The Banking Regulation Review

Thirteenth Edition

Editor
Jan Putnis

The LawReviews

THE

BANKING REGULATION REVIEW

THIRTEENTH EDITION

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This article was first published in May 2022
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Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34–35 Farringdon Street, London, EC4A 4HL, UK

www.TheLawReviews.co.uk

ISBN 978-1-80449-070-9

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ADNAN SUNDRA & LOW

ADVOCATUR SEEGER, FRICK & PARTNER AG

ADVOKATFIRMAET BAHR AS

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PREFACE

The past year in banking regulation has been dominated, in most parts of the world, by the severe economic effects of the coronavirus pandemic. Governments and regulators have taken unprecedented steps to support businesses and individuals through the crisis. In financial terms, much of this support has been channelled through banks, and banks have had to work hard to continue to lend and to serve their customers in this difficult period.

Despite the human suffering and long-term economic damage that the pandemic has caused, there has been no significant banking crisis in the past year and, in most countries, no real sign that banks are failing to weather the storm so far. While there are of course exceptions, this is in large part a consequence of the relatively strong capital and liquidity position that banks around the world were in before the pandemic struck, which was itself a position that would not have arisen in many countries without the comprehensive prudential regulatory reforms that followed the global financial crisis of 2007–2009. Indeed, some regulators have commented that the pandemic is proving to be the first real test of those reforms and that, at least so far, the rules and institutional frameworks for banking regulation that were created after the global financial crisis have proven their worth.

As in all ongoing crises, there are causes for both pessimism and optimism. A pessimistic assessment with which it is hard to argue in many parts of the world is that we are still at an early stage in the economic damage that the pandemic has caused. The gradual withdrawal of government support programmes for businesses and the consequent further increases in non-performing loans with which banks have to deal will pose a further severe test for the banking systems of many countries at a time when governments will be relying on banks to support economic recovery. In some countries the strong links between bank viability and the ability of governments to issue sovereign debt at sustainable interest rates may re-emerge as a significant problem.

The optimistic assessment is necessarily a longer-term one given the challenges that the pandemic continues to present. The pandemic has undoubtedly provided the banking sector with an opportunity to show that it can be a force for financial stability and economic renewal at a time of crisis, in marked contrast to the blow to confidence that the sector suffered following the global financial crisis. This opportunity is closely linked to moves by many banks to consider their corporate purpose, the sustainability of their activities in environmental and social terms, and the quality, and in many cases the diversity, of their governance. This somewhat disparate collection of objectives, referred to as ESG (for environmental, social and governance) in many parts of the world, is increasingly dominating discourse between banks and their regulators and investors. Whether this would have happened in quite the way it has without the pandemic is impossible to know, but it does not seem much of an exaggeration to suggest that in many countries the banking sector that will emerge from the pandemic will have a series of cultural and business objectives that are quite different from those that existed before.

Regulators have become more assertive on these matters, particularly with regard to environmental objectives, and we will increasingly see a harder edge to the expectations that they are forming of banks' adherence to policies designed to address climate change. The repricing of many risks that is expected to take place as opinion settles on the pace at which transition to a low-carbon economy should take place will have a profound effect on the balance sheets of many banks. Shareholder pressure will force change in some banks, and banks with significant exposure to the petroleum economy will have to consider radical changes to their business models.

On social matters, financial inclusion and fair treatment of vulnerable customers are motivating legal and regulatory reform in many countries. There is a strong link between financial inclusion and the adoption of new technologies and business models, particularly in payment services. Many of the businesses that are contributing to the adoption of these technologies are not banks but rely on banks (or payment systems that are owned or controlled by banks) in order to operate. Allied to this are the increasingly serious and well-resourced attempts by firms using distributed ledger technologies to develop new means of payment, including stablecoins.

Regulators struggle to keep pace with these developments, but they hold back at their peril on addressing the implications for banks. The concept that the same or similar services and activities should be regulated in the same way is proving to be difficult to apply in practice, not least because there is a fundamental difference in financial stability terms between institutions that take deposits and those that do not. But the challenge of how to establish a level playing field on which to supervise banks and non-bank payment firms and lenders is one that must surely be addressed, and addressed soon, by regulators in a coordinated way around the world. The time for regulators to congratulate themselves on the effectiveness of financial sector reform following the global financial crisis has come to an end. It is now time to think hard about where risks lie and how risks will develop in the emerging tech-enabled financial system, and the possible causes of the next financial crisis.

It is perhaps surprising, given all the disruption caused by covid-19, that some countries have managed to push through significant legal and regulatory reforms in banking in the past year. These measures have included significant overhauls of the whole bank regulatory regime in some countries and, in other countries, further moves to implement Basel III standards. We have already seen some important changes of policy and emphasis in the United States under the new Biden administration. Legal and regulatory reform has continued in the European Union, although many initiatives have been delayed by the pandemic. The final departure of the United Kingdom from the European Union single market on 31 December 2020 and the resulting decoupling of London as a major banking centre from the European Union legal framework will continue to have reverberations and structural implications for banks operating in Europe. The long-term implications of Brexit for banks remain hard to predict; in particular, whether it will be a prelude to further fragmentation in banking regulation around the world.

This edition of *The Banking Regulation Review* covers 33 countries and territories in addition to the usual chapters on International Initiatives and the European Union. My thanks go to the authors for continuing to prepare informative chapters in the difficult and uncertain conditions in which many of them have been working over the past year. They continue to make this book the useful overview and guide to banking regulation around the world that it is.

Thank you also to the partners and staff of Slaughter and May in London and Hong Kong for continuing to support and contribute to this book, and in particular to Nick Bonsall, Ben Kingsley, Peter Lake, Emily Bradley, Ben Goldstein, Selmin Hakki, David Kasal, Tolek Petch, David Shone, Adrien Yeung and Ada Zhang.

The team at Law Business Research once again deserve great thanks for their hard work and understanding of the authors on this edition. Thank you, in particular, to Hannah Higgins.

Jan Putnis
Slaughter and May
London
April 2022

Chapter 34

UNITED KINGDOM

Jan Putnis, Nick Bonsall and David Shone[1]

I INTRODUCTION

After the challenges of Brexit and the covid-19 pandemic, UK banking groups are currently enjoying what is, by the standards of recent years, a relatively settled operating environment. Increased domestic growth and two successive Bank of England base rate rises have raised hopes of increased profitability and potential M&A activity.

The long-term effects of the pandemic and the macroeconomic consequences of the ongoing war in Ukraine, however, remain to be seen. Equally, while the UK has now been free to set its own rules in the financial services sector for over a year, it is not yet possible to discern any clear direction of travel or predict the extent of any likely divergence from EU standards in the medium- to long-term.

For now, the regulatory landscape remains relatively familiar. This will likely change as the UK exercises its new rule-making 'freedoms', but in the meantime 2022 in some respects offers the prospect of a return to normal for the sector after years of Brexit-related uncertainty and challenging macroeconomic conditions arising from the pandemic.

The top five UK banking groups by market capitalisation are HSBC Holdings plc, Lloyds Banking Group plc, Barclays plc, NatWest Group plc and Standard Chartered plc.[2] Other than Standard Chartered plc, these banks, together with Santander UK plc (the UK subsidiary of the Spanish banking group), are the most prominent in the UK personal and business banking markets, although the market share of smaller challenger and digital banks continues to develop.

II THE REGULATORY REGIME APPLICABLE TO BANKS

Under the Financial Services and Markets Act 2000 (FSMA), it is a criminal offence for a person to engage in regulated activities by way of business in the United Kingdom unless authorised (an authorised person) or exempt from the authorisation requirement. Firms that wish to carry on deposit-taking activities (i.e., prospective banks and building societies) are required to seek authorisation to do so from the Prudential Regulation Authority (PRA).

The PRA forms part of the Bank of England (which discharges its role as the PRA through the Prudential Regulation Council (PRC)). The PRA is also responsible for the

1 Jan Putnis and Nick Bonsall are partners and David Shone is an associate at Slaughter and May.

2 As at 7 March 2022. The names stated here are the listed holding companies of the banking groups concerned.

authorisation of insurers and certain systemically important investment firms, and for the prudential supervision of all firms that it has authorised, including UK banks and building societies.

Banks authorised in jurisdictions outside the UK may seek authorisation to carry on business in the UK through a UK branch or subsidiary. If an overseas bank's UK retail deposit-taking activities are deemed by the PRA to be significant, or its wholesale banking activities are deemed to be systemically important, the PRA would generally expect that bank to carry on its business in the UK through a separately authorised UK subsidiary.

The Financial Conduct Authority (FCA) is responsible for the authorisation and prudential supervision of firms that are not subject to prudential regulation by the PRA. This may include certain entities within banking groups, such as dedicated consumer credit lenders or investment firms. The FCA also regulates conduct of business of all authorised firms in the United Kingdom (including banks and other PRA-authorised firms) and the conduct of business in respect of wholesale and retail financial markets and market infrastructure. It also has powers to regulate competition in the financial services sector that are concurrent with those of the Competition and Markets Authority.

Both the PRA and the FCA have the power under FSMA to make rules, and to issue related guidance, that apply to the firms that they regulate. In the case of the PRA, these rules are set out in a rule book published by the PRA (the PRA Rulebook), and guidance is set out in associated supervisory statements and statements of policy. Rules and guidance made by the FCA are set out in the FCA Handbook.

Alongside its roles as a prudential regulator (exercised in its capacity as the PRA) and as the central bank of the UK, the Bank of England has specific regulatory functions relating to financial stability.

In particular, it is the resolution authority responsible for the enforcement of the special resolution regime introduced by the Banking Act 2009 (as amended) (the Banking Act) (see Section III.iv) and, acting through the Financial Policy Committee (FPC), has the macroprudential objective of protecting and enhancing financial stability and the resilience of the UK financial system. While the FPC has the power to issue macroprudential recommendations and directions to the PRA and the FCA, it cannot exert control over, or issue directions to, individual firms.

III PRUDENTIAL REGULATION

i Relationship with the prudential regulator

The PRA applies a judgment-led approach to supervision, focusing on the most significant risks to its statutory objectives. In doing so, it draws on a broad set of information and data submitted by the firms that it supervises (including banks) or gathered through its own investigations.

Periodically, the PRA may validate data through on-site inspections conducted either by its own supervisory staff or by third parties. To support its information-gathering and analysis, the PRA requires firms to participate in meetings with supervisory staff at senior and working levels, and expects to be kept informed of all material developments relevant to the prudential situation of a UK bank or its group. This includes, for example, details of proposed acquisitions, disposals and significant intra-group transactions.

ii Management of banks

Senior managers and certification regime

Individuals intending to carry on certain specified senior management functions (SMFs) at UK banks require prior approval by the PRA or the FCA (depending on the SMF in question). The relevant regulator will approve an individual to perform an SMF only if satisfied that the candidate is a fit and proper person.

Both regulators are interested in the qualifications of applicants, and expect banks to carry out extensive referencing and due diligence before appointing new directors and other individuals performing SMFs. The PRA and the FCA have, and frequently exercise, the power to interview prospective directors and other individuals proposing to perform SMFs.

A separate certification regime applies to individuals who do not perform any SMFs but could pose a risk of significant harm to a firm or its customers. Neither the PRA nor the FCA pre-approves these individuals, but banks are required to certify that the individuals are fit and proper for their roles, both at the point of recruitment and at least annually thereafter.

Conduct rules

The FCA and the PRA have each issued high-level conduct rules that reflect core standards expected of individuals within their scope.

The FCA's conduct rules apply to all individuals approved as senior managers or covered by the certification regimes, as well as to:

a any non-executive directors (NEDs) who are not required to seek pre-approval from the PRA or the FCA (these are referred to as 'notified NEDs'); and

b all other employees (other than certain specified ancillary staff who perform a role that is not specific to the financial services business of the firm).

The PRA's conduct rules apply to individuals approved as senior managers or covered by the certification regime, and to notified NEDs.

Both sets of conduct rules are set out in two tiers: those that apply to all individuals within scope (individual conduct rules) and those that apply only to senior managers (senior management conduct rules). In addition to the individual conduct rules, notified NEDs are subject to a senior management conduct rule that requires them to disclose to the PRA and the FCA any information of which the regulators would reasonably expect notice.

Duty of responsibility and individual liability

UK legislation also imposes individual liability on senior managers and other individuals performing certain functions in relation to UK banks. In particular:

a under the FSMA, the PRA or the FCA can bring a misconduct claim against a senior manager if an authorised firm has contravened a relevant requirement, and the senior manager with the relevant responsibility did not take reasonable steps to avoid the contravention occurring or continuing;

b the FCA and PRA may take action against a senior manager, director or employee of an authorised firm who fails to comply with a conduct rule, or who is knowingly involved in a contravention by an authorised firm of any requirement imposed on it by or under the FSMA, or FCA or PRA rules; and *c* the Financial Services (Banking Reform) Act 2013 (as amended) (the Banking Reform Act) imposes criminal liability in respect of misconduct by a senior manager that leads to the failure of a bank, building society or PRA-authorised investment firm.

Remuneration

Remuneration rules for UK banks are largely derived from EU legislation, and apply to certain senior and risk-taking individuals in UK banks, staff engaged in control functions, and those earning in the same remuneration bracket as senior management and risk-takers. If a UK bank forms part of a broader prudential consolidation group, the rules also apply at the level of that group, including in respect of entities that are established in countries or territories outside the UK.

Current UK remuneration rules prohibit guaranteed variable remuneration (other than in exceptional circumstances), and cap variable remuneration at 100 per cent of fixed remuneration, although this can be increased to 200 per cent with shareholder approval. At least 50 per cent of variable remuneration must be paid in shares or equivalent instruments, and at least 40 per cent to 60 per cent of variable remuneration (depending on total remuneration) must be deferred for between four and five years. Variable remuneration must also be subject to clawback arrangements, which must cover specific criteria (such as a failure to meet appropriate standards of fitness and propriety).

Certain smaller banks are not subject to the full range of restrictions and may, for example, disapply the requirement to maintain ratios between fixed and variable remuneration.

Ring-fencing

Since 1 January 2019, UK banking groups with 'core deposits' (broadly, UK and EEA retail deposits) in excess of £25 billion have been required to organise themselves such that their core deposit-taking business is legally and financially independent of other group entities that carry on various wholesale or investment banking activities.

The entities through which affected groups carry on their core deposit-taking business (referred to as ring-fenced banks) are subject to significant restrictions on their banking activities. These include prohibitions (subject to exceptions) on proprietary trading, trading in commodities and the incurrence of exposures to certain other financial institutions, and limitations on the types of financial products and services that they may provide.

iii Regulatory capital and liquidity

Regulatory capital

UK banks are subject to capital requirements that were originally formulated under the EU Capital Requirements Regulation (CRR)[3] and are now set out under the retained EU law version of that regulation (the UK CRR).

A bank's minimum capital requirements (referred to as 'Pillar 1') are expressed as a percentage of its risk-weighted assets (RWAs). RWAs are calculated by weighting the accounting value of a bank's assets and credit exposures according to their potential to suffer loss. These Pillar 1 requirements can be summarised as follows:

a regulatory capital of at least 8 per cent of RWAs;

b Common Equity Tier 1 (CET1) capital of at least 4.5 per cent of RWAs; and

3 Regulation (EU) No. 575/2013.

c Tier 1 capital (comprising CET1 capital and Additional Tier 1 (AT1) capital) of at least 6 per cent of RWAs.

CET1 capital is the highest quality of capital and generally comprises ordinary share capital and reserves, which must, in each case, meet eligibility criteria specified by the UK CRR. AT1 capital is the next highest quality of capital and comprises perpetual subordinated debt instruments or preference shares that meet the relevant eligibility criteria, chief among which is that the relevant instruments or shares must automatically be written down or converted into CET1 upon the bank's CET1 ratio falling below a specified level, which, in practice, the PRA expects to be at least 7 per cent. Tier 2 capital is capital of a lower quality and comprises subordinated debt or capital instruments with an original maturity of at least five years that meet the relevant eligibility criteria.

In addition to the Pillar 1 requirements, banks must hold capital against risks not adequately captured under the Pillar 1 regime (referred to as Pillar 2A) and in respect of the following capital buffers:

a the combined buffer, which is formed of a capital conservation buffer of 2.5 per cent of RWAs, a countercyclical capital buffer (CCyB) (currently 1 per cent in respect of UK exposures), a buffer for global and other systemically important institutions and, for banks subject to UK ring-fencing requirements, a systemic risk buffer; and

b the PRA buffer (also referred to as Pillar 2B), which is set by the PRA and takes account of a bank's ability to withstand a severe stress scenario, any perceived deficiencies in its risk management and governance framework, and any other information deemed relevant by the PRA.

UK banks must meet the Pillar 2A requirement with at least 56 per cent CET1 capital, while both the combined buffer and the PRA buffer must be met exclusively with CET1 capital. In practice, UK banks therefore need to maintain a CET1 capital ratio significantly in excess of the minimum 4.5 per cent CET1 ratio. The PRA has the power to restrict the payment of distributions (in the form of dividends, coupons and staff bonuses) by UK banks if the combined buffer is breached.

Capital requirements apply to UK banks on a stand-alone (solo) basis and to their ultimate UK parent undertakings on a consolidated basis. Where that parent undertaking is a holding company (and not authorised as a bank or investment firm in its own right), it must (subject to certain exceptions) also be approved by the PRA under Part 12B of the FSMA.

Large exposures

Subject to certain exceptions, UK banks are required to report any exposure to a counterparty or group of connected counterparties of 10 per cent or more of Tier 1 capital, and prohibited from incurring exposures to counterparties or groups of connected counterparties in excess of 25 per cent of Tier 1 capital. These requirements apply on a solo and consolidated basis.

Liquidity

Under the Pillar 1 UK liquidity regime, banks must:

a maintain liquidity resources equal to at least 100 per cent of anticipated net liquidity outflows over a 30-calendar-day stress period (the liquidity coverage ratio (LCR));

b ensure that long-term obligations are adequately met with a diversity of stable funding instruments under both normal and stressed conditions; and *c* maintain available stable funding equal to at least 100 per cent of required stable funding (the net stable funding ratio (NSFR)).

These requirements apply on a solo and consolidated basis. Pillar 2 requirements also apply. The PRA can waive the application of the requirements on a solo basis in relation to (sub-) groups of institutions authorised in the UK. UK banks are, therefore, generally not able to rely on liquidity from non-UK subsidiaries to satisfy UK liquidity requirements.

Leverage ratio

At present, only UK banks and building societies that have retail deposits equal to or greater than £50 billion are subject to a binding leverage ratio requirement. This is set at 3.25 per cent, with additional buffers set at 35 per cent of the institution-specific countercyclical buffer, and, for UK global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs), a further institution-specific supplementary leverage ratio buffer. These requirements must be met with Tier 1 capital, at least 75 per cent of which must be CET1.

The UK CRR also requires all UK banks to calculate, report and disclose their leverage ratios on a solo and consolidated basis. From 1 January 2023, these requirements will also apply to banks with non-UK assets equal to or greater than £10 billion.

iv Recovery and resolution

The Bank of England is the UK's resolution authority. Its resolution powers are derived from the Banking Act, which first introduced the 'special resolution regime' for UK banks (SRR).

The SRR enables the Bank of England to exercise five pre-insolvency stabilisation options (transfer to a private sector purchaser, bridge bank or asset management vehicle; bail-in; and transfer to temporary public sector ownership), and includes modified insolvency and administration procedures for insolvent banks. The Bank of England is also able to exercise various pre-resolution powers (by directing the removal of perceived impediments to resolution, or the mandatory conversion or write-down of certain capital instruments, or both) without placing a bank in resolution.

As the UK resolution authority, the Bank of England is also required to set minimum requirements for own funds and eligible liabilities (MREL) for UK banks, building societies and certain investment firms. The Bank's approach to setting MREL reflects EU requirements originally set out in the EU Bank Recovery and Resolution Directive (BRRD)[4] and also implements the Financial Stability Board's total loss-absorbing capacity standard in the UK. It should be noted that the UK did not implement changes to EU MREL requirements arising under BRRD II.[5]

UK G-SIBs and material subsidiaries of non-UK G-SIBs are also subject to a binding MREL requirement under the UK CRR, and are bound by the higher of the two requirements. MREL requirements have been phased in since 1 January 2019. UK G-SIBs and D-SIBs have been subject to their 'end-state' requirements since 1 January 2022. End-state MRELs will apply to other institutions within scope of the SRR from 1 January 2023.

4 Directive 2014/59/EU.

5 Directive (EU) 2019/879.

IV CONDUCT OF BUSINESS

There are certain overarching legal and regulatory principles that UK banks must consider in the conduct of their business, such as the FCA's Principles for Businesses, which include a principle that firms must treat their customers fairly (the TCF principle).

The FCA's Banking Conduct of Business Sourcebook contains a set of high-level FCA rules that apply in relation to deposit-taking activities, and relate to matters such as communications with customers, financial promotions, post-sale requirements and cancellation rights in relation to banking products. The remainder of this Section considers specific conduct of business requirements relevant to UK banks.

i Regulated lending

While corporate lending is generally unregulated in the UK, consumer lending is subject to detailed conduct of business requirements.

The Mortgage and Home Finance Conduct of Business Sourcebook contains FCA rules in respect of activities associated with regulated mortgage contracts. A regulated mortgage contract is, broadly, a loan secured by a mortgage on land in the UK where at least 40 per cent of that land is used, or intended to be used, as or in connection with a dwelling by the borrower where the borrower is an individual or a trustee.[6] Since March 2016, this has included second charge mortgages and certain buy-to-let mortgages. The lenders of consumer buy-to-let mortgages have also been subject to a separate registration and conduct regime since that date.

The regulatory framework for other regulated consumer lending is complex, and is split between requirements under the Consumer Credit Act 1974 (as amended) (CCA), secondary legislation made under the CCA and the FSMA, and the FCA's own consumer credit rules. Firms carrying out consumer credit activities are subject to various parts of the FCA Handbook (including the FCA's Principles for Businesses and its Consumer Credit Sourcebook).

ii Investment business

Investment business, in this context, includes activities such as dealing in investments (whether as principal or as agent), managing investments and providing investment advice. If a bank, or another entity within its group, intends to carry on these regulated activities in the UK, it must be appropriately authorised by the PRA or FCA (as applicable). These activities are subject to their own detailed conduct of business rules, including the rules in the FCA's Conduct of Business Sourcebook and its Principles for Businesses.

The provision of various investment services and activities in relation to certain financial instruments is also subject to UK law and regulation implementing the Markets in Financial Instruments Directive II,[7] which came into force on 3 January 2018, including the retained EU law version of the Markets in Financial Instruments Regulation[8] and applicable FCA rules.

6 For loans entered into between 21 March 2016 and IP Completion Day, the definition extends to mortgages over land in the EEA.

7 Directive 2014/65/EU.

8 Regulation (EU) No. 600/2014.

iii Payment services and electronic money

The Payment Services Regulations 2017 (PSRs) and Electronic Money Regulations 2011 (EMRs), in each case as amended, set out an authorisation and supervisory regime for payment service providers and electronic money institutions. UK banks carrying on payment services activities are exempt from authorisation under the PSRs, but must be authorised under the FSMA to issue electronic money. In both cases, UK banks carrying on such activities are subject to conduct of business supervision by the FCA under the PSRs and EMRs (as applicable).

V FUNDING

UK banks raise funding from a number of different sources. In addition to deposits, interbank lending and wholesale funding, receipts from securitisations are gradually becoming more important as the securitisation market continues to recover. The Bank of England also makes available certain liquidity facilities to UK banks, in particular through its discount window facilities and open market operations.

VI CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESS

i Control regime

Outline of the regime

Any person who decides to acquire or increase 'control' of a UK-authorised person must first obtain the approval of the 'appropriate regulator' (which is the PRA in relation to control over UK banks and other PRA-authorised firms, and the FCA in relation to control over other FCA-authorised firms). Acquiring or increasing control in a UK authorised person without prior approval from the appropriate regulator is a criminal offence, and may result in the acquirer's shareholding rights being restricted or a court ordering the sale of the shares.

The term 'control' is broadly defined, such that a person (A) will have control over a UK bank (B) if A holds 10 per cent or more of the shares or voting power in B or a parent undertaking (P) of B, or holds shares or voting power in B or P as a result of which A is able to exercise significant influence over the management of B. Voting power held by a controlled undertaking of A (i.e., broadly, an undertaking in respect of which A exercises majority voting control) is also attributed to A. A controller's (or proposed controller's) shareholdings or voting power are aggregated with those of any person with whom it is acting in concert.

A will be treated as increasing its control over B, and requiring further approval from the appropriate regulator if the level of shareholding or voting power in B or P increases through any threshold step. In addition to 10 per cent, threshold steps occur at 20 per cent, 30 per cent and 50 per cent, and upon becoming a parent undertaking.

The PRA and FCA do not apply the provisions of the Joint European Supervisory Authorities' 'Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector' relating to the identification of indirect qualifying holdings. As a result, a person may be identified as holding a qualifying holding in an EEA institution without also being a controller of UK-authorised entities within the same group structure.

The approval process

The appropriate regulator has an assessment period of 60 working days to make its determination, commencing on the date on which it acknowledges receipt of a complete change in control application. This can be extended by a further 20 working days if the appropriate regulator requests further information (30 working days if the notice-giver is situated or regulated outside the UK or Gibraltar, or is not subject to supervision under UK or Gibraltarian laws implementing certain EEA financial services directives). The process can be completed well within the maximum time allowed, but it can never be assumed that this will be possible.

The PRA and FCA have published standard forms (available on its website) that must be used to apply for change in control approval. If a proposed controller proposes to become a parent undertaking of a UK bank, it must also prepare and submit a business plan that includes a strategic development plan, estimated financial statements and information about the anticipated impact of the acquisition on the corporate governance and organisational structure of the UK bank (and any other UK regulated firms) subject to the change in control. The PRA attaches great importance to the business plan in its assessment of a change in control application.

An existing controller of a UK-authorised person that decides to reduce its control over that person is required to give notice of that intention to the appropriate regulator (although no formal consent is required for such a reduction).

Every UK bank is also required to take reasonable steps to keep itself informed about the identity of its controllers, and to notify the PRA as soon as it becomes aware that any person has decided to acquire, increase or reduce control of the bank.

It is important to note that the control regime described above also applies with respect to intra-group reorganisations as well as transactions involving external counterparties.

ii Transfers of banking business

It is possible to transfer banking business in the United Kingdom by way of a court-sanctioned banking business transfer scheme under Part VII of the FSMA (referred to as a Part VII transfer). This does not, however, prevent the use of other mechanisms for the transfer or assumption of assets and liabilities relating to banking businesses by other means, such as assignments or novations.

A Part VII transfer is, broadly speaking, a scheme whereby the whole or part of the business carried on by a UK bank is transferred to another entity and where the whole or part of the transferred business includes deposits. Deposit-taking business must form an integral part of the business to be transferred under a banking business transfer scheme, but need not be the sole or predominant business carried on.

A Part VII transfer takes effect without the consent of the depositors or other counterparties, although any person who alleges that he or she would be adversely affected by the carrying out of the scheme may be heard in the court proceedings required to sanction the scheme. The court may require assurance that those persons have been fairly treated. Both the PRA and the FCA are entitled to be heard in the proceedings and typically participate in them by counsel.

VII THE YEAR IN REVIEW

i Brexit

The transitional period for the UK's withdrawal from the EU ended on 31 December 2020 (IP Completion Day). EU law ceased to apply in the UK at that point, and UK and EU firms also lost their reciprocal market access rights in respect of financial services (i.e., their 'passporting rights').

The body of EU law existing on IP Completion Day was 'onshored' into UK domestic law on that date, subject to certain amendments intended to correct perceived deficiencies arising from that onshoring process. Subject to certain exceptions, the application of these onshoring amendments in relevant financial services legislation has effectively been suspended until 31 March 2022 due to transitional directions issued by the PRA, FCA and Bank of England.

Since IP Completion Day, the UK government has been free to amend or revoke any provision of retained EU law, although the extent of any divergences between the UK and EU regulatory frameworks in financial services remains relatively limited at present.

Due to the loss of passporting rights described above, UK firms (including banks) are no longer permitted to carry on business in the EEA unless separately authorised in the relevant EEA Member States. Equally, EEA firms wishing to carry on business in the UK, whether on a cross-border basis or through a branch, now require authorisation from the PRA or FCA (as applicable). Under 'temporary permissions regimes' established by the PRA and FCA, EEA firms that relied on passporting rights to carry on business in the UK prior to IP Completion Day may continue doing so for a period of up to three years following IP Completion Day, pending their authorisation under the FSMA. There is no EEA-wide equivalent for UK firms carrying on business in the EEA, although some jurisdictions have introduced their own domestic transitional measures.

ii Implementation of final Basel III standards

The Financial Services Act 2021 (FS Act) made a number of changes to the UK regime for the prudential regulation of banks and investment firms. These included the creation of a new regime for the prudential regulation of FCA-authorised investment firms (which are no longer subject to the prudential regime under the UK CRR) and amendments to the UK CRR and associated rules to implement remaining Basel III standards.

The FS Act gave HM Treasury the power to revoke (by subordinate legislation) certain existing provisions of the UK CRR, with the PRA empowered to make rules replacing those provisions and updating them to take account of the Basel standards. Both the PRA and HM Treasury have exercised these powers, with the result that requirements for large exposures, liquidity, leverage and the standardised approach to credit risk are now set out in the PRA Rulebook rather than the UK CRR.

The rules largely transpose existing UK CRR requirements, generally amending them only where this was deemed necessary to reflect Basel III standards. While these amendments broadly reflect similar developments at an EU level (as set out in the EU Banking Reform Package), there are a number of notable differences in approach. These include the treatment of intangible software assets, which must be deducted from CET1 capital in full. This reflects the requirements of the Basel III package, but represents a more conservative approach than that taken by the relevant EU legislation.

iii Covid-19

While covid-19 continued to dominate the headlines in 2021, its impact on the UK banking sector was less pronounced than in 2020. The macroprudential measures adopted by the Bank of England in response to the pandemic (which including the cutting of the CCyB to zero, the Bank of England base rate to 0.1 per cent and the introduction of a new term funding scheme) have now been reversed or no longer apply, as have many of the temporary measures introduced by the PRA and FCA.

While the Bank of England began 2021 by telling banks to prepare for the potential adoption of negative interest rates, it ended with an increase to the Bank of England base rate. A second consecutive rate rise in February 2022 has brought rates back to pre-pandemic levels, spurring much speculation about increased profitability and M&A opportunities in the sector.

iv Regulatory change

Alongside Brexit and the implementation of the remaining Basel III standards, UK banks had to grapple with a number of other significant regulatory change projects during 2021 and early 2022.

Chief amongst these was the discontinuation of LIBOR. The PRA and the FCA have, for a number of years, urged firms to proceed on the basis that LIBOR will be discontinued from the end of 2021, and most LIBOR settings ceased to be provided on 31 December 2021, although certain US dollar settings will continue until 30 June 2023. While certain sterling, dollar and yen LIBOR settings also continue to be published on a synthetic basis, UK banks and other firms worked throughout 2021 to update their inventory of instruments and other products referencing LIBOR ahead of its planned discontinuation.

June 2021 also saw the deadline for any holding companies of banks and PRA-authorised designated investment firms established on or before 29 December 2020 to apply for approval under Part 12B of the FSMA (see Section III.iv). While this inevitably took up some regulatory bandwidth during the first part of 2021, the approval process in many respects represents a formalisation of existing obligations rather than a radical transformation of the regulatory environment in which such holding companies operate.

UK banking groups with retail deposits over £50 billion were required to submit their first assessments of their resolvability to the PRA and the Bank of England by 8 October 2021 under the resolvability assessment framework (RAF) adopted by the PRA and the Bank of England. The RAF requires banks to assess their preparations for resolution, any risks to a successful resolution and their plans for dealing with those risks. Affected groups are required to publish summaries of their reports by June 2022.

HM Treasury's work on the ongoing Future Regulatory Framework Review (the FRF Review) also continues. This was announced in 2019 and is expected to feed into further legislative proposals during the current Parliament. The stated aim of this review is to develop a more coherent, agile regime that is better equipped to meet the specific regulatory needs of UK firms, markets and consumers. Phase I of the review (which reported in March 2020) considered cooperation arrangements between the regulators responsible for the supervision of financial services firms in the UK. Phase II of the review, which is ongoing, is examining possible changes to the current UK regulatory framework in the light of the UK's withdrawal from the EU. These include proposals to hand more rule-making powers to the PRA and the FCA, and may eventually result in changes to the regulatory environment in which UK banks operate.

VIII OUTLOOK AND CONCLUSIONS

The current outlook for UK banking groups is, in many respects, much more positive than it has been in recent years. Despite the current macroeconomic environment, and deteriorating geopolitical situation, UK banking groups are likely to enjoy a more settled, and profitable, operating environment throughout 2022 than has been the case in recent memory. This raises the prospect of potential merger and acquisition activity and consolidation involving some of the sector's smaller players, although there has been little evidence of this during the first few months of the year.

The regulatory framework for UK banks, meanwhile, has continued to evolve. While the FS Act and FRF Review have given some insight into the UK's direction of travel in a post-Brexit world, the future shape of UK banking regulation remains unclear. For now, though, the extent of any divergence between UK and EU financial services law and regulation remains relatively modest, and this is unlikely to change radically in the immediate future.

The year ahead is likely to bring greater clarity on these issues as the sector, and the United Kingdom itself, familiarises itself with the post-Brexit, post-pandemic 'new normal'.

Appendix 1

ABOUT THE AUTHORS

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Jan Putnis has been a partner at Slaughter and May in London since 2003. His practice focuses on financial regulation, with particular emphasis on international corporate and commercial transactions. Mr Putnis acts for a broad range of financial institutions, including banks, insurance groups and asset managers, on strategic regulatory matters and investigations, cross-border and domestic mergers and acquisitions, and outsourcings. His work involves extensive advice on regulatory capital and on capital structures of new businesses, as well as capital structures to facilitate acquisitions and group reorganisations.

Mr Putnis qualified as a solicitor in 1996. In a previous life, he graduated with a degree in physics from Oxford University in 1992.

NICK BONSALL

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Nick Bonsall has been a partner in the financial regulation group at Slaughter and May in London since May 2016. He advises on the supervision and regulation of banks, investment firms, payment institutions, insurance companies and building societies. Recently, his work has involved advising on various financial regulatory aspects of the acquisition and disposal of banking businesses, including through the FSMA banking business transfer regime, and on various matters relating to bank recovery and resolution plans. He has also advised on financial services outsourcings, the UK electronic money and payment services regimes, and agreements for the distribution of retail investment products.

He graduated from the University of Edinburgh with a degree in mathematics and statistics, and he qualified as a solicitor in England and Wales in 2009.

DAVID SHONE

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David Shone joined Slaughter and May in 2014 and qualified in September 2016 as an associate in the firm's financial regulation group. His practice incorporates advisory and transactional work for a broad range of established financial institutions and financial technology firms.

David has detailed practical experience of the prudential regimes that apply to UK financial institutions in all financial sectors, with a particular focus on the UK CRR and UK recovery and resolution regime. David regularly advises financial institutions and investors on the structuring of capital instruments, including in relation to non-standard funding models and group structures, as well as advising on a range of conduct-related questions.

David has been a contributing author to the UK chapter of *The Banking Regulation Review* since 2017. Before becoming a solicitor, he graduated with a BA and MPhil in English from the University of Cambridge.

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ISBN 978-1-80449-070-9