fencing rethink.** Rules forcing lenders to separate their retail and investment banking divisions were introduced after the global financial crisis and are aimed at protecting customers and preventing future state bailouts. Lawmakers will review these next year. Although changes may take years to implement, they could free up smaller banks like **Virgin Money** and **Santander** from having to follow the regulations. They could also give major banks like **NatWest** and **Lloyds** more freedom in how they fund operations and let them sell more complex products to customers.
2. **Addressing leaders' accountability.** Other rules under review include the Senior Managers Regime, which covers how executives are hired, monitored, and sanctioned. Introduced after 2008, the current regime forces executives to become personally responsible for rule breaking unless they've taken "reasonable steps" to prevent it. Penalties can be handed out for poor conduct, decision making, or workplace culture, and include fines and bans.
3. **Insurers' investments.** The government wants to give insurance firms more freedom to invest in long-term assets like housing and wind farms to boost investment.
4. **Bigger bonuses.** The government has already announced plans to ditch a cap on bankers' bonuses.
5. **ESG under focus.** The treasury said it will publish an updated Green Finance Strategy in early 2023 and will carry out consulting on bringing environmental, social, and governance (ESG) ratings providers into regulations.
6. **Cryptocurrencies considered.** The Edinburgh reforms mentioned ensuring the government has the powers to bring a range of crypto "activities into UK regulation." The government also mentioned plans to consult alongside the Bank of England on a UK retail central bank digital currency (CBDC) in the coming weeks.

Why it could work: The government is promoting the reforms as a lifting of overly strict EU rules which could give banks more freedom and foster growth in the sector.

- Removing ring-fencing rules could make UK banks more competitive by lowering their costs, which would be a boon for lenders like **Goldman Sachs' Marcus**.

- And relaxing rules for senior executives and insurance firms could reduce fears of punishments, giving them more freedom to take risks. The Edinburgh reforms also hint at the government's ambitions to make the UK a world leader in sustainable finance and global crypto center through favorable regulations—although so far, they're light on clear changes.

Words of warning: The biggest criticism of the regulatory shakeup is that it's encouraging banks to take more risks. Many of the rules were introduced to protect the sector from crises and the need for state bailouts of banks: **The government spent £137 billion ($161.12 billion) of public money to shore up the financial system after 2008**.

- Relaxing ring-fencing rules and cutting red tape for insurers will give financial institutions more freedom but will also weaken protections. And reducing accountability for senior executives could lead to more risk-taking behavior.
- The decision to remove bonus caps could also spark a political and public backlash amid the cost-of-living crisis. And its ability to improve UK banks' competitiveness could be questioned.
- As with most new regulations, changes will probably take a while, even with government backing. That means any benefits generated for the City and financial sector through deregulation could be some way off, and the government will have to wait to see how well its reform package has worked.