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Contributing Editors: **Peter Ch. Hsu & Daniel Flühmann**

glg global legal group

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United Kingdom

Alastair Holt & Simon Treacy
Linklaters LLP

Introduction

As interest rates rise in response to global inflation, an era of cheap money has come to an end. Many UK banks are expected to become more profitable due to an increase in their "net interest margin", the difference between the interest charged on loans *versus* the interest paid on deposits. However, the rise in the cost of living, including mortgage costs, is likely to lead to an increase in borrower defaults.

When borrowers struggle to service their debts, banks need to be particularly mindful of their regulatory obligations, including the requirement to treat customers fairly. A package of rules surrounding a new "consumer duty" will focus minds on how banks deliver good outcomes for retail customers.

Banks also face tighter standards around how they identify and manage risks relating to environmental, social and governance ("**ESG**") issues. Preventing greenwashing is top of the regulators' agenda. Separately, banks must adjust their compliance procedures to reflect IT developments. For example, the use of encrypted messaging apps by bank staff has been in the spotlight following high-profile enforcement action in the US.

Incoming legislation is laying the groundwork for future regulatory reforms that allow for more proportionate and responsive rules. This includes deregulation in targeted areas (such as the cap on banker bonuses and wholesale market reforms) and new regulation in others (such as ESG and cryptoassets). An exercise in rewriting retained EU law into regulators' rulebooks is also due to begin. UK banks with EU affiliates will keep a close eye on how their respective regulatory regimes are continuing to evolve and diverge post-Brexit.

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 for banks 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.

The PRA is part of the Bank of England. The Bank of England also supervises financial market infrastructure such as clearing houses (e.g. LCH) and payment systems (e.g. VISA). A separate Payment Systems Regulator 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).

The Financial Services and Markets Bill 2023 ("**FSM Bill**") is currently being considered by Parliament. The FSM Bill provides for a designated activities regime to sit alongside the Regulated Activities Order. The purpose will be to impose requirements relating to certain financial markets activities that are carried out by both regulated and unregulated firms. This will likely include certain areas of regulation that are currently covered by retained EU law (e.g. regulation relating to short selling, over-the-counter ("**OTC**") derivatives, securitisation, prospectuses and benchmarks). Any rules made by HM Treasury or the FCA under this regime would only apply to the designated activity and not to the wider activities of the firm.

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 relating to its withdrawal. 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 ("**PRIIPs**").

As a general matter, EU law applying in the UK at the end of the Brexit transition period (31 December 2020) was retained in UK law. This means that the UK left the EU with carbon

copies of directly applicable EU law transposed onto its statute books, subject to certain technical amendments that were needed to make the law operate effectively in the UK.

Looking ahead, the UK Government has committed to promoting global standard-setting via international sources (e.g. the Financial Stability Board and G20).

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 in the UK (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.

In 2022, the Government said it would take forward near-term reform measures proposed by an independent review of the ring-fencing legislation, including changes that would allow ring-fenced banks to service smaller financial institution clients and establish branches outside the UK and EU. The Government also said it would consult on increasing the deposit threshold to £35 billion and open a call for evidence on the long-term benefits of retaining the ring-fencing regime.

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 was the loss of their EU passporting rights. This means that they can only provide a limited range of products directly from the UK to clients based in the EU, 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.

As they are no longer treated as EU banks, UK banks also face other challenges under EU regulation. For example, UK banks have restricted access to EU financial market infrastructure as regulatory licensing constraints and requirements in rulebooks mean that, in some cases, only EU firms can be members of EU trading venues and clearing houses. There are also restrictions on the ability of UK banks to act as primary dealer for some EU Member State Government debt issuances, and a prohibition on UK banks providing direct electronic access to EU trading venues.

These challenges, and others, have led to many 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 ESG-related regulation applies to banks?

The PRA has set out its expectations on banks for considering climate change risks in their governance arrangements and risk management practices. It has noted the challenges that banks face in this context, for example, when sourcing information on their counterparties' exposures or transition plans. Regulations require UK financial institutions (in addition to listed companies) to disclose information on these topics as well as analysis of their resilience to different climate scenarios. The largest UK banks have already been subject to stress tests on these climate scenarios by the Bank of England.

The FCA has proposed introducing disclosure rules for financial products to provide greater clarity to investors about sustainability. The proposals include a general anti-greenwashing rule applicable to all FCA-regulated firms, including banks, which is expected to come into effect in summer 2023. Another significant milestone will be the creation of a UK "taxonomy". This will establish the criteria for determining whether an economic activity is "environmentally sustainable" and will feed into future ESG regulation. An advisory group is advising the Government on adapting the EU's taxonomy for the UK.

Besides environmental matters, the UK regulators have engaged with the industry on diversity and inclusion in the financial sector and continue to emphasise the role of culture to reduce the potential for harm caused by inappropriate conduct.

Are there recent developments regarding IT or cybersecurity?

The UK regulators have introduced rules requiring banks to take a more systematic approach to operational resilience. The rules require banks to, for example, identify their important business services, map the resources necessary to deliver those services and set impact tolerances for disruption. 31 March 2025 is the longstop date for banks to make sure they can remain within their impact tolerances in the event of a severe but plausible disruption to operations.

New standards on outsourcing and third-party risk management complement the operational resilience regimes. The regulators will also use powers under the FSM Bill to impose resilience standards and testing requirements on third parties that are designated as being critical to the financial system, such as cloud service providers.

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 a lot of focus on the regulatory characterisation of different types of digital assets. Security tokens and e-money tokens are regulated financial instruments, whilst other tokens such as utility tokens and exchange tokens (e.g. cryptocurrencies such as Bitcoin) generally fall outside the regulatory perimeter.

Derivatives linked to unregulated products are regulated. The FCA has banned regulated firms (including banks) from marketing, selling or distributing to retail clients derivatives and exchange-traded notes linked to cryptoassets.

Cryptoasset exchanges and custodian wallet providers (including banks and other authorised persons providing those services) must register with the FCA for AML supervision.

The UK Government will use powers under the FSM Bill to create a regulatory regime for stablecoins (tokens linked to fiat currencies or other assets). Specifically, stablecoins that are used as a means of payment will be brought into existing e-money and payments regulation. HM Treasury is expected to consult on the wider regulation of cryptoassets. There are also plans to bring cryptoassets within the scope of the financial promotions restriction and for the FCA to treat these as high-risk investments. This would severely curtail how cryptoasset activities can be marketed in the UK.

The FCA and PRA have been exploring the use of artificial intelligence ("**AI**") in financial services for several years. Most recently, a discussion paper has invited feedback on the barriers firms face to the safe adoption of AI and machine learning technology. The FCA has also opened a discussion on Big Tech's entry and expansion into retail financial services.

In response to the long-term trend away from cash and towards card and digital payments, the FSM Bill allows HM Treasury to impose requirements on the largest retail banks and building societies to protect access to cash across the UK. Looking further ahead, another potential alternative to cash would be a central bank digital currency ("**CBDC**"). No decision has been made on whether to introduce a UK CBDC, but the Bank of England and HM Treasury are exploring the possibility. If the case for a CBDC is made, the earliest launch date would be in the second half of the decade.

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

The Government plans to reshape the UK's future regulatory framework via the FSM Bill. The Bill empowers HM Treasury to repeal retained EU law relating to financial services, allowing for its replacement by rules set and maintained by regulators. This will make it easier for obligations on firms to be waived or amended if appropriate, as there is much more flexibility to do this with regulatory rules as opposed to legislation.

In a package of proposals announced in 2022 known as the "Edinburgh Reforms", the Government confirmed that HM Treasury plans to take a phased approach to this "lift and shift" of firms' regulatory obligations, prioritising policy areas that can advance the Government's objective for a more competitive, open, technologically advanced and green financial services sector. Priority reforms include repealing retained EU law on PRIIPs and short selling and replacing them with alternative rules set by regulators. The FSM Bill also amends regulatory requirements before this process begins. For example, it implements aspects of a review into the rules for wholesale markets, including by removing the share trading obligation and double volume cap from UK MiFIR.

Once enacted, the FSM Bill will enable further 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. It is notable in this context that the FSM Bill also gives the FCA and PRA a new secondary objective to act in a way that facilitates the long-term growth and international competitiveness of the UK economy.

The UK Government is considering whether and how to implement a MiFIR-style "equivalence" regime for overseas firms wishing to provide cross-border investment services into the UK, which 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.

Another significant regulatory change for banks is the introduction of the FCA's consumer duty. The duty includes a new principle requiring firms to deliver good outcomes for retail customers and rules requiring firms to act in good faith, avoid causing foreseeable harm, and enable and support customers to pursue their financial objectives. Additional rules specify the outcomes the FCA wants to see. These are intended to make sure that customers receive the support they need, communications they can understand, and products and services that meet their needs and offer fair value. The rules impact manufacturers and distributors of financial products. The consumer duty regime starts to apply from 31 July 2023.

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 continue to function or be wound down in an orderly way.

More recently, the Bank of England initiated a Resolvability Assessment Framework. This places responsibility on banks to demonstrate to the Bank of England, and publicly, their preparedness for resolution. As part of this, there is a focus on identifying and mitigating any risks to a successful resolution. For example, banks are required to assess the extent to which their financial contracts would be subject to the risk of early termination by counterparties if the bank were to enter resolution. This requires consideration of any contracts that are not covered by the Bank of England's stay powers that apply by operation of law or by compliance with the PRA's rules on contractual stays.

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 liabilities governed by non-UK law, the contractual consent of counterparties 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.

Similarly, the PRA requires financial contracts (e.g. derivatives and repos) that are governed by non-UK law to include "contractual stay" provisions that prevent the counterparty from

terminating in the event that the bank goes into resolution. Such contractual stay language is not needed where financial contracts are governed by UK law since the Bank of England's "general stay" powers will apply to those contracts by operation of law.

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 OTC derivatives under UK EMIR; and
- restrictions under UK MAR and SSR, as well as obligations under the Disclosure Guidance and Transparency rules ("**DTR**").

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 whether 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.

As part of its Edinburgh Reforms, the Government announced plans for HM Treasury and the regulators to review the effectiveness of the SMCR.

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. At the time of writing, the PRA is expected to open a consultation on removing the bonus cap.

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 clients, they are exposed to the risk that those clients might default on their obligations to repay the money to the bank. To mitigate this risk, banks are required to sort each type of loan into various risk categories, depending on the type and perceived 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 any applicable 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, and to hold capital against those. In this context, positions 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 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 plans to help challenger banks by introducing what it calls a "strong and simple" regime that would relax the capital and other prudential requirements applicable to new and growing banks.

Banks are also subject to rigorous liquidity rules. Whilst regulatory capital is concerned with the solvency of banks on a longer-term 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. Separately, the Net Stable Funding Ratio requires banks to ensure that their assets are funded by capital and other liabilities that are deemed to be sufficiently stable. A key aim of these requirements is to ensure that banks are not overly reliant on short-term inter-bank funding, which can be withdrawn with limited notice.

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 have engaged on their proposed structure 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 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 shocks caused by the COVID-19 pandemic, the war in Ukraine and high levels of inflation.

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 have required 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 relevant requirements of MiFID II) and UK MiFIR.

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, DTR, COBS, PRA and FCA expectations regarding the oversight of algorithmic trading functions, and relevant prudential and structural requirements (e.g. ensuring that 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 limited case allowance per year) pay to the FOS a fee of £750 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. The FOS has launched an action plan to improve its service, which includes taking a more robust and proactive approach to preventing complaints arising and resolving problems more efficiently.

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 have needed to decide whether to apply for a permanent UK branch authorisation (which would also allow them to provide cross-border services into the UK), wind down their UK business 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.

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 and criminal proceedings followed by fines and public censure.

Alastair Holt
Tel: +44 207 456 2760 / Email: alastair.holt@linklaters.com

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 that cuts through the complexity of the underlying issues and provides clients with tangible solutions. His experience includes advising financial institutions on Brexit, cross-border services, bank ring-fencing, CRD V, IFPR, new products and services, market abuse, compliance issues and the regulatory implications of corporate transactions in the financial services space. He was recognised as a "rising star" by *The Legal 500* directory for 2020 and as a "next generation partner" for 2021, 2022 and 2023.

Simon Treacy
Tel: +44 207 456 2451 / Email: simon.treacy@linklaters.com

Simon is a senior associate in the Linklaters financial regulation group. He monitors regulatory trends and developments in financial services and writes regular and *ad hoc* briefings and thought leadership for clients, as well as producing innovative knowhow for the Linklaters team. He provides interactive training on financial services regulation, including horizon scanning sessions. His current areas of focus include the UK's future regulatory framework, fintech and payments, and operational resilience. Other areas of expertise include the Senior Managers and Certification Regime, safeguarding of client assets and AI in financial services. Simon also hosts Linklaters' podcast series on payments regulation and operational resilience.

Linklaters LLP

One Silk Street, London EC2Y 8HQ, United Kingdom
Tel: +44 207 456 2000 / URL: www.linklaters.com

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