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# Banking Regulation

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# United Kingdom

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## Introduction

During the last year, UK banks have had to deal with the onslaught of COVID-19. This has cast into shadow various other challenges, including Brexit, regulatory reform, regulatory investigations, and a mixture of low interest rates and relatively high capital requirements.

Of course, COVID-19 has added new pressures. The largest is surely the related economic contraction, which has led to higher unemployment, turbulent markets and possible loan defaults. Through all this, UK banks continue to be heavily regulated, and so compliance with regulatory requirements, and effectively managing regulatory relationships, remains critical to the ongoing success of the industry.

Looking ahead, there is cause for optimism. At the time of writing, various COVID-19 vaccines appear to provide a genuine way forward for the nation and its economy, and the UK's banks will continue to be critical to its future success.

With the UK's departure from the EU, the Government is keen to ensure that the UK continues to be a leading financial centre internationally. Whilst this will mean continuing to have a robust regulatory framework, there is now some appetite to relax regulation in certain areas, to ensure proportionality and avoid imposing unnecessary burdens on banks. This has been welcomed by the industry, although there will be much to do in the coming months and years to keep track of and implement the changes in regulation that will follow.

## Regulatory architecture: Overview of banking regulators and key regulations

### Which bodies are responsible for regulating banks in the UK?

There are two key regulators in the UK. The Prudential Regulation Authority (“**PRA**”) is responsible for the financial safety and soundness of banks, while the Financial Conduct Authority (“**FCA**”) is responsible for how banks treat their clients and behave in financial markets.

Prudential issues such as capital and liquidity fall squarely within the PRA's remit, whereas conduct issues such as mis-selling and market abuse are matters for the FCA.

Both the PRA and FCA are interested in bank governance and systems and controls. This is because the ways in which banks organise their affairs and control their activities are relevant both to the financial health of a bank and the way it treats its clients and conducts itself in markets.

Besides these two regulators, it is worth noting that the Bank of England supervises financial market infrastructure such as clearing houses (e.g. LCH) and payment systems (e.g. VISA). There is also a separate Payment Systems Regulator, which focuses on competition issues.

### What are the key legislation and regulations applicable to banks in the UK?

The legislative framework for UK bank authorisations is set out in the Financial Services and Markets Act 2000 (“**FSMA**”). FSMA prohibits any person from carrying on regulated financial services business without having the relevant permissions.

The Financial Services and Markets Act (Regulated Activities) Order 2001 is the key secondary legislation that specifies the vast majority of financial services business that is regulated in the UK. Licensable business includes, among other things, deposit taking, securities and derivatives business, activities relating to investment funds, consumer credit and residential mortgage activities, and insurance underwriting and distribution.

Payment services are licensable under separate legislation (the Payment Services Regulations 2017 – “**PSRs**”), although licensed banks are automatically treated as being permitted to provide payment services in the UK.

Banks are required to comply with a wide range of law and regulation, including the PRA Rulebook, the FCA Handbook, and various pieces of primary and secondary legislation, much of which derives from the UK’s historic membership of the EU.

Some of these regulatory requirements apply to all UK banks (including most requirements relating to prudential regulation, governance and systems and controls) whereas other requirements are triggered by carrying out certain activities or providing particular products and services (various conduct of business rules).

### To what extent do supra-national regimes or bodies influence UK regulation?

For many years, until the beginning of 2021, the UK was bound by EU regulatory requirements relating to financial services. This was an inevitable consequence of the UK’s membership of the EU, and subsequent transitional arrangements that were in place for nearly a year until the end of 2020. EU requirements have shaped the UK regulatory regime in various ways, including in the following areas:

- prudential regulation – e.g. the Capital Requirements Regulation and Directive (“**CRR**” and “**CRD**”);
- investment/markets business – e.g. the Markets in Financial Instruments Regulation and Directive (“**MiFIR**” and “**MiFID**”), the Short Selling Regulation (“**SSR**”) and the Market Abuse Regulation (“**MAR**”);
- central clearing of derivatives – e.g. the European Market Infrastructure Regulation (“**EMIR**”); and
- retail disclosures – e.g. the Regulation on Packaged Retail and Insurance-Based Investment Products.

As a general matter, EU law applying in the UK at the end of the Brexit transitional agreement (31 December 2020) was automatically on-shored into UK law from 1 January 2021. This means that the UK left the EU with carbon copies of EU law transposed onto the UK’s statute books, subject to certain technical amendments that were needed to make the law operate effectively in the UK.

However, the influence of the EU on the UK’s regulatory regime should not be overstated, for the following reasons. Firstly, the UK has long been a global leader in regulation and has pioneered various regulatory initiatives (e.g. principles-based regulation). This meant that in many cases the UK’s regulatory regime pre-dated the corresponding EU initiatives on the same topics. Secondly, the UK played a key role in influencing the development of EU regulatory policy whilst the UK was a member of the EU. Thirdly, a substantial proportion of regulatory reform derives from international sources (e.g. the G20, Basel and IOSCO).

## Are there any restrictions on the activities of banks in the UK?

### *Regulatory permissions*

Banks can only carry out activities for which they hold the appropriate regulatory permissions. These are sorted by activity type (e.g. dealing, arranging, advising, consumer lending), product type (e.g. shares, bonds, derivatives, funds) and customer type (e.g. retail, professional and eligible counterparty).

Before granting regulatory permissions, the PRA and FCA will want to understand the business plan of the bank and the resources it has available (e.g. front-line staff, operational infrastructure and compliance oversight) to execute against that business plan.

If the PRA or FCA become particularly concerned about aspects of a bank's business, they have the power to impose limitations on the type or quantum of activities that it can carry out, pending resolution of the relevant issues.

### *Ring-fencing*

In the aftermath of the financial crisis, the UK introduced a ring-fencing regime, requiring the structural separation of certain investment banking activities from retail banking activities. The key objectives were, broadly, to make big retail banks less likely to fail, and to ensure that, if they do fail, state support can be directed at saving the retail bank within a broader group, without deploying taxpayers' money to rescue an investment bank within the same group. The UK ring-fencing regime is primarily set out in FSMA, certain secondary legislation (the "Core Activities Order" and the "Excluded Activities Order"), and the PRA Rulebook.

The regime applies to UK-incorporated banks with at least £25 billion of "core deposits", which generally includes deposits from retail and small corporate clients. Building societies are excluded from the regime but are subject to other restrictions on the activities that they can undertake under the Building Societies Act 1986.

Where ring-fencing applies to a UK banking group, only the ring-fenced banks within the group can accept "core deposits". The ring-fenced banks are also subject to general prohibitions on dealing in investments (e.g. securities, derivatives and investment funds) as principal and incurring an exposure to a "relevant financial institution" (e.g. making a loan to another bank, securities firm or investment fund), subject to certain exceptions.

A ring-fenced bank is also prohibited from maintaining a branch outside the UK or EEA, and a PRA supervisory statement effectively prevents a ring-fenced bank from having a subsidiary that undertakes activities that the ring-fenced bank is not itself permitted to carry out under the ring-fencing legislation.

The PRA rules impose further requirements regarding the relationship between the ring-fenced and non-ring-fenced side of the group, including, among other things, rules relating to independence, board composition, risk management, internal audit, HR and remuneration, intra-group services (ring-fenced banks are not generally permitted to receive services from the non-ring-fenced side of the group) and a requirement for arrangements between the two sides of the ring-fence to be on arm's length terms.

Although the ring-fencing regime imposes various restrictions, it also gives groups some flexibility to decide how to structure themselves. This has been reflected in the structures employed by the key retail banks in the UK market.

For example, NatWest Group and Lloyds Banking Group are heavily focused on retail and corporate banking business, mainly in the UK and EU. As a result, the ring-fenced bank side of their groups is much larger by asset valuation than their non-ring-fenced business.

By contrast, Barclays and HSBC run larger investment banking businesses, and have maintained a more global geographic footprint. Therefore, the non-ring-fenced sides of those groups make up a large majority of their overall group assets.

## **Recent regulatory themes and key regulatory developments in the UK**

### What has been the impact of Brexit?

For UK banks, the most significant impact of Brexit is the loss of their EU passporting rights. This means they are no longer free to provide their regulated products to clients across the whole of the EU. Instead, they can only provide a much more limited range of products to EU clients directly from London (e.g. products that are not regulated in the relevant EU jurisdiction or where there is a cross-border licence or exemption available in a specific EU jurisdiction). However, Brexit is not only a licensing issue for UK banks. As they are no longer treated as EU banks, UK banks face other challenges under EU regulation, including, notably:

- The mandatory trading obligation for shares and derivatives – EU regulation mandates that EU firms trade certain shares and derivatives only on EU trading venues or equivalent third-country venues. The UK has imposed a similar obligation on UK firms, requiring certain of their trading to take place only on UK venues, or venues in equivalent third countries. In late 2020, this looked set to create a potential conflict of laws where EU firms are trading with UK firms, particularly as neither the EU nor the UK granted equivalence in favour of the other. However, at a relatively late stage before the Brexit transitional agreement expired, the FCA offered temporary transitional relief. This allows UK firms to satisfy their UK mandatory trading obligations by trading on EU venues where certain conditions are satisfied. However, this does not solve the issue in the other direction – EU firms are still prohibited from trading on UK venues where this would breach their obligation to trade on an EU venue.
- Access to EU financial markets infrastructure – UK banks face restrictions on their ability to be members of EU trading venues and clearing houses. These include regulatory licensing constraints and requirements in some rulebooks that only EU firms can be members.
- Restrictions on the ability to act as primary dealer for some EU government debt issuances, and a prohibition on UK banks providing direct electronic access to EU trading venues.

These challenges, and others, have inevitably led to UK banks establishing or building out licensed EU affiliates that can benefit from EU passporting rights, and operate free from the restrictions referred to above. Nonetheless, EU bank affiliates will not typically operate in isolation from the UK bank and the rest of the group of which they form part. The EU bank will, to the extent permitted by regulatory requirements (including expectations of the European Central Bank), transfer risk back to the UK bank and rely on some of the operational infrastructure and personnel of the UK bank pursuant to intra-group agreements.

### What about COVID-19?

COVID-19 is a cross-cutting issue that affects banks and their compliance with regulation in numerous ways. Notably, there has been a focus on maintaining compliance with requirements whilst staff are working from home, ensuring that customers are treated fairly, particularly where they are vulnerable as a result of the pandemic, and ensuring that from a governance perspective, directors and other senior managers are actively engaged with the key risks and mitigants relating to the pandemic. Separately, there have been instances

in which the UK regulators have sought to provide regulatory forbearance in certain areas, but this has been fairly limited, and so banks have had to remain very focused on their regulatory responsibilities.

Have there been additional restrictions on the business that can be carried out by banks in the UK since the financial crisis?

UK banks have become subject to more onerous capital and liquidity requirements. This has constrained their balance sheet growth and made it more expensive for them to do business. The largest retail deposit-taking banks have also become subject to a bank ring-fencing regime. Further details on each of these topics are set out above and below.

Is there a recovery and resolution regime?

Shortly after the financial crisis, the UK introduced a domestic recovery and resolution regime under the Banking Act 2009. This gives the Bank of England powers to help resolve failing banks. The key strategies for resolving banks are bail-in (writing off debts to absorb losses), transferring critical functions to a bridge bank before being sold on, and putting the bank into a modified insolvency regime, which focuses on promoting financial stability and protecting depositors. The EU's Bank Recovery and Resolution Directive ("**BRRD**") was subsequently enacted and the UK regime was amended where necessary to ensure consistency with that Directive.

To support the Bank of England's resolution powers, banks are required to put in place a comprehensive resolution plan (also known as a "living will") detailing their key business lines and functions and how they could be wound down in an orderly way.

The PRA has recently initiated a new Resolvability Assessment Framework. This aims to develop further the work that banks have done to prepare for resolution. Banks falling within the scope of this new initiative are required to submit a report to the PRA by October 2021 and to publish a summary of that report by June 2022.

Are there requirements to ensure through contractual means that recovery and resolution orders, such as bail-in, will be enforceable?

The bank recovery and resolution regime is supported by PRA rules regarding contractual recognition of bail-in. These rules require UK banks to obtain, for certain of their liabilities governed by foreign law, the contractual consent of counterparties to agree to have their claims bailed-in if the Bank of England exercises its bail-in powers in respect of the bank's liabilities.

Such contractual consent is not needed where liabilities are governed by UK law, since UK law will automatically recognise the Bank of England's bail-in powers.

Prior to Brexit, UK banks did not need to insert contractual recognition of bail-in clauses within contracts governed by EEA law, but EEA law-governed contracts now fall within the scope of the UK requirement, subject to limited transitional relief for certain types of liabilities.

Due to its extremely broad scope, which derived from the EU's BRRD, the rules on contractual recognition of bail-in have caused somewhat of a headache for the industry. However, the PRA has sought to adopt a more pragmatic approach in the form of an exemption for "impracticability".

Are banks and financial institutions subject to rules on derivatives trading?

UK banks are subject to various rules on derivatives trading, including:

- conduct of business rules ("**COBS**") in the FCA Handbook that derive from MiFID;
- a requirement under UK MiFIR to trade certain interest rate swaps and credit default swaps on a trading venue;

- mandatory clearing, margining and reporting requirements for over-the-counter derivatives under UK EMIR; and
- restrictions under UK MAR and SSR, as well as obligations under the Disclosure and Transparency rules.

#### Are there recent developments regarding IT or cyber security?

The PRA and FCA have been very focused on the operational resilience of banks. By this, they mean the ability of banks to respond to, and quickly recover from, disruption to their business.

Disruption could be caused by a range of events including cyber attacks, IT system upgrades, the failure of a third-party service provider or financial market infrastructure, data breaches, the outage of a messaging system, or, as we know all too well, a global pandemic.

The UK regulators have proposed rules that will require banks to take a more systematic approach to ensuring that they are resilient from an operational perspective. These rules will require identification and prioritisation of critical business services, mapping people, processes, technology and data to those services, setting impact tolerances for disruption, scenario testing the bank's ability to remain within those tolerances in a disruption fire drill, having an appropriate communications strategy, and ensuring that there is effective governance and senior management oversight in relation to operational resilience.

#### How are UK regulators addressing new developments in fintech and digital ledger technology?

The UK regulators are highly supportive of innovation in the financial services sector. This is evident from the large number of challenger banks and fintech firms that have received authorisation in recent years, and the FCA's regulatory sandbox, which allows firms to test innovative products in a controlled environment.

There has been lots of focus on the regulatory characterisation of different types of crypto assets. At the time of writing, security tokens and e-money tokens are regulated, whilst other tokens such as utility tokens and exchange tokens (e.g. cryptocurrencies such as Bitcoin) are generally outside of the regulatory perimeter.

Stable coins (tokens linked to fiat currencies or other assets) will generally be unregulated exchange tokens or potentially regulated e-money. However, the Government is consulting on whether to introduce a new category of regulated product that would apply to stable coins specifically.

Derivatives linked to unregulated products are regulated, and firms dealing in unregulated products are nonetheless subject to various anti-money laundering requirements.

A UK Jurisdiction Taskforce has issued a legal statement confirming that crypto assets are capable of being owned, and that smart contracts can be, or be part of, binding legal contracts under English law. The High Court subsequently relied on this analysis in finding that crypto assets are capable of being owned for the purposes of English law.

#### Are there plans for developments relating to the regulation of banks in the UK?

The UK's chancellor has stated that Brexit will help "reinforce the UK's position as a globally pre-eminent financial centre". In practice, this means that the UK intends to use its newly found regulatory autonomy to ensure that its regulatory regime promotes the success of its financial services industry. This is likely to lead to some divergence from the EU's regulatory rulebook, primarily to avoid imposing regulation on UK firms that the Government and the PRA/FCA do not think is appropriate.



At the time of writing, the UK regulators:

- are considering whether and how to implement various aspects of the EU's CRR 2 framework on prudential regulation;
- are considering whether to impose a less onerous prudential regime on small banks;
- are considering whether and how to implement a MiFIR-style "equivalence" regime for overseas firms wishing to provide cross-border investment services into the UK – this might force firms in certain jurisdictions to rely on UK equivalence rather than the existing overseas persons exemption ("OPE"), and to comply with new UK reporting and other UK obligations that do not currently apply to overseas firms using the OPE;
- are expected to launch a review of the UK's MiFID regime for investment business, which will likely focus on potential changes to the rules on best execution reporting, costs and charges disclosures, and market data and transparency requirements; and
- have decided not to implement the settlement discipline regime within the EU's Central Securities Depositories Regulation.

### **Bank governance and internal controls**

Does UK regulation require board members to have specific expertise, or for a certain proportion of the board to be independent of management?

The Senior Managers and Certification Regime ("SMCR") requires most board members and other senior managers (e.g. heads of business lines and key functions) to obtain regulatory approval prior to commencing a senior management function at a bank.

As part of this process, the relevant bank, and the regulators, will consider if the individual is "fit and proper" to carry out the role. This assessment will have regard to, among other things, the professional experience of the candidate and any issues relating to their personal integrity.

The PRA generally expects a bank board to include directors with significant financial services experience, and has a strong preference for the chairman and non-executive directors to be independent. The regulators can call individual candidates for interview where appropriate.

Does UK regulation require certain committees to be maintained by all banks?

UK banks are generally required to maintain various committees that oversee certain areas of the bank's operations. For example, an audit committee, a nominations committee and a risk committee. Exceptions can apply for banks that are less significant in size and scale.

Does UK regulation require banks to comply with rules regarding the remuneration of certain categories of staff?

Senior managers and other "material risk-takers" who affect the bank's risk profile are subject to stringent remuneration restrictions. These include a bonus cap, requirements to pay a certain proportion of bonuses in shares or other non-cash instruments, deferral of some bonus payments, and provisions to allow banks to claw back bonuses where appropriate.

What are the key requirements governing the organisation of banks' internal control environment?

The SMCR has placed a greater emphasis on senior managers' individual accountability for the operation of a particular business area or function, and for the compliance of that area with applicable regulation. In other words, regulatory compliance cannot simply be left to the control functions, such as compliance and risk, although those functions play a critical role.

Individual role profiles and management responsibilities maps are used to document who is responsible for what, and how the overall governance structure works, including hard reporting lines within a legal entity and matrix reporting lines on a group or functionalised basis.

Does UK regulation require banks to have a dedicated compliance function, risk function or internal audit function?

The UK regulators expect that the business lines within a bank should assume primary responsibility for identifying and managing regulatory risk.

In this context, the business is often referred to as the “first line of defence”. However, the compliance and risk functions (the “second line of defence”) have an important role to play in ensuring that the business manages risk effectively, and the internal audit function (the “third line of defence”) provides a further check on the business, as well as the compliance and risk functions.

In large banks, compliance and risk will typically be separate functions, and internal audit should always maintain independence from the business, compliance and risk, to ensure it can provide objective assessment and challenge.

What requirements apply to the outsourcing of bank functions?

Banks are generally permitted to outsource functions, either to a group entity or a third-party supplier, subject to various regulatory restrictions. These include, among other things, that the bank maintains sufficient substance and expertise to effectively oversee and control the outsourcing, that the bank retains its regulatory responsibilities to clients and the regulators, and that the documentation of outsourcing arrangements includes various contractual provisions that protect the bank.

## **Bank capital requirements**

What regulatory capital and liquidity requirements apply to banks in the UK?

UK banks are subject to rigorous regulatory capital rules. The amount of capital that they need to hold will broadly be determined by the size of their balance sheet and the value and riskiness of their exposures. In particular, banks will be required to hold capital against the following risks:

- **Credit risk:** where banks lend money to customers, they are exposed to the risk that those customers will default on their obligations to make interest and principal payments to the bank. To mitigate this risk, banks need to sort each type of loan into various risk categories, depending on the type and creditworthiness of the borrower, and having regard to the benefit of any credit risk mitigation, such as security or guarantees. The riskier a borrower is perceived to be (having regard to credit ratings), the more capital the bank will need to hold against its loan to that borrower.
- **Market risk:** where banks underwrite issuances of securities, or hold positions in equities, fixed income instruments, funds or derivatives, they are exposed to the risk that the value of those positions will move against them, thereby causing the bank to suffer a loss. Banks are therefore required to calculate the value, nature and riskiness of their positions. These are generally assessed on a net basis (e.g. certain short positions in a particular instrument can be offset against long positions in the same instrument).
- **Operational risk:** there is a lot that can go wrong when running a bank. IT systems can fail, front-line staff could be accused of mis-selling products, and the bank may incur the expense of dealing with regulatory investigations, enforcement action or litigation. These are just some of the risks inherent in the operations of a bank, and banks will need to hold an appropriate amount of capital against such risks.

The default means for calculating regulatory capital requirements for credit and market risk is known as the standardised approach. However, banks with a proven track record may apply for regulatory permission to use an internal model for calculating their capital requirements. This allows those banks to use their own data and systems in order to adopt a more nuanced (and generally less capital-intensive) approach to assessing their regulatory capital requirements.

New and growing banks have historically found it challenging to obtain approval to use an internal model and consider that this puts them at a disadvantage when compared to the incumbents. However, the PRA has recently shown an increased willingness to help challenger banks by considering a possible relaxation of capital and other prudential requirements applicable to those banks.

Banks are also subject to rigorous liquidity rules. Whilst regulatory capital is concerned with the solvency of banks on a balance sheet basis, liquidity is concerned with ensuring that banks have enough cash (or assets they can quickly convert to cash) to meet their obligations as they fall due. To this end, the Liquidity Coverage Ratio requires banks to envisage a 30-day period of stress, and to ensure that they hold sufficient high-quality liquid assets to enable them to meet their liabilities under this scenario. In this context, a bank's obligations could include repayment of its own debts to creditors, and its obligations to provide funding under committed but undrawn facilities.

Do these regulatory capital and liquidity rules derive from national law, supra-national regulations or international standards?

The Basel Committee on Banking Supervision (“**BCBS**”) sets global standards for bank capital and liquidity, which are periodically updated and strengthened. These have been implemented at EU level via the CRR and CRD. As the UK was required to comply with EU regulatory standards until the end of 2020, the UK's regulatory capital and liquidity regime is largely the same as the EU's, although the UK now has freedom to determine its own prudential rules and is expected to deviate from the EU rules in some areas.

For example, under the EU's CRD V, non-EU-headquartered banking groups (e.g. US-, Asian- and UK-headed groups) with at least €40 billion of assets in the EU, may be required to hold all their EU banks and investment firms beneath a common EU Intermediate Parent Undertaking (“**IPU**”), which will be subject to EU consolidated supervision. Most affected groups will benefit from transitional relief. This means they will have until the end of 2023 to put in place their new structure, although regulators will expect them to engage on their proposed structure during 2021, in good time to obtain any necessary regulatory approvals and execute on any required reorganisations. The EU's IPU will be relevant to UK banks with significant EU operations, but the UK is not proposing to implement an equivalent IPU regime in the UK.

By contrast, the UK has chosen to implement an EU-led initiative to require bank holding companies to obtain regulatory approval as Financial Holding Companies (“**FHCs**”). Relevant FHCs will need to comply with various requirements relating to their directors and governance, as well as the prudential rules that apply on a consolidated group basis.

What is the impact of international initiatives on bank capital and liquidity?

Since the global financial crisis of 2008, there has been a drive to:

- increase the quantity and quality of regulatory capital held by banks, and to require systemically important banks to maintain other liabilities that could be bailed-in if needed (loss-absorbing capacity);

- ensure that banks have sufficient liquid assets to enable them to pay creditors and meet other commitments during periods of stress; and
- ensure that banks are not over-leveraged by limiting the extent to which they can fund their assets by debt (which needs to be repaid to creditors) as opposed to equity (which does not need to be repaid to shareholders).

This global drive, led by the BCBS, has led to UK banks being in a better position to withstand shocks than was the case going into the 2008 financial crisis. This additional level of preparedness has been critical given the latest economic crisis caused by the COVID-19 pandemic.

### **Rules governing banks' relationships with their customers and other third parties**

Different regulatory requirements apply to different types of products, services and activities. There is not space for a comprehensive analysis in this chapter, but the below should help identify the key rules that may apply to a range of selected products and activities.

#### What regulatory regimes apply to the following?

##### *Deposit-taking activities*

For retail deposit-taking business, including current and savings accounts, the Banking Conduct of Business Sourcebook applies. Where a bank is providing payment services, which will be the case where a bank is providing a current account or a credit card, the PSRs apply.

##### *Lending activities, including the substitution of LIBOR*

Where a bank is providing credit to consumers (for example, via a personal loan, overdraft or credit card), applicable regulation includes the Consumer Credit Act 1974, secondary legislation under that Act, and the Consumer Credit rules in the FCA Handbook. For residential mortgage lending, the relevant rules are set out in the Mortgage Conduct of Business Sourcebook.

By contrast, wholesale/corporate lending is largely unregulated in the UK and there is no specific rulebook for these products. However, the UK regulators are requiring banks to move away from using LIBOR and have set out various expectations on banks relating to the fair treatment of customers in this context.

##### *Investment services*

For investment services such as brokerage, trade execution and advice on securities and derivatives, there are comprehensive conduct rules set out in various rulebooks. The most significant are the COBS in the FCA Handbook (this transposes the requirements of the UK's MiFID II) and the UK's MiFIR legislation.

##### *Proprietary trading activities*

Where a bank is engaged in proprietary trading, it should have regard to a range of regulatory requirements. These include, among others, UK MAR, UK SSR, COBS, PRA and FCA expectations regarding the oversight of algorithmic trading functions, and relevant prudential and structural requirements (e.g. ensuring positions are supported by sufficient regulatory capital, and that trading is consistent with the ring-fencing rules, where applicable).

#### Are there any financial services-specific mechanisms for addressing customer complaints in the UK?

If a customer has a complaint about a financial product or service that has not been resolved by the bank to the customer's satisfaction, the customer can refer the complaint to the Financial Ombudsman Service ("FOS").

Referring complaints to the FOS is free for the customer, but can be expensive for banks. Aside from the risk of being required to compensate customers, banks must (except for a 25-case allowance per year) pay to the FOS a fee of £650 for each case that the FOS considers, regardless of whether the FOS upholds the claim or not.

This may create an incentive for banks to settle complaints before customers refer them to the FOS, although it should be noted that the FOS is significantly cheaper than court proceedings, all other things being equal.

#### Are there any compensation schemes that cover customers in the case of the failure of UK banks?

Deposits held at UK banks by retail and corporate customers are generally protected by the Financial Services Compensation Scheme (“FSCS”) up to £85,000 per customer, per bank. Temporary high balances that result from certain protected arrangements (e.g. home purchases or sales, or a pay-out from life insurance) can be protected up to £1 million for up to six months.

Other products, such as insurance and pensions, may also benefit from FSCS protection, although the protection limits and eligibility criteria differ by product and need to be carefully examined on a case-by-case basis.

#### What restrictions apply to overseas banks providing cross-border services into the UK?

EU banks historically relied on the EU passporting regime to service UK clients. Following Brexit, the inbound passport for UK business expired at the end of 2020. However, the UK’s Temporary Permissions Regime allows EU banks that were passported into the UK prior to Brexit to benefit from a temporary UK licence for branch and/or cross-border business. This extends the benefits of the old UK passport for up to three years. During this period, EU banks will need to decide whether to apply for a permanent UK branch authorisation (which would also allow them to provide cross-border services into the UK), or to seek to rely on the UK’s OPE, which is considered below.

Banks based outside of the UK (whether in the EU or further afield), and which do not have a UK place of business, are able to provide certain cross-border products and services to UK clients without triggering a UK licensing requirement. This is based on a mixture of the UK’s characteristic performance test and its OPE.

For example, the UK’s characteristic performance test effectively provides that deposit-taking and custody services are provided at the location where the accounts are located and the assets held. Therefore, if an EU bank is providing an EU-based bank or custody account to UK clients, the EU bank should not generally be regarded as carrying out the regulated activity of accepting deposits or providing custody services in the UK, and therefore should not need a UK regulatory licence to offer these services to UK clients.

Where the characteristic performance test dictates that an activity is regarded as being carried out in the UK even though it is provided by an offshore bank on a cross-border basis, an exemption is required to avoid triggering a UK licensing requirement for that offshore bank. The UK’s OPE has, broadly, the effect of allowing offshore firms without a UK place of business to provide various investment services (e.g. securities and derivatives dealing or underwriting) to professional UK clients on a cross-border basis without triggering a UK licensing requirement. This exemption has earned the UK a reputation for having a liberal cross-border licensing regime in respect of such business.

However, the characteristic performance test and OPE do not provide a solution for all cross-border services, so a case-by-case assessment is necessary.

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At the time of writing, the UK Government is consulting on the current operation of the OPE and how it might operate alongside a future UK equivalence framework.

What is the regulatory framework on anti-money laundering in the UK?

The UK has a comprehensive financial crime regime. This includes, among other things, the Proceeds of Crime Act 2002, the Terrorism Act 2000, the Money Laundering Regulations 2017, comprehensive guidance from the Joint Money Laundering Steering Group, and requirements in the Systems and Controls section of the FCA Handbook.

Most notably, banks need to develop and maintain appropriate systems and controls that enable them to fulfil their obligations relating to client due diligence and ongoing monitoring.

In recent years, banks have been subject to increasing levels of regulatory scrutiny relating to those systems and controls, and in some cases, this has led to enforcement action followed by fines and public censure.

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Alastair is a partner specialising in financial services regulation. He covers all types of regulatory issues, including structuring, licensing, conduct of business, governance and prudential regulation, for a wide range of clients. Alastair aims to give clear, practical guidance, which cuts through the complexity of the underlying issues and provides clients with tangible solutions. His experience includes advising financial institutions on Brexit, UK Bank Ring-Fencing, CRD V, new products and services (including FinTech), compliance issues and the regulatory implications of corporate transactions. He was recognised as a rising star by *The Legal 500* directory for 2020.

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