



October 9, 2013

Banking Reform Bill Team  
HM Treasury  
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London  
SW1A 2HQ

[Banking.commission@hmtreasury.gsi.gov.uk](mailto:Banking.commission@hmtreasury.gsi.gov.uk)

BY EMAIL

Dear Sir,

### **JAC response to HMT consultation paper – Banking Reform Bill Draft Secondary Legislation**

This paper responds to the Banking reform draft secondary legislation consultation. The Joint Associations Committee on Retail Structured Products (the **JAC**<sup>1</sup>) welcomes the opportunity to comment on the proposals in this consultation paper. We set out in the General Comments section below our comments on the importance of the availability of retail structured products to the UK market and the relevance of ring-fencing to how they may be sold. Appendix 1 provides our response to the relevant questions in the Consultation.

The members of the JAC comprise most of the major firms (both financial institutions and law firms) involved, among other things, in the creation (and to some extent distribution) within the EU of structured issues. The JAC is therefore well positioned to comment on the implications of ring-fencing for the availability of structured products.

#### **GENERAL COMMENTS**

The market for structured products is an important part of the UK financial market. Amongst other things it provides for the needs of investors for long-term financial security and, in particular, retirement funding. Firms engaged in this market perform a critical social function. Structured products are designed to meet retail investors' risk/reward needs and offer unique benefits that cannot be obtained from other forms of investment. The availability of structured products also encourages competition and consumer choice.

In light of these benefits the JAC is of the view that it is critical that retail investors continue to be able to access structured products as an asset class. To this end, ring-fenced banks must be able to distribute structured products. In order to foster competition the rules should not differentiate between the distribution of group and third party products. The current draft of the ring-fencing statutory instrument appears not to allow the sale of third party products (or, as importantly, their repurchase), where the entitlement to commission arising from the sale (or repurchase) is to give the

<sup>1</sup> The JAC is sponsored by multiple associations with an interest in structured products. In the first instance, queries may be addressed to ftaylor@isda.org.

ring-fenced bank an exposure to the financial institution which originates or sells the product. Exposures of this sort in no way threaten the objectives of the ring-fence: the legislation needs to make clear that such exposures are not prohibited.

In addition, there seems to be little risk posed to the objectives of the authorities in ring-fencing in allowing the issuance of structured products by ring-fenced banks, provided that issuance is limited consistent with the limitations on simple derivatives. To this end, the inclusion of provisions enabling the sale by ring-fenced banks of simple derivatives to clients is welcome, but the scope of the products that may be offered and the conditions under which such products can be sold are insufficiently clear and in some cases too narrow. The JAC is therefore seeking confirmation that issuance of structured products within the parameters of the simple derivatives carve-out will be permitted under the ring fencing secondary legislation.

We would be very happy to discuss our response further with you and please do not hesitate to contact us should you have any questions.

Yours faithfully

A handwritten signature in black ink, appearing to read "Tim Hailes". It is a cursive style with a large, sweeping flourish on the left and a more structured, triangular shape on the right.

Mr. Alderman Timothy R Hailes, JP

Chairman – Joint Associations Committee on Retail Structured Products

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## **APPENDIX 1 – RESPONSES TO RELEVANT QUESTION IN THE BANKING REFORM, DRAFT SECONDARY LEGISLATION HMT CONSULTATION**

We have set out below our responses to the questions raised in the banking reform, draft secondary legislation HMT consultation which is relevant for JAC members in relation to structured issues.

**27. Do you think that ring-fenced banks should be allowed to offer structured products? Which types of product do you think would be suitable?**

Structured products provide investors with choice and help to spread market risk, compared to investors having to buy individual investments. Preventing access to structured products will impair investors' ability to access asset classes and risk profiles that would not otherwise be available to them. This ultimately reduces investor choice.

There are two sets of activities which are relevant to the offer of structured products. The first is acting as product provider – whether as issuer of securities or deposit-taker in relation to structured deposits. The second is acting as distributor of a product. Paragraph 3.23 of the consultation conflates the two concepts. The JAC believes that they need to be dealt with separately, as they raise different regulatory issues.

**(a) Distribution**

The JAC is of the view that it is critical that retail investors continue to be able to access structured products as an asset class. Ring-fenced banks will represent a very substantial portion of the distribution capacity for financial services in the UK. Preventing access to liquidity in structured products to clients of ring-fenced banks will have damaging impact for investors – particularly those seeking to liquidate holdings, who may struggle to locate a non-ring-fenced organisation through which to deal.

To this end, ring-fenced banks must be able to continue to be involved in the distribution of structured products. The distribution of structured products on a riskless basis (for example dealing as agent, sales agent, marketer or similar) does not pose prudential risks to a ring-fenced bank and does not expose it to the risks which ring-fencing is seeking to address.

*Third party products*

The current draft of the ring-fencing statutory instrument does not allow the sale of third party products (or, as importantly, their repurchase), where the entitlement to commission arising from the sale (or repurchase) is to give the ring-fenced bank an exposure to the financial institution which originates or sells the product. Exposures of this sort in no way threaten the objectives of the ring-fence: the legislation needs to make clear that such exposures are not prohibited.

*Group products*

The draft allows some exposures to financial institutions within a group, subject to PRA rules (which are not yet made). We are unable to comment on the effect of the statutory instrument without sight of the PRA rules on this area, but would emphasise that the point in the preceding paragraph applies equally to the distribution of group products as it does to third party products.

**(b) Issuance of own products**

The JAC welcomes the recognition in the consultation paper that the sale of simple derivatives to investors should be permissible, but sees no policy reason for differentiating derivatives from those products which embed derivatives. There seems to be little risk posed to the objectives of ring-fencing in allowing the issuance of structured products by ring-fenced banks where that issuance is limited consistent with the limitations on simple derivatives. To this end, the JAC seeks confirmation that issuance of structured products within the parameters of the simple derivatives carve-out will be permitted under the ring fencing secondary legislation.

Any applicable limits on the quantum of derivative products issued, market or credit risk should be carefully assessed to ensure that they do not impose disproportionate restrictions on the availability of retail structured products.

## PARTICIPATING ASSOCIATIONS



Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: [www.isda.org](http://www.isda.org).



ICMA represents financial institutions active in the international capital markets; its members are located in 50 countries, including all the world's main financial centres. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years, providing the framework of rules governing market practice which facilitate the orderly functioning of the market. ICMA actively promotes the efficiency and cost effectiveness of the capital markets by bringing together market participants and regulatory authorities. For more information see: [www.icmagroup.org](http://www.icmagroup.org).



The UK Structured Products Association ('UKSPA') is an organisation established by leading companies that create and distribute structured products to the UK financial services market. Their aim is to provide a useful and responsive source of information, education and comment on structured products by promoting their contribution to effective financial planning.