Ringing the changes: the road towards structural reform

Lloyds Banking Group is currently implementing ring-fencing—the centrepiece of the UK’s structural reform agenda in the banking sector. Last year we introduced ring-fencing. Here we highlight the progress being made, and explore the effect on the Group’s Financial Institution (FI) clients.

Ring-fencing: a refresher
Following the financial crisis, UK legislation was passed to better protect retail and business banking customers and the day-to-day banking services they rely on. The new rules mean large UK banks must separate personal and business activities such as current and savings accounts, from risks in other parts of the business such as complex wholesale banking. This is called ‘ring-fencing’. Banks are taking different approaches to how they are implementing these rules and are making changes now, to complete them by 1 January 2019.

Together with recovery and resolution planning (RRP), ring-fencing is one of the key building blocks of the UK Government’s legislative agenda to structurally reform the banking sector in the wake of the 2007/08 financial crisis.

Ring-fencing requires Retail and SME core deposit activities to be offered from within a ring-fenced bank (RFB) whilst more complex activities are to be housed into a separate entity, commonly referred to as a non-ring-fenced bank (NRFB).

At Lloyds Banking Group, our NRFB will be called Lloyds Bank Corporate Markets plc. Meanwhile, Lloyds Bank plc and Bank of Scotland plc will become the ring-fenced bank (RFB) for Lloyds Banking Group, where the vast majority of transaction banking services will be provided.

Key points to consider

1. Lloyds Bank Corporate Markets plc has been established as the non-ring-fenced bank for Lloyds Banking Group.

2. Our intention is that FI clients will continue to be served via a single relationship manager, and there will be no change to a client’s account numbers, sort codes, SWIFT BICs or Agency sort codes.

3. A client communication programme is in place to ensure clients remain informed of the whole process and any potential affect upon them.
Aims and objectives of ring-fencing legislation in the UK

01 Reduce probability and impact of bank failure

- Reduce systemic risk by separating retail and SME core deposits from other ‘riskier’ banking activities.
- In the event that the riskier activities lead to a stress scenario or failure event, these activities would not compromise core retail and SME activities.

02 Prevent systemic risk contagion in financial services

- The legislation prevents ring-fenced banks from maintaining material credit exposure to other financial institutions to avoid risk contagion.
- The aim is to avoid systemic risk propagating throughout the financial services sector, with the failure of one bank in turn bringing down other financial institutions.

03 Support effective recovery and resolution of UK banks

- The UK ring-fencing regime, and indeed the broader structural reform agenda, is not intended to enact a ‘zero-failure’ regime.
- The aim, rather than preventing all bank failures, is to ensure that in the event of a failure, ring-fenced banks in particular provide continuity of service for critical economic functions, and are easier to resolve as a result.

Timeline of ring-fencing

Q3 2017
S&P and Fitch publish preliminary credit ratings of Lloyds Bank Corporate Markets plc

Q3 2017
Lloyds Bank Corporate Markets plc authorised by PRA with restrictions

Dec. 2017 to Feb. 2018
Period for clients to object to the transfer of contracts through RFTS

Late Q2 2018
Target date for transfer of contracts to Lloyds Bank Corporate Markets plc

Late Q2 2018
Fully functional separate banks and formal public credit ratings

Q3 2017
Lloyds Bank Corporate Markets plc authorised by PRA with restrictions

Dec. 2017
Lloyds Banking Group sends clients impacted by a product transfer or change a letter to advise of the proposed RFTS and provide details of how to object.

Q1-Q2 2017
Lloyds Banking Group engages clients to provide an overview on ring-fencing and our planned response

Q3-Q4 2017
Lloyds Banking Group conducts follow up discussions to explain our proposed approach to transferring impacted contracts and any changes to our offering

Jan. 2019
Ring-fencing reforms in place
Our non-ring-fenced bank is called Lloyds Bank Corporate Markets plc.

This new entity is authorised by the Prudential Regulation Authority (PRA) with restrictions which are expected to be lifted by mid-2018. Lloyds Bank Corporate Markets plc will be strategically aligned to Lloyds Banking Group in order to meet client needs.

**Lloyds Bank Corporate Markets plc management team:**

- **Chairman:** Lord Lupton
- **Executives:**
  - **Chief Executive Officer (CEO)** – Mark Grant, who will report to the Chairman of Lloyds Bank Corporate Markets plc and the Lloyds Banking Group Chief Financial Officer.
  - **Chief Finance Officer (CFO)** – Phil Piers, who will report to the CEO of Lloyds Bank Corporate Markets plc and the Commercial Banking Finance Director.
  - **Chief Risk Officer, designate (CRO)** – Karen Bothwell, who will report to the CEO of Lloyds Bank Corporate Markets plc and the Group Chief Risk Officer.

Lloyds Bank Corporate Markets plc has received preliminary credit ratings of A and A- from Fitch and S&P respectively. Moody’s is expected to publish its rating in H1 2018.

Lloyds Bank Corporate Markets plc will have international branches in the US, Singapore and Jersey, enabling financial institutions to be served from booking locations outside the European Economic Area (EEA). It will own several subsidiaries including Lloyds Securities Inc. (Lloyds Banking Group’s existing US broker-dealer) and Lloyds Bank International Ltd, its bank in the Channel Islands. Live UK operations are planned to begin in late Q2 2018, with the full international capability established ahead of the 1 January 2019 deadline.

The ring-fencing transfer scheme (RFTS)

The ring-fencing transfer scheme (RFTS) is a process set out in the ring-fencing legislation that facilitates the transfer of large volumes of eligible contracts between a ring-fenced entity and a non-ring-fenced entity in order to enable banks to comply with ring-fencing regulations. It is the most practical way of transferring certain client contracts. Some contracts (not included in the RFTS) will be novated through a process known as contract-specific novation.

**A simple and straightforward approach for FI clients**

One of our key aims is to minimise any disruption to our product and service proposition.

- Our intention is all clients will still have a single Relationship Manager who acts as the primary point of contact whether they are accessing core banking products from Lloyds Bank Corporate Markets plc or products from Lloyds Bank plc or Bank of Scotland plc.
- Unlike some competitor banks, there will be no change to sort codes and account numbers, or to SWIFT BICS or Agency sort codes for FI clients.
- More complex products and services, such as risk and liquidity management, will be moved into Lloyds Bank Corporate Markets plc. This will allow clients to continue to access these after the implementation of ring-fencing legislation.
- Cash management and payments services will be delivered by the RFB, including the provision of Vostro overdraft facilities to correspondent banks under Payment Services exemptions.
- Overdrafts to other Relevant Financial Institutions (RFIs) will not be permitted under the legislation, and Lloyds Banking Group is working closely with affected clients on alternative solutions that will address their needs.

• Trade products will be available from both the RFB and Lloyds Bank Corporate Markets plc. Our processes have been specifically designed to utilise trade exemptions available within the legislation, where possible, that allow RFI exposure in the RFB, supporting the trade of goods and services. If a RFI trade-related deal cannot be booked in the RFB, the client will be consulted prior to it being booked in Lloyds Bank Corporate Markets plc with the client’s agreement.

The expectation is for very minimal affect to be felt by most FI clients who use Global Transaction Banking (GTB) products and services. For our correspondent banking clients, the ring-fencing legislation provides payment exposure exemption for exposures arising as part of correspondent bank activity. This allows for Vostro overdrafts to FI Bank clients to be maintained, subject to usual credit processes.

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1. Lloyds Bank Corporate Markets plc is the business name for Lloyds Banking Group’s new Non-Ring-Fenced Bank. Lloyds Bank Corporate Markets plc was authorised with restrictions on 25 July 2017, and is now included on the Financial Services Register (Reference number: 763256). Until the restrictions are removed by the Prudential Regulation Authority (PRA), Lloyds Bank Corporate Markets plc is limited in its ability to undertake or have migrated to it any regulated financial services activities.
**Case study**

- An FI client with a current account and Vostro overdraft facility with Lloyds Bank.
- They also have a correspondent banking relationship with Lloyds Bank and utilises Trade Services, specifically Letters of Credit and Guarantees.
- Their banking relationship manager has been constant for a number of years.

In this case study, the current relationship between the client and Lloyds Bank is compared to the same relationship post-ring-fencing.

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<thead>
<tr>
<th>Currently</th>
<th>Post ring-fencing</th>
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<tr>
<td><strong>Relationship Manager</strong></td>
<td>Single point of contact for all banking needs.</td>
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<tr>
<td><strong>Cash Management &amp; Payments</strong></td>
<td>Use an overdraft to manage intra-day payment requirements.</td>
</tr>
<tr>
<td><strong>Trade</strong></td>
<td>All trade deals are currently booked with Lloyds Bank.</td>
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**Our commitment to clients**

Ring-fencing has not changed Lloyds Banking Group’s strategy. Within Commercial Banking, we remain as committed to serving our clients as ever. Our structural reform strategy provides a solution for UK prudential regulation – not a change in our business or participation choices.
Frequently Asked Questions

1. What are the preliminary credit ratings for Lloyds Bank Corporate Markets plc?
S&P Global Ratings and Fitch Ratings published preliminary/expected credit ratings for Lloyds Bank Corporate Markets plc on 17 July 2017. Both credit rating agencies took a top-down approach which reflects the importance assigned to Lloyds Bank Corporate Markets plc as part of the wider Lloyds Banking Group. The published preliminary credit ratings were:

- Fitch Ratings: A/Stable/F1 (exp) (expected Long-Term Issuer Default Rating/outlook/expected Short-Term Issuer Default Rating) Lloyds Bank International Ltd, Lloyds Banking Group’s presence in Jersey, has been assigned the same preliminary credit ratings as Lloyds Bank Corporate Markets plc. Moody’s is expected to publish its credit rating for Lloyds Bank Corporate Markets plc in H1 2018.

2. How will Lloyds Bank Corporate Markets plc be capitalised?
The intention is that Lloyds Bank Corporate Markets plc will be a robust and strongly capitalised wholly-owned subsidiary of Lloyds Banking Group. It will be capitalised in line with the Group’s risk appetite, which includes buffers in excess of regulatory requirements.

3. When will clients be informed about their new business relationship with Lloyds Bank Corporate Markets plc?
We have already started talking to our FI clients about our proposed approach to ring-fencing. We will also write to affected clients before the end of 2017 about any changes to existing products and services and any contracts that will transfer to Lloyds Bank Corporate Markets plc.

4. Will there be a change to the relationship team due to ring-fencing?
Our intention is clients will continue to be served via a single relationship manager, reflecting their current service arrangement and experiences.

5. Will account numbers, sort codes and SWIFT BICs change?
There will be no change to current FI clients’ account numbers, sort codes or SWIFT BICs. This is because the cash management and payments proposition for Commercial Banking clients (including current accounts) will continue to be offered from the RFB, including for Lloyds Bank Corporate Markets plc’s clients.

6. Will there be any affect on Agency Bank arrangements or correspondent banking relationships?
The core agency and correspondent bank proposition remains unchanged. Similarly, there will be no changes to agency sort codes or account numbers, and clients will continue to be served by the RFB. Access to payment systems will be through the RFB, with existing overdraft limits maintained, as the ring-fence legislation provides a payment exposure exemption to support day-to-day processing.

7. How will clients know if a trade deal they originate will be handled by the RFB or Lloyds Bank Corporate Markets plc?
Most trade deals originated by correspondent banks will be booked with the RFB. However, if a trade exemption cannot be applied to a deal, it may need to be booked with Lloyds Bank Corporate Markets plc. In these instances, the relationship manager will make direct contact with the correspondent bank to explain the implications.

The intention is that Lloyds Bank Corporate Markets plc will be a robust and strongly capitalised wholly-owned subsidiary of Lloyds Banking Group.
8. Will there be an Invoice & Asset Finance (I&AF) product capability within Lloyds Bank Corporate Markets plc for an RFI?
There will not be an I&AF capability through Lloyds Bank Corporate Markets plc in the UK. However, an Asset Finance product will remain available in the US. There may be an opportunity to structure an Asset Finance deal that benefits from a trade exemption and if this is the case, it may be booked in the RFB in the UK.

9. Will Lloyds Banking Group’s current correspondent banks remain in place for Lloyds Bank Corporate Markets plc?
There may be some changes to correspondent banking relationships. A review of all correspondent banks for Lloyds Bank Corporate Markets plc is taking place and relevant organisations will be contacted by the end of 2017.

10. Will standard settlement instructions (SSIs) change?
There will be no changes to SSIs for correspondent banking clients who will continue to do business in the same manner as today. SSI data, such as BIC codes, for Lloyds Bank Corporate Markets plc will change after the implementation of ring-fencing. As such, clients or counterparties dealing with Lloyds Bank Corporate Markets plc on a bilateral basis will need to update SSI instructions for this entity. An update to affected clients will be provided in H1 2018.

11. What do clients need to do to onboard to Lloyds Bank Corporate Markets plc?
Clients will be provided with SSIs and onboarding Know Your Customer (KYC). We will be in touch with more details in the future.