

Retail banking market investigation

Regulatory framework applicable to the retail banking industry in the UK

1 May 2015

This is one of a series of consultative working papers which will be published during the course of the investigation. This paper should be read alongside the updated issues statement and the other working papers which will be published soon. Working papers do not form the inquiry group's provisional findings. The group is carrying forward its information-gathering and analysis work and will proceed to prepare its provisional findings, which are currently scheduled for publication in September 2015, taking into consideration responses to the consultation on the updated issues statement and working papers. Parties wishing to comment on this paper should send their comments to retailbanking@cma.gsi.gov.uk at the latest by the same deadline for comments as the updated issues statement (which will be confirmed upon publication of the updated issues statement).

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Introduction

1. This working paper describes the key aspects of banking regulation affecting retail banks operating in the UK market. It is not intended to be a comprehensive description of every piece of legislation or rule by which banks are required to abide, but provides an overview of the principal institutions that regulate the industry in the UK, and a high-level description of the most significant forms of regulation with which banks must comply. The paper also provides a description of key initiatives currently being carried out by UK financial industry regulators, the UK government and the EU.
2. Understanding the regulatory framework applicable to the industry is particularly important to the CMA's consideration of barriers to entry to the retail banking market, and of the feasibility of potential remedies. For further information on the CMA's consideration of whether banking regulation might form a barrier to entry to the retail banking market, please refer to the separate working paper on barriers to entry.

UK regulatory authorities – overview

3. In July 2010, in response to the financial crisis, the government published a consultation document¹ outlining proposals to overhaul the UK financial regulatory system in favour of more specialised and focused regulators. The consultation document identified a number of problems with the existing regime:
 - The Financial Services Authority (FSA) had too broad a remit and insufficient focus to identify and tackle issues early.
 - The Bank of England (BoE) did not have the tools or levers to fulfil its responsibility for ensuring financial stability.
 - HM Treasury (the Treasury) had responsibility for maintaining the institutional framework but no clear responsibility for dealing with a crisis which put public funds at risk.
 - No single institution had the responsibility or authority to monitor the system as a whole, to identify risks to financial stability and act decisively to tackle them.

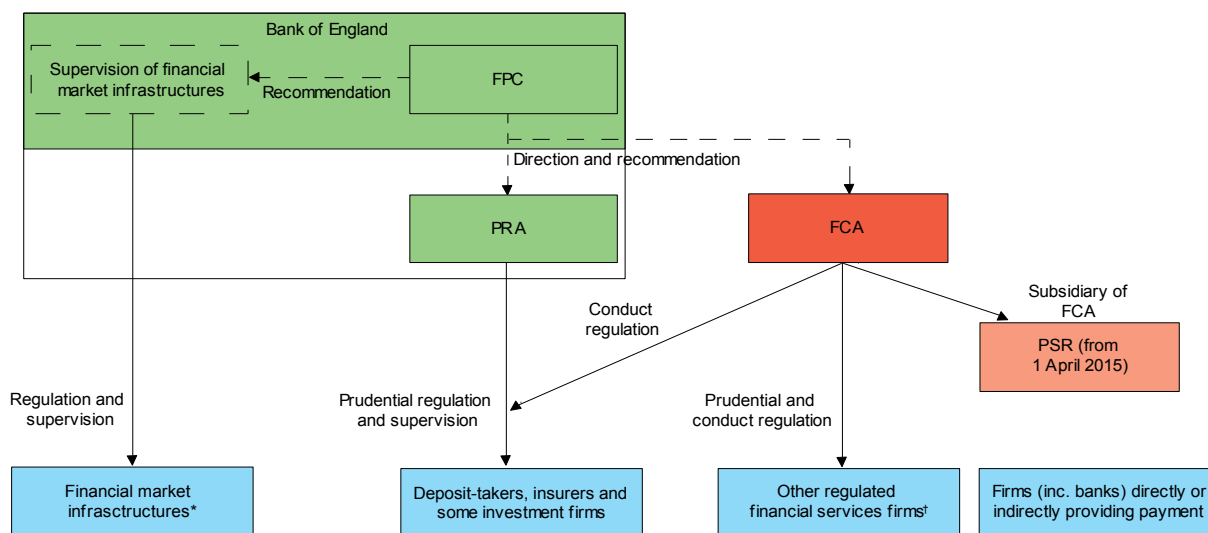
¹ [A new approach to financial regulation: judgement, focus and stability](#), 26 July 2010.

4. Following the consultation, a White Paper was published in June 2011,² including a draft Financial Services Bill, which came into force as the Financial Services Act 2012 (FS Act) on 1 April 2013.
5. The FS Act implements a new regulatory framework for financial services in the UK. It is primarily concerned with the institutions that oversee the industry, rather than with the subject-matter of the rules and regulations for which those institutions are responsible.
6. Changes introduced by the FS Act include separating the prudential and conduct regulation of banking operations. Both forms of regulation were previously carried out by the FSA. From 1 April 2013, prudential regulation of banking operations has been carried out by the Prudential Regulation Authority (PRA), which was established by the FS Act, and conduct regulation by the Financial Conduct Authority (FCA), which replaces the FSA. The roles performed by the PRA and FCA respectively are considered in greater detail at paragraph 17 onwards and paragraph 82 onwards.
7. In addition to the changes to the regulatory framework brought about by the FS Act, the Financial Services (Banking Reform) Act 2013 (FSBRA) enacted a number of further reforms related to the UK's banking sector. In particular, FSBRA gave the Treasury and the relevant regulators, primarily the PRA, powers to implement some of the recommendations made by the Independent Commission on Banking³ (ICB) – in particular, the ICB's recommendations for ring-fencing requirements for banks (see paragraph 156 onwards).
8. It also provided for the establishment of the Payment Systems Regulator (PSR). The role of the PSR is considered in detail from paragraph 106 onwards.

² [A new approach to financial regulation: the blueprint for reform.](#)

³ The Independent Commission on Banking was a UK government inquiry looking at possible reforms to the banking industry in the wake of the financial crisis of 2007-08. It was established in June 2010 and published its final report and recommendations in September 2011. It was chaired by Sir John Vickers. Its headline recommendation was that banks should 'ring-fence' their retail banking divisions from their investment banking arms, to safeguard against riskier banking activities. The UK government announced the same day that it would introduce legislation to implement the recommendations.

Figure 1: Overview of regulatory landscape



*Excludes regulation of trading platforms, which is the responsibility of the FCA.

†Includes asset managers, hedge funds, exchanges, insurance brokers and financial advisers.

The Bank of England

9. The BoE is the central bank of the UK. Its stated mission is to ‘promote the good of the people of the UK by maintaining monetary and financial stability’. The FS Act brought about a major expansion of the BoE’s main responsibilities, which are now clearly defined by Parliament.
10. The BoE performs its main functions through the following committees and authorities:
 - Financial policy (eg looking out for future risks and weaknesses in the financial system) – The Financial Policy Committee (FPC).
 - Monetary policy (eg setting interest rates, decisions on quantitative easing) – The Monetary Policy Committee.⁴
 - Safety and soundness of banks and other financial institutions – The Prudential Regulation Authority (PRA).
11. The FS Act established both the FPC and the PRA, and gave each of these bodies new responsibilities for the supervision of financial institutions.
12. The BoE also plays a role in the regulation of payment systems, which is discussed further at paragraph 76.

⁴ The activities of the Monetary Policy Committee are not relevant to the CMA’s investigation so are not discussed further in this paper.

The Financial Policy Committee

13. The FPC's primary role is to identify, monitor, and take action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system as a whole. It comprises the Governor and five Deputy Governors of the Bank of England, the Chief Executive of the FCA, five external members and a non-voting Treasury member. The Committee has a secondary objective to support the economic policy of the government.
14. The FPC can issue directions and make recommendations to the PRA and the FCA, and can make recommendations to other bodies. For banks, the FPC has the power to set the rate of the countercyclical capital buffer under the Capital Requirements Directive IV and the Capital Requirements Regulation (see further at paragraph 49).
15. The FPC meets quarterly to a published schedule. Each quarterly round comprises a briefing on financial system developments, focused discussions of key threats to stability and potential macro-prudential policy interventions, and a formal meeting to agree on policy decisions, for example to make directions and/or recommendations.
16. The FPC must explain any decisions it has taken, review progress against previous recommendations and directions, and, twice a year, publish a Financial Stability Report, setting out its assessment of risks and weaknesses in the financial sector.

Prudential Regulation Authority

17. The PRA is responsible for the prudential regulation and supervision of all deposit-taking institutions (banks, building societies and credit unions), insurers and major investment firms. The PRA works alongside the FCA creating a 'twin peaks' regulatory structure in the UK,⁵ with the FCA carrying out conduct regulation of deposit-takers, and prudential and conduct regulation of other financial firms. In total the PRA regulates around 1,700 financial firms. It is a subsidiary of the BoE.⁶ The PRA's most significant supervisory decisions are taken by its Board – comprising the Governor of the Bank of England, the CEO of the PRA, the Deputy Governor for Financial Stability, the Deputy Governor for Markets & Banking, the Deputy Head of the

⁵ The FCA is a separate institution and not part of the BoE.

⁶ The BoE recently announced plans to change the legal status of the PRA from a subsidiary to a full part of the Bank of England on a similar footing as the MPC and FPC. See [Transparency and Accountability at the Bank of England](#), 11 December 2014, p7.

PRA, and five independent non-executive members. The Board is accountable to Parliament.

18. The PRA derives its responsibilities and powers from the Financial Services and Markets Act 2000 (as amended by the FS Act 2012) (FSMA⁷) and the relevant EU Directives and directly applicable EU Regulations, for which it is a competent authority (eg the Capital Requirements Directive and the Capital Requirements Regulation – see further at paragraph 49).
19. The PRA has two primary statutory objectives (set out in FSMA): to promote the safety and soundness of the firms it supervises and, specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders. FSMA requires the PRA to pursue the first objective primarily by:
 - seeking to ensure that the business of the firms it authorises is carried on in a way which avoids any adverse effect on the stability of the UK financial system; and
 - seeking to minimise the adverse effect that the failure of one of the firms it regulates could be expected to have on the stability of the UK financial system.
20. The PRA prioritises its resources to focus on those firms with the greatest potential to affect financial stability adversely, whether through the failure of those firms or through the way in which they carry on their business.
21. The PRA has a secondary objective to facilitate effective competition in relevant markets, so far as reasonably possible. The PRA has no concurrent competition powers, and this secondary objective only applies when the PRA is advancing its primary objectives and therefore does not operate as a self-standing objective. For example, the PRA would consider possible effects on competition when introducing new rules for authorised firms, but it would not on its own initiative introduce rules aimed purely at promoting competition.⁸
22. One of the PRA's key functions is the authorisation of new banks, which is considered in detail below.

⁷ References to FSMA in this paper are to be read as references to the Financial Services and Markets Act 2000 as amended by the FS Act 2012.

⁸ The obligation on the PRA is only to facilitate competition, not to behave as a competition advocate, promoting competition in markets.

Authorisation as a bank by the PRA, under Part 4A FSMA

23. A firm can only carry on a regulated activity in the UK if it is authorised or exempt.⁹ Firms based in the European Economic Area (EEA) may obtain authorisation from the PRA in a variety of ways. Some may obtain a passport from their home state regulator on the basis of an EEA right, eg to establish a branch in the UK, which the PRA then endorses.
24. Firms that are incorporated and have their head office or registered office in the UK must apply to either the PRA or the FCA (depending on the activities they plan to carry out) for authorisation under Part 4A of FSMA.
25. The FSMA Regulated Activities Order 2001 (RAO)¹⁰ sets out those activities for which PRA authorisation is required (PRA-regulated activities). These are:
 - accepting deposits;
 - effecting a contract of insurance as principal;
 - carrying out a contract of insurance as principal; and
 - managing the underwriting capacity of a Lloyd's syndicate as a managing agent.
26. The RAO also lists other regulated activities, for which FCA authorisation is required, such as consumer credit lending. A bank, which is a deposit taker and a credit provider, would be subject to conduct regulation by the FCA, and prudential regulation by the PRA.

Application process

27. A firm seeking authorisation as a bank (ie to accept deposits) will be dual-regulated and so will have its application considered by both the FCA and the PRA.¹¹ However, it must apply initially to the PRA. The PRA will assess applicant firms from a prudential perspective and the FCA will assess applicants from a conduct perspective. The PRA will lead on the authorisation process, although it must obtain the consent of the FCA before granting authorisation.

⁹ Section 19, FSMA. This is referred to as the 'general prohibition'.

¹⁰ [FSMA Regulated Activities Order 2001](#).

¹¹ The term 'FCA-authorized firm' means a firm that is regulated solely by the FCA, and the term 'PRA-authorized' means a firm that is dual-regulated by the FCA (for conduct purposes) and the PRA (for prudential purposes). All banks carrying on regulated activities within the UK are PRA-authorized.

28. Following publication of the Independent Commission on Banking's Report in 2011, the Treasury asked the FSA and the BoE to review the prudential and conduct requirements for new entrants to the banking sector to ensure that they do not pose excessive barriers to entry or expansion. In March 2013, the FSA and the BoE published a 'Review of requirements for firms entering or expanding in the banking sector'¹² also commonly referred to as the Barriers Report. This report led to a number of changes to the process. The three main features of the changes were:
- reduced capital requirements at the authorisation stage;
 - removal of new bank liquidity premium; and
 - a changed authorisation process to ease business start-up (the so-called 'mobilisation' approach – see further at paragraph 32).
29. In addition the regulators committed to a voluntary deadline for reaching a decision on a banking application of six months from the date of a complete submission.
30. A further report¹³ published by the PRA and the FCA in July 2014 provided an update on progress in implementing these changes and clarified some issues that had arisen following the original review. Several developments were mentioned in the follow-up report:
- Both the PRA and FCA have greatly increased the level of pre-application support they offer firms. In the 12 months to 31 March 2014, the regulators held 47 pre-application meetings with over 25 potential applicants.
 - The application pack for banks has been reviewed and restructured and both regulators have streamlined the material and information applicant firms have to submit.
31. The information to include in an application for a Part 4A permission is not set out in FSMA, but is set out on both the PRA and FCA's websites.¹⁴ Applicants are currently required to pay a fee of up to £25,000 for authorisation.

¹² [Review of requirements for firms entering or expanding in the banking sector](#).

¹³ [BoE Barriers to Entry Report](#).

¹⁴ This includes information such as the firm's business plan, the scope of permission for which it is applying, details of its financial resources, recovery and resolution plans, details of its compliance, HR and internal audit policies, and details of its infrastructure. For more information please see the [PRA website](#).

32. The FCA has published a guide¹⁵ to the banking authorisation process. Among other things, it explains the two options available for banking applications:
- Option A: this approach is also referred to as the ‘straight-through’ authorisation and is designed for firms that already have the staffing, capital and infrastructure to allow them to set up a bank. For example, this approach would be used for the subsidiarisation¹⁶ of branches of foreign banks and where firms are able to use existing IT and other infrastructure.
 - Option B: this option is also referred to as the ‘mobilisation’ route. Under mobilisation, firms are authorised, but with a restriction, to enable them to have the certainty of being authorised before committing to costly infrastructure builds and staff hire. It is intended to address barriers to entry that some applicants face, such as having the necessary capital or costly hire and IT build. Option B enables firms to submit a shorter application, which focuses on essential elements such as business case, capital, liquidity and key senior appointments. The remaining documentation, such as detailed policies and procedures, is submitted during the mobilisation period.
33. The authorisation process for applicants applying to be a bank or building society is separated into three stages:
- (i) Pre-application.¹⁷ This is designed to help the prospective applicant understand the authorisation process and to receive some feedback from the PRA and FCA on its proposals. This stage will include a number of structured discussions with the PRA and FCA as appropriate. To initiate pre-application, a prospective applicant must send a slide-pack to the PRA, including high level details of:
- the proposed business model;
 - ownership structure;
 - details of any proposed board members and senior members already identified; and
 - the applicant's capital and liquidity strategy.

¹⁵ [FCA Guide to Authorisation as a Bank](#).

¹⁶ For example, where banks regulated in other jurisdictions seek to convert pre-existing branches in the UK to legal subsidiaries.

¹⁷ A full description of the process for applying for PRA authorisation is set out on the PRA's website: [BoE Guide to Authorisation Process](#).

- (ii) **Assessment.** The PRA and FCA will assess new applications against the Threshold Conditions (see further at paragraph 34) and where judged by both that an applicant meets the Threshold Conditions and regulatory requirements (eg capital and liquidity), the PRA, following receipt of the consent of the FCA, will grant authorisation to the applicant firm. For those going through the mobilisation option (Option B), this authorisation will include a restriction on the activities they can carry on until fully mobilised.
- (iii) **Mobilisation.** This stage applies to ‘Option B’ applicants and is primarily designed to deal with the operational elements of becoming a fully functioning bank (for example, seeking additional capital or implementing full IT infrastructure). Mobilisation will normally be discussed at the pre-application stage.

Satisfying the Threshold Conditions

34. When authorising a firm, the PRA and the FCA must ensure that the applicant firm will currently satisfy, and will continue to satisfy, the Threshold Conditions for which each regulator is responsible. Where a firm is seeking to become a dual-authorized firm, the PRA and FCA are responsible for separate Threshold Conditions. The PRA and the FCA’s Threshold Conditions are set out in statute,¹⁸ but in summary judging new firm applications against the PRA and FCA Threshold Conditions will include consideration of the following matters:
- Viability of the business plan.
 - Capital and liquidity.
 - Governance arrangements (including ownership, legal structure and management).
 - Risk management and controls.
 - Resolvability¹⁹ of the applicant firm (relevant to the PRA’s assessment of an applicant bank, building society or credit union).²⁰

¹⁸ Set out in Schedule 6 to FSMA, as amended by the Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013.

¹⁹ For example, how easy it would be to put the bank into bankruptcy or restructuring while inflicting the minimal damage possible on the rest of the UK financial system.

²⁰ Firms judged to be resolvable are eligible for lower capital requirements (as set out in the Barriers to Entry report).

Granting or refusing a firm's application

35. The PRA and the FCA have committed to assess an application within six months from the date they receive a complete application.²¹ For dual-regulated firms, the FCA must also give consent within the same timeframe.
36. If the PRA grants an application for Part 4A permission, it will send the firm a scope of permission notice that sets out the regulated activities the firm has permission to carry on, and any requirements or limitations placed on the firm's permission.
37. If proposing to refuse an application, the PRA will issue a warning notice to the applicant prior to issuing a decision notice of refusal. Such decisions are appealable to the Upper Tribunal (Tax and Chancery Chamber).²²

Ongoing compliance: PRA Rulebook and the Fundamental Rules

38. Firms must ensure they are compliant with all applicable PRA rules and directly applicable EU regulations,²³ including the Fundamental Rules²⁴ as set out in the PRA Rulebook. The Fundamental Rules require firms to act in accordance with the PRA's 'safety and soundness' objective, by setting specific high-level requirements:
 - Fundamental Rule 1: A firm must conduct its business with integrity.
 - Fundamental Rule 2: A firm must conduct its business with due skill, care and diligence.
 - Fundamental Rule 3: A firm must act in a prudent manner.
 - Fundamental Rule 4: A firm must at all times maintain adequate financial resources.
 - Fundamental Rule 5: A firm must have in place effective risk strategies and risk management systems.

²¹ If the application is judged incomplete on receipt, the statutory deadline for assessment is 12 months from the date of receipt.

²² The appeal body for decisions in financial services cases made by the FCA, PRA, The Pensions Regulator, BoE, Treasury or Ofgem.

²³ The term 'directly applicable' in the context of EU legislation means that it applies directly to firms and/or individuals within the EU, without first having to be transposed into domestic law.

²⁴ [BoE Policy Statement outlining Fundamental Rules](#).

- Fundamental Rule 6: A firm must organise and control its affairs responsibly and effectively.
 - Fundamental Rule 7: A firm must deal with its regulators in an open and co-operative way, and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.
 - Fundamental Rule 8: A firm must prepare for resolution²⁵ so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services.
39. The Fundamental Rules are supported by more detailed rules, contained in the PRA Rulebook,²⁶ and directly applicable EU regulations. The Rulebook contains rules and directions issued under the PRA's FSMA powers. Supervisory statements issued by the PRA provide additional general guidance where necessary.

Reporting to the PRA

40. The PRA works closely with the FCA in the collection and management of regulatory data, most of which is collected by the FCA through its GABRIEL online system.

Supervision and intervention by the PRA

41. The PRA supervises firms to judge whether they are 'safe and sound', and whether they meet, and are likely to continue to meet, the Threshold Conditions. Its approach is forward-looking; it assesses firms not just against current risks, but also against those that could plausibly arise in the future.
42. Where the PRA judges it necessary to intervene, it generally aims to do so at an early stage. It focuses on those issues and those firms that pose the greatest risk to the stability of the UK financial system, and the frequency and intensity of supervision applied by the PRA to a particular firm increases in line with the risk it poses.
43. The PRA works closely with the FPC, which is able to make recommendations and give directions to the PRA. The PRA also co-operates closely with the rest of the BoE on, for example, market intelligence and oversight of critical financial infrastructure, and with the Bank's Resolution Directorate on

²⁵ Resolution is the process by which the authorities can intervene to manage the failure of a firm, with minimum impact on the rest of the financial market. The BoE seeks to ensure that firms can fail without causing the type of disruption that the UK experienced in the recent financial crisis, without exposing taxpayers to loss.

²⁶ [PRA Rulebook](#).

resolution planning, contingency planning for firm failure and operational resilience.

44. The FS Act 2012 requires the PRA to investigate and report to the Treasury on events which indicate possible regulatory failure.

Regulatory capital framework

Basel Accords I, II & III

45. The Basel Accords – Basel I, Basel II and Basel III – is a set of recommendations for regulations in the banking industry. They are issued by the Basel Committee on Banking Supervision (BCBS), a committee made up of representatives of banking supervisory authorities from major economies and banking hubs, providing a forum for regular co-operation on banking supervisory matters, and to encourage convergence toward common standards. It is expected that member authorities and other nations' authorities will take steps to implement BCBS recommendations in their own national regulatory frameworks, whether in statutory form or otherwise. The BCBS is part of the Bank for International Settlements.
46. Basel I – issued by the BCBS in 1988 – set out for the first time minimum capital adequacy requirements for banks (see further at paragraph 53). Basel II was issued in June 2004, building on and extending the recommendations first introduced by Basel I. It has since been extended and now (mostly) superseded by Basel III.
47. Basel II defined the 'three pillars concept' underlying effective banking regulation, which divides types of regulation into three categories:
 - (i) Pillar 1: minimum capital requirements.
 - (ii) Pillar 2: supervisory review.²⁷
 - (iii) Pillar 3: market discipline.
48. Basel III places new capital, leverage and liquidity requirements on banks. It was scheduled to be introduced by 2015; however implementation into domestic regulation has twice been extended, most recently to 31 March 2019. The EU Capital Requirements Directive IV (see further below) imposes the standards set out in Basel III on EU member states, and that Directive has

²⁷ In the UK, this is review by the PRA and FCA (as appropriate).

been transposed into UK law by the PRA,²⁸ which will also be responsible for ongoing compliance with its requirements.

The EU Capital Requirements Directive IV (CRD IV)

49. The Capital Requirements Directive IV (CRD IV) is an EU legislative package covering prudential rules for banks, building societies and investment firms. The EU text was published in the Official Journal of the EU on 27 June 2013. The majority of the rules contained in the legislation have been applicable since 1 January 2014.
50. CRD IV comprises:
 - the Capital Requirements Regulation (CRR), which is directly applicable to firms across the EU, and implements the Basel III standards on capital, leverage ratios, liquidity and related matters such as large exposures and standardised regulatory reporting; and
 - the Capital Requirements Directive (CRD), which must be implemented through national law, and which makes changes to rules on corporate governance, remuneration and introduces capital buffers.
51. CRD IV is a maximum harmonisation Directive,²⁹ meaning national authorities have little discretion to apply standards other than those set out in CRD IV, to create a level playing field in banking regulation across all EU member states.
52. In December 2013 the PRA published a Policy Statement³⁰ setting out its Rules and Supervisory Statements in order to transpose CRD IV into UK law.

Capital adequacy, leverage and liquidity requirements

53. This section of the paper will describe at a high level the capital adequacy requirements imposed on banks operating in the UK by the PRA (the 'Pillar 1'

²⁸ The provisions of the Capital Requirements Directive were transposed into UK law by inclusion in the PRA Rulebook. Under paragraph 16 Schedule 1ZB FSMA, the PRA is able to legislate through the making of rules. The Capital Requirements Regulation is directly applicable to firms, so did not need to be transposed into UK law.

²⁹ Most EU legislation is not directly applicable, and instead has to be transposed by the governments of the member states into domestic law, in order to be binding on the citizens of those member states. If a piece of EU law is described as 'maximum harmonisation', this means that when a member state transposes it into domestic law, the resulting domestic law must meet the standards set out in the Directive, but must not exceed the terms of the original EU legislation. This creates a level playing field between member states. 'Minimum harmonisation' means that the original piece of EU legislation contains only the minimum requirements that must be transposed into domestic law; member states are free to include more onerous requirements if they wish (but cannot 'water down' the original EU law). It is common for EU legislation to consist of a mixture of maximum harmonisation and minimum harmonisation clauses.

³⁰ [Policy Statement on transposing CRD IV](#).

aspects of the Basel Accords). As explained above, these requirements derive from the Basel Accords via CRD IV.

54. The aim of the capital adequacy regime is to require banks always to hold a certain amount of 'safe' capital resources (ie capital that is not owed to anybody) to absorb some or all of its losses in the event of a crisis.
55. The Basel Accords identify two types of capital that make up a bank's 'capital resources' – ie classes of capital which can be used by the bank to shore itself up in the event of crisis:
 - Tier 1 capital – this is the safest form of capital, and is, essentially, shareholders' equity, which does not have to be repaid except at the bank's discretion and therefore can absorb losses without the bank becoming bankrupt.
 - Tier 2 capital – this will absorb losses only in the event that a bank is wound up, and so provides a lesser degree of protection to depositors than Tier 1 capital.
 - *Tier 1 and Tier 2 capital*
56. Tier 1 (or 'core') capital is the core measure of a bank's financial strength from a regulatory point of view. It is composed of capital that ordinarily does not need to be repaid to anyone, and so is the safest source of funding to absorb a bank's losses, while allowing the bank to continue in operation.
57. Tier 1 capital is formed of two types of capital:
 - (i) Common Equity Tier 1 Capital (CET1) (ie shareholders' equity: ordinary shares, reserves, retained earnings, share premiums). CET1 is subordinate to all other claims on a bank's capital and there is no obligation to pay a dividend. CET1 provides the front line of defence in a banking crisis, as it does not have to be repaid to anyone.
 - (ii) Additional Tier 1 Capital (AT1): AT1 is senior only to ordinary shares, with discretion to pay a coupon, and usually callable only after five years. AT1 is formed of securities that are a hybrid of debt and equity. Because in certain circumstances AT1 must be repaid to the holder of the security, it is the second line of defence in a crisis.
58. Tier 2 capital represents 'supplementary capital'. This comprises debt-like instruments, with mandatory coupon payments, senior to Tier 1 instruments and subordinate only to senior creditors. Tier 2 capital will therefore only

absorb losses in the event a bank is wound up. In regulatory terms, Tier 1 and Tier 2 together are referred to as a bank's 'Capital Resources'.

59. CET1 deals with a smaller insolvency crisis by wiping out shareholder equity. In a larger crisis, AT1 is wiped out. In both cases, the bank would survive (albeit in a weakened state). In a still bigger crisis which renders the bank insolvent, Tier 2 capital should be sufficient to absorb the insolvency losses without threatening customer deposits.

- *Capital Adequacy Ratio*

60. The preceding section described the types of capital a bank must hold in order to protect its depositors in the event of a crisis. The following section describes the calculations that are used to determine how much of each type of capital a bank must hold.
61. The Capital Adequacy Ratio (CAR) is, broadly speaking, the ratio of a bank's capital to its risk. Maintaining a sufficiently high ratio of capital to assets (including investments, loans and other financial instruments, as well as physical assets), weighted according to the level of risk each asset carries, is key to ensuring that a bank can absorb any losses that stem from those assets, protecting depositors and promoting the stability of financial systems.
62. National regulators (in the UK, the PRA) monitor a bank's CAR to ensure that it can absorb a reasonable amount of loss should a crisis event arise.

$$\text{Capital Adequacy Ratio} = \frac{\text{Capital Resources}}{\text{Risk weighted Assets}}$$

63. In calculating the CAR, a bank's 'Capital Resources' (ie the numerator) comprises Common Equity Tier 1 (CET1), Additional Tier 1 Capital (AT1) and Tier 2 Capital (as explained at paragraph 58).
64. Risk-weighted Assets ('RWA' – the denominator in the equation above) are the total of assets held by the bank, each weighted for risk. Risk weights can reflect credit risk, market risk and operational risk. Typically, credit risk³¹ represents by far the largest component in firms' RWA bases. For example, a bank will need to hold a greater level of capital resources to cover a high-risk mortgage than it will to cover sovereign debt.

³¹ Credit risk is the risk of losses arising from a borrower or counterparty failing to meet its obligations to pay as they fall due.

65. In order to apply a risk weight to each asset it holds, a bank has two approaches available:
- (i) Standardised Approach – using standardised risk weights set out in CRD IV.³²
 - (ii) Internal Ratings Based (IRB) approach – risk weights based on a firm’s own estimates of risk parameters.³³ Firms are responsible for validating IRB parameters. The PRA is responsible for reviewing firms’ IRB models and granting approval for their use where the IRB requirements are met.
66. As an example, using the Standardised Approach, cash-in-hand usually has zero risk weight, while the riskiest loans will carry a risk weight of 150% of their face value.
67. Banks are required to have a CAR of at least 8%, comprising a minimum of 6% Tier 1 Capital (made up of a minimum of 4.5% CET1 and 1.5% AT1) and 2% Tier 2 Capital.
- *Leverage Ratio*
68. The leverage ratio is designed to complement the risk-weighted framework (ie the CAR calculation) by abstracting from any distinctions in riskiness of different asset types, as it treats all assets on the balance sheet equally. The leverage ratio limits banks’ ability to expand their operations in just one asset class.³⁴ The leverage ratio places a floor on the minimum capital that banks must hold.
69. An FPC consultation³⁵ published in October 2014 on the review of the leverage ratio gives significant detail on the differences between the capital (ie risk-weighted) regime and the leverage regime, and explains their relative merits and flaws.

³² In December 2014 the Basel Committee published a [consultation](#) on proposed revisions to the risk weights. The revisions are intended to address existing ‘weaknesses’ in the standardised approach (SA) to credit risk, including lack of granularity and risk-sensitivity. It has been claimed that the SA provides an insufficient number of risk weight buckets that fail to differentiate between different risk profiles. The consultation closed on 27 March 2015. The Basel Committee has published [comments](#) received on its consultation, but at the date of publication of this paper had not responded.

³³ For more detail on IRB, see Basel Committee on Banking Supervision, [An Explanatory Note on the Basel II IRB Risk Weight Functions](#), July 2005.

³⁴ For example, a bank might wish to focus on riskier loans, as these have the potential to be more profitable than other asset classes. The leverage ratio requirements would act to constrain the bank’s ability to focus its operations too heavily on such loans.

³⁵ [FPC review of leverage framework](#).

In summary, the leverage ratio measures Tier 1 Capital over the Leverage Exposure Measure,³⁶ which is a measure of assets not weighted for risk:

$$\text{Leverage Ratio} = \frac{\text{Tier 1 Capital}}{\text{Leverage Exposure Measure}}$$

70. The FPC's consultation explains (page 14 onwards) that below a certain average risk weight³⁷ (35%), only the leverage ratio will bind a firm. However, when a bank's average risk-weight reaches 35%, the risk-weighted requirements begin to have a noticeable effect, and further increases in measured risk will increase a bank's capital requirement.³⁸ The leverage ratio requirement will consequently have a relatively greater impact on certain types of banking business models that attract relatively low-risk weights.³⁹
71. The leverage ratio can be described as a guardrail against risks arising from errors in the standardised and IRB approaches described above, as well as unforeseeable events, and to prevent unsustainable bank balance sheet stretch (eg in a particular asset class).
72. Following on from the publication of the FPC's consultation paper, on 6 April 2015 the Statutory Instrument⁴⁰ giving the FPC the Power of Direction over the leverage ratio framework came into force. Under that SI, the FPC can make a direction to the PRA to impose a minimum leverage ratio on banks. If the FPC makes a direction to the PRA under that Statutory Instrument, the PRA leverage ratio would comprise (as set out in the October 2014 consultation document):
- 3% minimum requirement for all PRA-regulated banks, building societies and investment firms;
 - countercyclical leverage ratio buffer applied to all firms and set at 35% of equivalent countercyclical capital buffer (see further on capital buffers below); and

³⁶ The 'Leverage Exposure Measure' is very similar to total accounting assets.

³⁷ Average risk weight is measured as risk-weighted assets/total assets.

³⁸ The FPC's average risk-weight indicator for a peer group of major UK banks stood at 39.9%, as of the latest reading. This suggests a 3% minimum requirement is consistent with the FPC's leverage ratio framework playing a strong complementary role alongside the risk-weighted framework, but with risk-weighted requirements forming the binding constraint for a majority of UK firms most of the time (see page 16 of [The Financial Policy Committee's review of the leverage ratio](#), October 2015).

³⁹ By and large there are two types of business models most likely to be impacted by the introduction of the leverage ratio, specifically: banks and investment firms that have a high proportion of investment banking activities, such as trading in intra-financial sector products (ie securities, repo and derivatives market activity); and banks and building societies that have PRA permission to use internal models to determine risk-weighted capital requirements for their mortgage books (see page 26 of the [FPC's review of the leverage ratio](#)).

⁴⁰ [The Bank of England Act 1998 \(Macro-prudential Measures\) \(No.2\) Order 2015](#).

- supplementary leverage ratio buffer applied to firms with a systemic risk buffer in the risk-weighted framework, also set at 35% of that corresponding buffer.
73. The proposed FPC framework will apply initially only to systemically-important banks.⁴¹
- *Liquidity requirements*
74. Basel III introduced a new liquidity⁴² ratio, which will come into force on 1 October 2015. The 'Liquidity Coverage Ratio' requires a bank to hold sufficient high-quality liquid assets to cover its total net cash outflows over 30 days.
- *Capital Adequacy Buffers*
75. Basel III included recommendations for the introduction of Capital Adequacy Buffers, which offer an additional layer of protection beyond the basic Tier 1 capital adequacy requirements. All capital buffers must be provided solely out of CET1 capital. A firm can use the CET1 capital set aside to cover the buffers for other purposes, however where a firm does so it will become subject to increasing restrictions on distributions of earnings (dividends, payment of coupons, variable remuneration etc) and must compile and implement a plan to restore its capital position. Five capital buffers are required for PRA-regulated firms:
- (i) Conservation buffer: a buffer of 2.5% CET1 to RWA.
 - (ii) Counter-cyclical buffer: the size of this buffer alters through economic cycles, based on policy decisions made by the FPC and PRA.

⁴¹ Defined in the consultation paper as 'G-SIIs and other major domestic UK banks and building societies, including ring-fenced banks [ie under the new ring-fencing regime]'. The FPC has further signalled that it intends to expand the scope of the leverage framework to all PRA-regulated firms from 2018, subject to a review in 2017. This review will take into account developments on an international leverage ratio framework.

⁴² Liquidity refers to a firm's ability to meet its short-term financial commitments and/or its ability to sell assets quickly to raise cash. Solvency refers to a firm's ability to meet its long-term financial commitments. A solvent company is one that owns assets (eg cash, property, plant and equipment) worth more than it owes; in other words, it has a positive net worth and a manageable debt load. A firm with adequate liquidity may have enough cash available immediately to pay its bills, but it may nonetheless be insolvent if its total assets are worth less than the overall amount it owes. Solvency and liquidity are equally important, and healthy companies are both solvent and possess adequate liquidity.

- (iii) Global systemically important institutions buffer: imposed on Global Systemically Important Institutions⁴³ (G-SIIs), providing extra protection in the event of a crisis.
- (iv) The systemic risk buffer: imposed to prevent or mitigate long term cyclical risks posed by 'systemic risk buffer institutions' (which are identified using an FPC framework and PRA discretion). The Treasury has exercised the discretions allowed by the CRD to enable the application of this buffer only to ring-fenced banks to protect 'core services' (following the Independent Commission on Banking's recommendations, see further at paragraph 233) and large building societies.
- (v) Capital planning buffer: this is a Pillar 2 buffer (referred to as 'Pillar 2B'),⁴⁴ which is determined by stress-testing individual firms, to ensure a firm has enough capital to continue to meet its minimum capital requirements through a severe stress over the next three to five years. This is set at the PRA's discretion.

The BoE's role in Financial Market Infrastructure supervision – payment systems

- 76. The BoE has responsibility for overseeing certain payment systems, as well as securities settlement systems and central counterparties. Its oversight powers derive from Part 5 (Interbank Payment Systems) of the Banking Act 2009 (the Banking Act).⁴⁵
- 77. Payment systems are not automatically supervised by the BoE, and there is no authorisation process. The Treasury specifies which payment system should be recognised and therefore fall within the scope of the BoE's regime, in accordance with section 185 of the Banking Act.
- 78. Current recognised payment systems are:
 - Bacs;⁴⁶

⁴³ On 27 February 2015, in accordance with the Capital Requirements Directive, the PRA disclosed the 2014 list of UK headquartered Global Systemically Important Institutions (G-SIIs) and their respective subcategories. The PRA also disclosed the applicable G-SII buffers. These are: HSBC (2.5%); Barclays (2%); RBS (1.5%); and Santander (1%). These buffers will be phased in from 1 January 2016, coming into full force by 1 January 2019 in line with the CRD. The list of G-SIIs will be updated annually.

⁴⁴ Under Basel II and III, supervisory authorities may set requirements for additional funds where they deem it necessary given firm-specific risks. The PRA implements this via its Pillar 2 regime which consists of a Pillar 2A requirement and a Pillar 2B buffer (currently referred to as the capital planning buffer).

⁴⁵ [Part 5 \(Interbank Payment Systems\) Banking Act 2009](#).

⁴⁶ BACS (Bankers' Automated Clearing Services) is a scheme for the electronic processing of financial transactions within the UK. Direct debits and direct deposits are made using the BACS system. The payments

- CHAPS;⁴⁷
- CLS;⁴⁸
- CREST;⁴⁹
- LCH.Clearnet Ltd;⁵⁰
- Visa Europe;⁵¹
- Faster Payments Service;⁵² and
- ICE Clear Europe.⁵³

79. For recognised payment systems, the international CPMI-IOSCO Principles for Financial Market Infrastructure form the basis for oversight and supervision.⁵⁴ These Principles apply to financial market infrastructures (ie including payment systems) that facilitate the clearing, settlement, and recording of monetary and other financial transactions.

80. The BoE's oversight regime concerns only the stability of recognised payment systems and does not give rise to any responsibility for relationships between members of payment systems and individual users or consumers; these responsibilities fall to the FCA and PSR.

take three working days to clear: they are entered into the system on the first day, processed on the second day, and cleared on the third day. The system is owned and controlled by a group of UK banks, and operated by BACS Payment Schemes Limited.

⁴⁷ The Clearing House Automated Payment System or CHAPS offers same-day sterling fund transfers. It tends to be used for high-value transactions, such as property purchases (including residential mortgages).

⁴⁸ CLS (originally Continuous Linked Settlement) is a specialist US financial institution that provides settlement services to its members in the foreign exchange market.

⁴⁹ CREST is a UK-based central securities depository that holds UK equities and UK gilts as well as Irish equities and other international securities, in electronic form. It is owned and operated by Euroclear. The name is not an acronym for anything. CREST also assists in the payments of dividends to shareholders.

⁵⁰ LCH.Clearnet is a European independent clearing house that serves major international exchanges, as well as a range of OTC markets. It is a major clearer of financial assets such as bonds, repurchase agreements (repos), interest rate swaps, commodities, securities, exchange traded derivatives, credit default swaps, energy contracts, freight derivatives.

⁵¹ Operated jointly by Visa Europe and Visa UK.

⁵² Faster Payments Service (FPS) is a UK banking initiative to reduce payment times between different banks' customer accounts from three working days using the BACS system, to a few hours. In contrast to CHAPS (which also offers a same-day service), FPS is focused on smaller value transactions – individual banks sets the upper limit for FPS payments, with some allowing up to £100,000.

⁵³ ICE Clear Europe provides central counterparty clearing services for ICE's global energy markets. It provides secure clearing, risk management and physical delivery services for ICE markets across interest rate, equity index, agricultural and energy derivatives, as well as European credit default swaps.

⁵⁴ The Committee on Payments and Market Infrastructures (CPMI) is part of the Bank for International Settlements. The CPMI promotes the safety and efficiency of payment, clearing, settlement and related arrangements, thereby supporting financial stability and the wider economy. In April 2012, the CPMI and the Technical Committee of the International Organization of Securities Commissions (IOSCO) published Principles for financial market infrastructures (PFMIs). The PFMIs are part of a set of 12 key standards that the international community considers essential to strengthen and preserve financial stability.

81. The BoE has entered into a joint Memorandum of Understanding (MoU)⁵⁵ with the FCA, PRA and PSR, covering payment systems regulation.

The Financial Conduct Authority

82. The FCA replaced the FSA on 1 April 2013. It is accountable to the Treasury and Parliament, but operates independently of government and is funded entirely by the firms it regulates.⁵⁶ The Board of the FCA is appointed by the Treasury,⁵⁷ and sets FCA's strategic aims and policy, but day-to-day decisions and staff management are the responsibility of the Executive Committee.
83. The FCA's strategic objective is to ensure that the relevant markets function well. To support this, it has three statutory objectives:⁵⁸
- (i) to secure an appropriate degree of protection for consumers;
 - (ii) to protect and enhance the integrity of the UK financial system; and
 - (iii) to promote effective competition in the interests of consumers.
84. The FCA is responsible for the prudential regulation of those financial services firms not supervised by the PRA, such as asset managers, payment service providers and independent financial advisers.
85. The FCA supervises firms differently depending on their size and the nature of their business. This includes:
- continuous conduct assessment for large firms and regular assessment for smaller firms;
 - monitoring products to ensure firms play fairly and do not compromise consumer interests;
 - responding quickly and decisively to events or problems that threaten the integrity of the industry; and
 - ensuring firms compensate consumers when necessary.

⁵⁵ [MoU](#) outlining how the PSR will interact with the BoE, the FCA and the PRA.

⁵⁶ FCA corporate governance.

⁵⁷ Jointly with BIS in the case of two of the non-executive director positions.

⁵⁸ Set out in section 1B FSMA (as amended by the FS Act).

The FCA Handbook

86. Firms regulated by the FCA are bound by the rules contained in the FCA Handbook.⁵⁹ The Handbook was developed out of the FSA Handbook, which was split between the FCA and the PRA to form two new handbooks, one for the FCA and one for the PRA (the PRA refers to this as its Rulebook as noted in paragraph 38).
87. The FCA's Handbook shows all rules applicable to banks, including those provisions that are imposed and monitored only by the PRA. It is clearly marked in the Handbook where provisions apply only to dual-regulated firms.

Concurrent competition powers of the FCA

88. One of the FCA's operational objectives is to promote competition in the interests of consumers. As a result it can, for example, make rules, and exercise certain firm specific powers to advance that objective. In addition, the FCA has a duty to promote effective competition in the markets for financial services which requires it, so far as is compatible with its consumer protection and integrity objectives, to discharge its general functions in a way that promotes competition in the interests of consumers.
89. The Financial Services (Banking Reform) Act 2013 (FSBRA) amended FSMA to give the FCA powers concurrent with the CMA to:
 - enforce the competition law prohibitions under Chapters I and II Competition Act 1998 (CA98) in relation to the provision of financial services; and
 - conduct market studies and make market investigation references to the CMA under the Enterprise Act 2002, for detailed review of a particular financial services market.
90. The same concurrent powers, and a competition objective, were also granted to the new Payment Systems Regulator (see further at paragraph 124).
91. The concurrent competition law powers came into force on 1 April 2015. In line with the changes to the wider competition law concurrency regime which came into force on 1 April 2014, and which were designed to ensure that sector regulators make greater use of their competition powers, the FCA will

⁵⁹ [FCA Handbook](#).

be required to consider whether it would be more appropriate to use its Competition Act powers before using certain of its regulatory powers.

92. The procedures set out in the Competition Act 1998 (Concurrency) Regulations 2014⁶⁰ (the Concurrency Regulations) and the CMA's guidance⁶¹ on the concurrent application of competition law to regulated industries will also become fully applicable to the FCA on 1 April 2015. The Concurrency Regulations and Guidance deal with issues such as case allocation between the CMA and concurrent regulators (based on whether the CMA or the relevant regulator is better placed to deal with a particular case), the transfer of cases between the CMA and the regulators, information sharing and use of staff and resources.
93. The FCA and CMA entered into an MoU on 12 June 2014,⁶² setting out the framework for co-operation between the two authorities in relation to competition issues, consumer protection and access to payment systems. The FCA and CMA intend to enter into a revised MoU to reflect the FCA's concurrent powers which took effect on 1 April 2015.
94. In January 2015, the FCA issued for consultation⁶³ draft guidance in anticipation of obtaining concurrent competition powers under the CA98 on 1 April 2015. This explains the relationship between the FCA's concurrent CA98 powers and its regulatory powers under FSMA. It also explains the FCA's proposed approach to selecting CA98 investigations, conducting and concluding investigations (including settlements). The FCA also consulted on a proposed amendment to the Supervision Manual (part of the FCA Handbook) to clarify that FCA-regulated firms are obliged to notify the FCA of any competition law infringements that have or may have occurred.
95. The FCA also consulted on draft guidance on market studies and market investigation references. This explains how the FCA will conduct market studies under either its FSMA powers or under the Enterprise Act 2002, the differences between these two types of market study, and how the FCA might choose which of its powers to use. It also explains the factors that the FCA will take into account in deciding whether to make a market investigation reference to the CMA. The consultation closed on 13 March 2015.
96. The FCA and the CMA must consult each other before exercising any of their concurrently held functions under the Enterprise Act 2002 or CA98, and must

⁶⁰ [The Competition Act 1998 \(Concurrency\) Regulations 2014.](#)

⁶¹ [CMA's Guidance on the concurrent application of competition law to regulated industries.](#)

⁶² [MoU between CMA and FCA.](#)

⁶³ [FCA consultation on concurrency.](#)

not exercise the same functions in relation to the same matter if the other has already exercised those functions.

97. Where the FCA exercises any of its concurrent competition functions, its general duties under FSBRA do not apply. This is to ensure that the FCA is free to exercise its new competition functions without being bound by general duties to which the CMA would not itself be bound when exercising those functions.

Anti-money laundering provisions

98. The FCA is the competent authority for supervising compliance of most credit and financial institutions with the Money Laundering Regulations 2007.
99. All firms that are subject to the Money Laundering Regulations 2007 (including all banks) must put in place systems and controls to prevent and detect money laundering. Many authorised firms (including banks) have an additional regulatory obligation to put in place and maintain policies and procedures to mitigate their money laundering risk.⁶⁴
100. These include systems and controls to identify, assess and monitor money-laundering risk as well as customer due diligence (CDD) measures and monitoring to manage the risks identified. Firms must determine the extent of CDD measures and monitoring on a risk-sensitive basis depending on the type of customer, business relationship and product or transaction.
101. Firms must ensure the policies and procedures they establish in accordance with the requirements of the FCA Handbook include systems and controls that:
- enable firms to identify, assess, monitor and manage money laundering risk; and
 - are comprehensive and proportionate to the nature, scale and complexity of a firm's activities.
102. A firm must carry out a regular assessment of the adequacy of its systems and controls to ensure that they continue to comply with the Handbook.
103. A firm should ensure that its AML systems and controls include:

⁶⁴ The AML requirements the FCA imposes on banks are contained in the FCA Handbook at [SYSC 6.1](#) and [SYSC 6.3](#), which should be read in conjunction with other relevant guidance, such as the Financial Crime Guidance and Joint Money Laundering Steering Group Guidance.

- appropriate training for its employees in relation to money laundering;
- appropriate provision of information to its governing body and senior management, including a report at least annually by that firm's money laundering reporting officer (MLRO) on the operation and effectiveness of those systems and controls;
- appropriate documentation of its risk management policies and risk profile in relation to money laundering, including documentation of its application of those policies;
- appropriate measures to ensure that money laundering risk is taken into account in its day-to-day operation, including in relation to:
 - the development of new products;
 - the taking-on of new customers; and
 - changes in its business profile;
- appropriate measures to ensure that procedures for identification of new customers do not unreasonably deny access to its services to potential customers who cannot reasonably be expected to produce detailed evidence of identity.

104. Firms must ensure that their systems and controls enable them to identify suspicious transactions. They are required under the Proceeds of Crime Act 2002 to submit a Suspicious Activity Report to the National Crime Agency where they know or suspect that a person is engaged in, or attempting, money laundering.

105. Firms must ensure that they are able to demonstrate the extent of their CDD measures is appropriate in view of the risks of money laundering and terrorist financing. All firms who are subject to the AML rules must allocate overall responsibility for AML systems and controls to a director or senior manager. They must also appoint a Money Laundering Reporting Officer (MLRO), who should act as a focal point for the firm's anti-money laundering activity.

Payment Systems Regulator

106. FSBRA also created a new economic regulator, the Payment Systems Regulator (PSR) with concurrent competition powers in relation to the participation in payment systems. In April 2014, the PSR was incorporated as a subsidiary of the FCA, but has its own statutory objectives and governance,

including a Managing Director and Board. It has been fully operational since 1 April 2015.

107. FSBRA provides that the PSR will regulate those domestic payment systems that are designated by the Treasury. The Treasury may designate any payment system where deficiencies in the design of the system or any disruption of its operation would be likely to have serious consequences for current or prospective users. The PSR can consider commercial disputes in the payment systems sector, using the powers described below.
108. Following consultation,⁶⁵ on 19 March 2015 the Treasury designated interbank and card payment systems for regulation by the PSR from 1 April 2015, which are:
- Bacs;
 - CHAPS;
 - Faster Payments Service;
 - LINK;⁶⁶
 - C&C (Cheque & Credit);
 - Northern Ireland Cheque Clearing;
 - MasterCard;⁶⁷ and
 - Visa Europe.
109. For each designated system, all the ‘participants’ in that payment system will fall under the PSR’s regulatory remit.⁶⁸ Participants in a payment system include the operator that manages or operates that system, the payment service providers (eg credit institutions like banks and building societies, Authorised Payment Institutions, Electronic Money Institutions) using that system, and the infrastructure providers to the payment system. The PSR’s concurrent competition powers apply more broadly to participation in any payment system, including non-designated payment systems.

⁶⁵ [Treasury consultation on designation of payment systems.](#)

⁶⁶ LINK is a shared interbank network of automated teller machines (ATMs) operating in the UK. Its members are banks and building societies issuing LINK ATM cards, and independent ATM operators that do not issue cards. Virtually every ATM in the UK is connected to LINK. The LINK network infrastructure is operated by VocaLink. The LINK ATM scheme is a separate entity which is run by the scheme members.

⁶⁷ Operated by MasterCard Inc.

⁶⁸ Save for functions falling to the FCA’s regulatory remit under the Payment Services Regulations 2009.

110. On 25 March 2015, following a consultation process the PSR published a Policy Statement⁶⁹ setting out how it will regulate the payment systems industry. The Policy Statement contains the PSR's regulatory approach, the guiding principles it will follow and a set of policies, directions and guidance that clarifies what regulation by the PSR means for the industry.

PSR's relationship with other financial regulators

111. Sections 98-102 FSBRA⁷⁰ govern the PSR's relationship with the other financial regulators (the FCA, PRA and BoE). Those sections provide the BoE, PRA and FCA a limited right of veto over the PSR's actions, and also place a general obligation on all four authorities to co-ordinate the exercise of their relevant functions. Relevant functions means, in relation the PSR, its functions under Part 5 of FSBRA; in relation to the BoE, its functions under Part 5 of the Banking Act 2009; and in relation to the FCA and the PRA, their respective functions under FSMA 2000.

Power of veto

112. The veto power can only be exercised where certain conditions are fulfilled. The detailed conditions are specific to each authority, and are set out in the legislation, but in general terms, the veto can be exercised where the authority exercising it believes it is necessary to prevent an action by the PSR adversely affecting the vetoing authority's ability to achieve its own objectives. The veto cannot however be used to prevent the PSR taking an action that is required by EU law or any other international obligation of the UK.

Duty to co-ordinate exercise of functions

113. The PSR, the BoE, the PRA and the FCA are under a general obligation under FSBRA to co-ordinate the exercise of their regulatory functions. As part of this they must consult each other in connection with any proposed exercise of a relevant function in a way that may have a material adverse effect on the advancement by another of the authorities of any of its own objectives. The obligation to co-ordinate does not, however, apply where it would be incompatible with the advancement of the relevant authorities' objectives, or would impose a burden on them that is disproportionate to the benefits of doing so.

⁶⁹ [PSR Policy Statement](#).

⁷⁰ [Sections 98-102 FSBRA](#).

114. The PSR has entered into an MoU⁷¹ with the BoE, FCA and PRA, setting out how it expects the statutory duty to co-ordinate to apply. The duty to co-ordinate will reduce the likelihood that the veto powers will be used.

Interaction with Payment Services Regulations

115. Payment Services Providers (PSPs) are currently covered by the Payment Services Directive (PSD), while the PSR is the competent authority for the access provisions contained in the PSD. The FCA is the competent authority for most aspects of the PSD. The UK implemented the PSD through the Payment Services Regulations 2009, which came into effect on 1 November 2009. There is some overlap between the firms subject to FCA supervision and participants to payment systems which come within the purview of the PSR. The PSD and the Payment Services Regulations are dealt with in greater detail at paragraph 220.

The PSR's general duties

116. In discharging its general functions relating to payment systems, the PSR must, so far as is reasonably possible, act in a way that advances one or more of its payment systems objectives:⁷²

- (i) The competition objective – to promote effective competition in:
 - the market for payment systems;
 - the markets for services provided by payment systems; and
 - in the interests of those who use, or are likely to use, services provided by payment systems.
- (ii) The innovation objective – to promote the development of, and innovation in, payment systems in the interests of users of services provided by payment systems, with a view to improving the quality, efficiency and economy of payment systems – this includes in particular promoting the development of, and innovation in, infrastructure to be used for the purpose of operating payment systems.
- (iii) The service-user objective – to ensure that payment systems are operated and developed in a way that takes account of, and promotes,

⁷¹ [MoU on statutory co-operation between regulators](#).

⁷² S 49(1) FSBRA. For the PSR's objectives, see SS 50-52 FSBRA.

the interests of those who use, or are likely to use, services provided by payment systems.

The PSR's regulatory powers

117. The PSR's regulatory powers as set out in FSBRA are wide-reaching and are summarised below.

Directions

118. The PSR can give participants in regulated payment systems written specific or general directions under section 54 FSBRA:

- requiring or prohibiting the taking of specified action in relation to a system; and/or
- setting standards to be met in relation to a system.

System rules

119. The PSR has the power under section 55 FSBRA to require a system operator to establish rules for its system or to change existing rules. It may also require operators to notify it if they propose to change their rules or may require them not to change their rules without the PSR's approval. Requirements to notify changes to rules and to prohibit changes without prior approval may be general or relate to specific systems or categories of systems.

Access to payment systems

120. If a person applies to the PSR for access to a regulated payment system, the PSR can require:

- the system operator to enable the applicant to be a payment service provider in relation to the system (section 56 FSBRA).
- any payment service provider with direct access to a system to enter into an agreement with the applicant to enable the applicant to become a payment service provider in relation to the system (section 57 FSBRA). This allows smaller financial institutions or other PSPs to obtain indirect access to a payment system through a 'Sponsor Bank' (who is a direct member of the payment system in question).

Variation of agreements relating to payment systems

121. The PSR has power to vary the terms and conditions in existing agreements as follows:
- The PSR may vary the terms and conditions relating to the payment service provider's participation in the payment system (including fees or charges payable under the agreement) for any agreement between the operator of a regulated payment system and a payment service provider (ie varying an agreement relating to existing direct access to the system).
 - The PSR may vary the terms and conditions relating to the payment service provider's participation in the payment system (including fees or charges payable under the agreement) for any agreement between a payment service provider with direct access to a regulated payment system and another person for the purpose of enabling that other person to become a payment service provider (ie varying an agreement relating to existing indirect access to the system). The PSR may vary the fees or charges payable under the agreement for any agreement relating to fees or charges payable in connection with participation in a regulated payment system or the use of services provided by a regulated payment system.
122. The PSR is only able to exercise this power on the application of one of the parties to the agreement (typically the access-seeker or fee-payer).

Disposal of interest in payment systems

123. The PSR has the power to require a person who has an interest in the operator of a regulated payment system to dispose of all or part of that interest. The PSR is only able to do this if it is satisfied that, if it does not exercise its power, there is likely to be a restriction or distortion in competition in the market for payment systems or the market for services provided by payment systems. This power is subject to the consent of the Treasury. It is enforceable by civil proceedings brought by the PSR. The Small Business, Enterprise and Employment Act 2015 extends the PSR's powers of disposal to require a person who has an interest in an infrastructure provider of a regulated payment system to dispose of all or part of that interest.

Concurrent competition powers of the PSR

124. The PSR, like the FCA, has enforcement powers under Chapters I and II of the Competition Act 1998 and market study and market investigation reference powers under Part 4 of the Enterprise Act 2002, as far as these

powers relate to participation in payment systems. These powers will be exercised concurrently with the CMA.

125. The following principles apply to the PSR in relation to its concurrent competition powers:
- The PSR has a duty to consider whether it would be more appropriate to take action under its powers in the Competition Act 1998 before exercising the certain of its regulatory powers under FSBRA. This duty does not arise in all circumstances. For example, it does not arise where the PSR is considering imposing a general direction or a generally-imposed requirement.
 - In relation to its Enterprise Act 2002 concurrent powers, the PSR and the CMA must consult each other before exercising any of their concurrently held functions, and must not exercise the same functions in relation to the same matter if the other has already exercised those functions. The same rules apply to exercise by the PSR and FCA of their concurrent functions.
 - Where the PSR exercises any of its concurrent competition functions, its general duties under FSBRA do not apply. This is to ensure that the PSR is free to exercise its new competition functions without being bound by general duties to which the CMA would not itself be bound when exercising those functions.
126. Since 1 April 2014, the PSR has had competition powers under the Enterprise Act 2002 (EA02) to conduct market studies and make market investigation references to the CMA, and it will obtain its new competition powers under the Competition Act 1998 (CA98) on 1 April 2015. In January 2015, the PSR published a consultation⁷³ on proposed guidance relating to the exercise of its concurrent competition powers.
127. The consultation covers draft guidance on the PSR's powers and procedures under the Competition Act 1998. This explains the relationship between the PSR's concurrent competition powers and its regulatory powers under FSBRA. It also explains the PSR's proposed approach to selecting investigations, conducting and concluding investigations (including settlements).
128. The PSR is also consulting on draft guidance on market reviews, market studies and making market investigation references to the CMA. This explains how the PSR will conduct market reviews under its FSBRA powers or market

⁷³ [PSR consultation on concurrency](#).

studies under the Enterprise Act 2002, and how the PSR might choose which of its powers to use. It also explains the factors that the PSR will take into account in deciding whether to make a market investigation reference to the CMA.

Legislating for the banking industry

The position in the EU

129. Under the Lisbon Treaty the European Commission has the right of legislative initiative. The Directorate General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) is responsible for initiating and implementing policy in the area of banking and finance.⁷⁴
130. The European Parliament may also request the Commission to submit a proposal for new legislation. Generally, a European Parliament Committee will have prepared an own-initiative report that forms the basis of the request. The Economic and Monetary Affairs Committee deals with reports on banking and financial services. A European Parliament Member may also initiate a proposal.

Committees and expert groups

- *High-level Expert Group on reforming the structure of the EU banking sector*
131. In 2011 the Commission set up a High-level Expert Group (also named the Likaanen Group after its chairman), intended to emulate the UK's Independent Commission on Banking. Its mandate was to determine whether structural reforms of EU banks would strengthen financial stability, improve efficiency and consumer protection in addition to the regulatory reform of the EU bank sector.
 - *Economic and Monetary Affairs Committee*
 132. The Economic and Monetary Affairs Committee published an own-initiative report in June 2013, based on the Likaanen Group's findings on reforming the structure of the EU banking sector. In January 2014 the Commission

⁷⁴ In specific cases, provided for by the EU Treaties, a legislative act can also be initiated by a group of member states, the European Parliament, or on a recommendation from the European Central Bank, or at the request of the Court of Justice of the European Union or the European Investment Bank.

submitted a proposal⁷⁵ for a regulation on structural measures improving the resilience of EU credit institutions. It includes measures to ring-fence the trading and other high-risk activities of credit institutions. The proposal is currently working its way through the European Parliament, and is expected to come into force from 1 January 2017.

- *European Banking Committee*

133. The European Banking Committee was set up by the Commission in November 2003. The Committee provides advice to the Commission on banking policy issues. The Committee is composed of high-level representatives from the member states, mainly from Ministries of Finance, and observers from the European Central Bank and the European Banking Authority.

- *Expert Group on Banking, Payments and Insurance*

134. The Expert Group on Banking, Payments and Insurance is composed of experts appointed by the member states. The Expert Group provides advice to the Commission in its preparation of draft delegated acts.

- *European Banking Authority*

135. The European Banking Authority (EBA) was established in January 2011 as an independent EU Authority. The EBA has assisted the Commission in the development of the European Single Rulebook in banking.⁷⁶ The Single Rulebook will set out a single set of harmonised prudential rules for financial institutions in the EU (ie those contained in CRD IV), aiming to ensure uniform application of Basel III in all member states.

The position in the UK

HM Treasury

136. The Treasury is the government's economic and finance ministry, maintaining control over public spending, and setting the direction of the UK's economic policy. The majority of legislation affecting the banking sector is drafted by the Treasury.

⁷⁵ [European Commission proposal for a regulation on structural measures improving the resilience of EU credit institutions.](#)

⁷⁶ [European Single Rulebook in banking.](#)

Treasury Select Committee

137. The Treasury Select Committee is appointed by the House of Commons to examine and hold to account the expenditure, administration and policy of the Treasury, HM Revenue & Customs, and associated public bodies, including the BoE, FCA and PSR.
138. The Committee chooses its own subjects of inquiry. Depending on the subject, external deadlines, and the amount of oral evidence the Committee decides to take, an inquiry may last for several months and give rise to a report to the House; other inquiries may simply consist of a single day's oral evidence which the Committee may publish without making a report.

Independent Commission on Banking

139. The Independent Commission on Banking (ICB) was set up in June 2010, with Sir John Vickers as its Chair, in response to the financial crisis. The ICB's task was to examine the UK banking sector and to make recommendations on structural and non-structural measures to promote stability. The ICB published its final report (the ICB Report), including recommendations for reform of the banking sector, in September 2011. The Financial Services (Banking Reform) Act 2013 gave the Treasury and some regulators power to implement several recommendations made by the ICB including its recommendations on ring-fencing requirements (see further at paragraph 156).

Parliamentary Commission on Banking Standards

140. The Parliamentary Commission on Banking Standards was established in July 2012, as a joint parliamentary committee chaired by Andrew Tyrie MP. The Commission makes recommendations for legislative action. On 19 June 2013 the Parliamentary Commission published its final report 'Changing banking for good'. Many recommendations made by the Parliamentary Commission on Banking Standards were incorporated into FSBRA.

Department for Business Innovation and Skills

141. The Department for Business, Innovation and Skills (BIS) is the department for economic growth. The department invests in skills and education to promote trade, boost innovation and help people to start and grow a business. BIS also protects consumers and reduces the impact of regulation. BIS has supported the Treasury in drafting and consulting on secondary legislation applicable to the banking industry.

Current EU and UK Initiatives affecting the banking industry

142. The following section summarises current key initiatives and actions being taken by UK regulators, the UK government, and/or deriving from EU legislation that have an impact on the retail banking industry within the UK.

Current PRA initiatives

143. The following is a list of current key projects relevant to the retail banking sector being undertaken by the PRA.

- *Assessing capital adequacy under Pillar 2*

144. The PRA published a consultation paper⁷⁷ on 19 January 2015 setting out proposed changes to the PRA's Pillar 2 (ie supervisory) framework, including changes to its rules and supervisory statements.

145. Under the Pillar 2 framework, the PRA assesses those risks either not adequately covered, or not covered at all, under the Pillar 1 capital requirements,⁷⁸ as well as seeking to ensure that firms can continue to meet their minimum capital requirements throughout a stress event.

146. The consultation paper also introduces the content of a proposed new statement of policy on the PRA's proposed methodologies for setting firms' Pillar 2A⁷⁹ capital requirements. The proposed policy is intended to ensure that firms have adequate capital to support the relevant risks in their business and that they have appropriate processes to ensure compliance with the Capital Requirements Regulation and Capital Requirements Directive. It is also intended to encourage firms to develop and use better risk management techniques in monitoring and managing their risks. Responses to the consultation are due by 17 April 2015. The PRA intends to publish a policy statement with feedback, final rules, a supervisory statement and a statement of policy in the third quarter of 2015.

⁷⁷ [PRA consultation on changes to Pillar 2 regime](#).

⁷⁸ For example, operational risks. Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk. Pillar 1 (the capital adequacy regime) does take into account operational risks, but only using gross income as a measure of risk, which is not sufficiently risk-specific. During the recent economic downturn, incomes dropped but operational risk exposures, in many cases, remained the same or increased. The PRA therefore assesses operational risk as part of its Pillar 2 review of firms' capital adequacy.

⁷⁹ For further discussion on Pillar 2A see paragraph 144.

- *Implementation of the Deposit Guarantee Schemes Directive*

147. The PRA published a consultation paper on 6 October 2014⁸⁰ setting out proposed changes to the PRA rules in order to implement the recast Deposit Guarantee Schemes Directive.⁸¹
148. The consultation paper proposes new rules to ensure that depositors protected by the Financial Services Compensation Scheme (FSCS)⁸² can have continuity of access to their accounts during the course of a resolution, as well as changes to the single customer view (SCV)⁸³ requirements on firms. This package of measures supports orderly resolution and timely pay-outs of FSCS-covered deposits to depositors. It must be implemented by July 2015.
149. The recast DGSD reduces the speed of pay-outs from 20 to seven working days for most depositors, with full compliance by 2023. The UK already has a seven calendar day target for most depositors.
150. There are also new disclosure requirements for firms to inform depositors about compensation arrangements.

- *Total Loss Absorbing Capacity for systemically important firms*

151. On 10 November 2014, the Financial Stability Board⁸⁴ published a consultation on a proposed standard for 'Total Loss Absorbing Capacity' (TLAC) for G-SIBs. TLAC requires G-SIBs to be funded by a minimum amount of capital and unsecured, uninsured liabilities with a residual maturity of more than one year. These requirements are additional to the capital requirements placed on all banks (detailed at paragraph 45 onwards).
152. Additional regulation of G-SIBs reflects the fact that they are of such size and importance that their failure would likely have severe consequences for the economy as whole.

⁸⁰ [PRA consultation on proposed changes to the PRA rules in order to implement the recast Deposit Guarantee Schemes Directive](#).

⁸¹ Published in June 2014, the recast Deposit Guarantee Schemes Directive (DSDG) establishes common standards across the EU for protecting savings in banks and building societies. It must be implemented by 2 July 2015.

⁸² The [FSCS](#) is the UK's compensation fund of last resort for customers of authorised financial services firms. It pays compensation to depositors if a firm is unable, or likely to be unable, to pay claims against it, up to a limit of £85,000 per claimant.

⁸³ Deposit-takers are required to develop a single customer view (SCV). A SCV provides the FSCS with the information required to make a fast pay-out. Organisations will often hold multiple records for the same individual and SCV encourages clean data-keeping so that the key information can be identified quickly.

⁸⁴ The [Financial Stability Board](#) (FSB) is an international body that monitors and makes recommendations about the global financial system.

153. The TLAC standard proposed by the FSB will apply to G-SIBs no earlier than 1 Jan 2019. Separate EU requirements on LAC (Minimum Requirements for own funds and Eligible Liabilities – MREL) will apply from 1 Jan 2016, and will be set on a case-by-case basis for each banking entity in the EU.⁸⁵

- *Risk-weightings in capital adequacy requirements: Internal Ratings Based and Standardised Approach review*

154. The PRA is feeding into a BCBS exercise to review the IRB and SA approaches. The BCBS published a consultation paper on 22 December 2014⁸⁶ with proposals for substantial revisions to the SA risk weights. Under the proposals, the risk weights for residential mortgages would be assigned by reference to the exposure's loan-to-value and debt service coverage ratios, rather than the current 35% or 100% flat risk weight, with a risk weights range from 25% to 100%.

155. The BCBS is also consulting⁸⁷ on the design of a standardised floor to be applied to banks using the IRB, to replace the current transitional floor, which is based on Basel I risk-weighted assets. The floor would be a percentage of standardised capital charges, but this calibration is yet to be discussed. The BCBS intends to publish the final standard, including calibration and implementation arrangements, by the end of 2015.

- *Implementation of ICB recommendations: ring-fencing of retail banking functions*

156. The PRA is responsible for the implementation of the ICB recommendations. Please see paragraph 233 onwards for a detailed consideration of the new ring-fencing regime.

Current FCA initiatives

157. The following is a list of projects currently being undertaken by the FCA relevant to the retail banking sector.

⁸⁵ See recent European Banking Authority's [consultation](#).

⁸⁶ [BCBS consultation on revisions to SA risk-weights](#).

⁸⁷ [BCBS consultation on a standardised floor for IRB](#).

- *Current Account Switch Service review*

158. On 12 March 2015, the FCA published its findings on its review of the effectiveness of the Current Account Switch Service (CASS).⁸⁸
159. It found that CASS addresses the main concerns expressed by consumers about switching, such as having to transfer salary payments and utility bills. The vast majority of switches are completed within seven days and without error, and most consumers who have used the service rated it positively. However it also found consumers lack awareness and confidence in CASS, and uncovered a small number of operational issues associated with CASS and the switching process more broadly. The FCA has recommended measures to address these points.
160. In considering its effect more broadly, the FCA found that there has been a small increase in switching volumes since CASS was launched, although this must be seen in the context of the other significant barriers to switching which the FCA considers still exist, such as consumer inertia. The FCA also found there have been some limited changes in provider behaviour, particularly in relation to the development of current account products.

- *Study of account number portability*

161. Alongside its review of CASS, the FCA also gathered evidence on other measures that may help make switching simpler and easier for consumers, including account number portability.
162. The FCA found that being able to keep bank account details increases consumer confidence in the bank account switching process and that a significant number of individual and small business customers would be more likely to switch if they could retain their account details.
163. The FCA has recommended that the PSR use the findings it gathered in relation to account number portability, alongside other possible innovations in payment systems, as part of its work going forward.

- *Cash savings market study*

164. The FCA carried out a recent review to examine the extent to which consumers' choice of savings provider is influenced by where they hold their

⁸⁸ [Approach to the review of Current Account Switching Service and account number portability](#).

personal current accounts. The FCA published its final findings and proposed remedies on 20 January 2015.⁸⁹

165. The FCA concluded that the cash savings market is not working well for many consumers, and held a consultation on the following proposed remedies:

- Giving consumers sufficiently clear and targeted information at the right time so that they can easily and quickly compare their savings accounts with alternative ones and know how to switch if they want to do so.
- Making the switching process as easy as possible so that it does not put consumers off moving their money to another savings provider or to another savings account with the same provider.
- Removing some of the advantages of the large providers by making it easier for firms to provide a way for consumers to view and manage accounts with different providers in one place.
- Being more transparent about the way in which providers are reducing interest rates on variable rate savings accounts the longer a consumer holds the account.

166. The consultation closed on 18 February 2015. The final remedies have not yet been published.

- *Credit card market study*

167. The FCA published its credit card market study terms of reference on 25 November 2014.⁹⁰ The study is intended to ascertain whether the market is working well and in the interests of consumers. The deadline for providing comments on the scope of the market study was 5 January 2015.

- *Monitoring of overdrafts*

168. The FCA is, as part of its supervisory work, continuing to monitor a number of trends that have a bearing on overdraft charges. Separately, on 11 March 2015 the FCA published an occasional paper⁹¹ on the impact of annual summaries, text alerts and mobile banking apps on consumers.

169. As a result of its analysis, the FCA concludes that annual summaries have no effect on consumer behaviour where incurring overdraft charges is concerned,

⁸⁹ [FCA Cash savings market study report](#).

⁹⁰ [FCA credit card market study](#).

⁹¹ [FCA paper on annual summaries, text alerts and mobile banking apps](#).

altering balance levels or switching to other current account providers. In contrast, signing up to text alerts or mobile banking apps reduces the amount of unarranged overdraft charges incurred by 5% to 8%, and signing up to both services has an additional effect, resulting in a total reduction of 24%. The FCA also found that text alerts and mobile banking apps also reduce current account balances, which is beneficial for consumers as they reduce the cost of holding funds in accounts with low credit interest rates. These services also appear to encourage consumers to switch without closing their original account.

- *Review of unauthorised transactions.*

170. The FCA will look at whether consumers are getting fair outcomes for unauthorised transactions. The FCA will, in particular, want to ensure that firms are not placing unreasonable obstacles or responsibilities on their customers, or unfairly rejecting claims.⁹²

- *Packaged bank accounts.*

171. The FCA will review how banks have implemented the packaged bank account rules introduced in March 2013 and how the banks are dealing with past complaints.

- *Project Innovate.*

172. The FCA has launched Project Innovate to encourage start-ups and established firms to bring innovative ideas to financial services markets, including innovation in retail banking.⁹³ Project Innovate will continue to assess and prioritise which changes could be made to FCA policies and processes in order to foster innovation in financial services and reduce barriers to entry.

- *Market study into investment and corporate banking*

173. On 19 February 2015, the FCA announced⁹⁴ that it plans to launch its first wholesale market study into investment and corporate banking. This followed the FCA's review of wholesale markets, launched in June 2014. The FCA found indications that the investment and corporate banking sectors may not be working well. In particular, it identified possible competition issues in

⁹² [Plan 2014/15 FCA Business Plan.](#)

⁹³ [Project Innovate.](#)

⁹⁴ [FCA announcement of corporate banking market study.](#)

relation to the transparency of information and the bundling or cross-selling of services, as well as possible conflicts of interest. The FCA intends to formally launch the market study and publish the terms of reference in spring 2015.

- *Other FCA projects*

174. Continuing in 2015, the FCA will review cost-cutting initiatives that affect a significant number of customers, such as the withdrawal of paper statements by some banks, which may impact those customers without access to the internet. The FCA aims to conclude this review by mid-2015.
175. The FCA has carried out a thematic review of mobile banking and payments and published its review on 11 September 2014.^{95,96}

Current PSR initiatives

176. The PSR has announced the launch of two market reviews. The first aims to assess the ownership and competitiveness of infrastructure provision in payment systems in the UK and consider whether current infrastructure provisions delivers outcomes which are consistent with the PSR's objectives of promoting effective competition, innovation and the interests of service users. The second aims to look into the economic issues around indirect access to payment systems, and whether current arrangements deliver good outcomes for all service users. The PSR is currently consulting⁹⁷ on its draft terms of reference (ToR) for each review, and the final ToR are expected to be published in May 2015, with the reviews each expected to take 12 months.
177. The PSR expects to be the competent authority to monitor and enforce the EU Interchange Fee Regulation (IFR) (discussed further at paragraph 228). The PSR has announced a programme of work in relation to card payment systems to examine the implications of the interchange fee caps and business rules introduced by the IFR, taking into account the wider characteristics of card payment systems.

⁹⁵ FCA, '[Thematic Review: Mobile banking and payments](#)' (September 2014) (TR 14/15).

⁹⁶ Please note that there are also European developments in this area such as the proposed Payment Services Directive II and security recommendations coming from the SecuRe Pay forum. The SecuRe Pay forum forms part of the European Central Bank and has produced draft recommendations for increasing the security of mobile payments.

⁹⁷ [Draft ToR: Market review into the supply of Indirect Access to payment systems. Draft ToR: Market review into the ownership and competitiveness of infrastructure provision.](#)

UK government initiatives and actions

- *The Midata project*

178. The Midata project is a programme of work being carried out by the UK government, together with businesses and consumer groups, to give consumers more control over, and better access to, personal data that companies hold about them. The aim of the Midata programme is to give consumers access to their transaction data in an electronic, portable and safe way, so that consumers can make more informed choices.⁹⁸
179. The programme is part of the government's consumer empowerment strategy 'Better Choices: Better Deals', which was jointly launched by the Department for Business, Innovation and Skills (BIS) and the Cabinet Office's Behavioural Insight Team, on 13 April 2011. The consumer empowerment strategy is designed to help consumers find and make the best choices for their needs and attempts to address some of the knowledge imbalances between businesses and consumer, thereby bolstering competition.⁹⁹
180. The programme is led by a steering group, chaired by Professor Nigel Shadbolt, which works with groups of businesses, consumer organisations and regulatory bodies. Since its launch the Midata initiative has been on a voluntary basis, though BIS has said it intends to keep this position under review.

- *Project Verde – TSB state aid divestiture*

181. In November 2009, the European Commission approved, under state aid rules, a restructuring plan for Lloyds Banking Group (LBG), following the bail-out of LBG by the UK government in October 2008.
182. The restructuring plan sought to ensure that LBG paid a substantial proportion of its restructuring costs, to secure a sustainable future for LBG without continued state support and that there would be no undue distortions of competition.
183. In order to limit the impact of the state aid on competition, the restructuring plan required LBG to divest part of its UK retail banking operations, initially called Verde, and subsequently re-branded as TSB. Under the restructuring

⁹⁸ BIS, 'Better Choices: Better Deals: Report on progress on the Consumer Empowerment Strategy' (December 2012).

⁹⁹ Ibid, p3.

plan, the divested entity was to have a 4.6% market share in the personal current account (PCA) market, gained through a network of at least 600 branches. The deadline for the divestment was 30 November 2013.¹⁰⁰

184. The Co-operative Group plc planned to acquire TSB, but pulled out in April 2013. As no other buyer could be found, LBG established TSB as a standalone bank.
185. Lloyds was unable to comply with the 2013 deadline and the UK government requested an extension for the disposal until 31 December 2015, with the possibility of further extending the deadline if the state of the UK capital markets did not allow for an orderly disposal by that date. The UK also sought authorisation to change the scope of the divestment, to remove certain assets and liabilities, in order to ensure that TSB would be in a sound financial position and able to compete effectively.
186. The European Commission accepted the UK's requests, and was satisfied that TSB's viability and competitiveness would not be endangered. Overall, the Commission concluded that the amendments satisfied the objectives on limiting distortions on competition and ensuring that the bank and its owners adequately contributed to the cost of LBG's restructuring.¹⁰¹
187. The new TSB Bank began operations on 9 September 2013, and LBG divested TSB (including 631 branches) through a stock market flotation on 20 June 2014.
 - *Project Rainbow – RBS state aid divestiture*
188. In December 2009 the European Commission approved, under state aid rules, a restructuring plan for Royal Bank of Scotland (RBS), which had also been bailed out by the UK government in October 2008.
189. Under the restructuring plan, RBS was required to divest RBS' insurance, transaction management, commodity trading operations and its UK SME and mid-corporate banking operations. The divested entity, Rainbow, was required to have a 5% market share in the SME and mid-corporate banking market gained through at least 300 branches and 40 business and commercial

¹⁰⁰ European Commission, '[State aid: Commission approves restructuring plan of Lloyds Banking Group](#)' (IP/09/1728) (18 November 2009).

¹⁰¹ European Commission, '[State aid: Commission approves amendments to restructuring plan of UK bank Lloyds Banking Group](#)' (IP/14/554) (13 May 2014).

centres. The committed deadline for the divestment was 31 December 2013.¹⁰²

190. RBS sought to divest Rainbow to a buyer with existing banking operations in the UK retail and SME market. In 2013, after three years of unsuccessful negotiations, RBS established Rainbow as a standalone bank, branded as Williams & Glyn (W&G), the name of a high street bank that was disbanded by RBS 30 years ago. RBS was unable to meet the committed deadline for the divestment.

191. The UK government requested a postponement of the Rainbow divestment, and in April 2014, the European Commission granted RBS an extension the end of 2016 to begin an IPO of W&G, requiring the disposal to be completed by the end of 2017. The UK authorities committed that RBS would develop the W&G business as a fully viable bank on a standalone basis and preserve its viability and competitiveness until the full divestment.

192. RBS has stated¹⁰³ that Williams & Glyn will begin operating by the end of 2016 and will consist of 308 former RBS branches in England and Wales and six former NatWest branches in Scotland.

- *Small Business, Enterprise and Employment Act 2015*

193. The Small Business, Enterprise and Employment Act 2015 aims to:

- enhance the transparency in the ownership of UK companies and increase trust in UK businesses;
- simplify company filing requirements and reduce 'red tape';
- improve the ability of SMEs to access finance; and
- reform aspects of the UK restructuring and insolvency regime.

194. The Act introduces a power for the BIS Secretary of State to make regulations intended to tackle barriers to the ability of SMEs to access invoice finance and other forms of receivables financing. The legislation addresses restrictions that may be included in business contracts preventing the assignment of debts.

¹⁰² European Commission, 'State aid: Commission approves impaired asset relief measure and restructuring plan of Royal Bank of Scotland' (IP/09/1915) (14 December 2009).

¹⁰³ RBS [information](#) on Williams & Glyn launch.

195. The Act also includes a range of measures intended to improve the ability of SMEs to access finance generally. The Act provides for the sharing of credit information on SMEs by, among other things:
- requiring banks (meeting a certain market share threshold) to share data on their SME customers with other lenders through credit reference agencies (CRAs), and requiring those CRAs to ensure equal access to that data for all lenders; and
 - providing for SME data protections, such that data will only be provided to CRAs where the business has signed terms and conditions allowing that data to be shared.
196. These measures are designed to improve the ability of challenger banks and alternative finance providers to conduct accurate risk assessments on SMEs and to make it easier for SMEs to seek a loan from a lender other than their bank.
197. On 15 December 2014, the Treasury published a draft of the Small and Medium Sized Businesses (Credit Information) Regulations 2015. The draft Regulations impose a duty on designated banks to provide information about SME customers to designated CRAs, and impose a duty on designated CRAs to provide information about SME customers to lenders. Banks are also required to forward on details of SMEs they decline for finance to platforms that will help them be linked up with alternative lending opportunities (subject to the SME's consent).¹⁰⁴
- *Funding for Lending Scheme*
198. The BoE and the Treasury launched the Funding for Lending Scheme (FLS) on 13 July 2012. The FLS is designed to incentivise banks and building societies to boost their lending to SMEs. It does this by providing funding to banks and building societies for an extended period, with both the price and quantity of funding provided linked to their lending performance. The FLS allows participants to borrow UK Treasury Bills in exchange for eligible collateral.
199. The FLS scheme has been extended until January 2016.

¹⁰⁴ See closed CMA consultation '[SME finance: help to match SMEs rejected for finance with alternative lenders](#)'.

- *Banking for the 21st century: driving competition and choice*

200. On 18 March 2015, the Treasury published a policy document setting out the range of actions the government has taken to increase competition in banking, and announcing further measures to build on this.

201. The document includes details of many of the initiatives listed above, and the ways in which the government expects they will improve competition in the sector. It also provides details of the following additional government initiatives:

- The government will legislate to apply anti-money laundering regulation to digital currency exchanges in the UK, to support innovation and prevent criminal use. It will also increase research funding in the digital currency area by £10 million. Finally, the government will work with the British Standards Institution and the digital currency industry to develop voluntary standards for consumer protection.
- The government has announced its intention to deliver an open Application Programming Interface (API) standard in UK banking. The Treasury will work closely with banks and financial technology firms to take the design work forward and will set out a detailed framework for an open API standard by the end of 2015. The aim is to increase consumer engagement by making it easier for customers to see where they could get a better deal. It also aims to increase competitive intensity by supporting the growth of technology that can be adopted by banks and non-bank providers to compete to offer new products.
- The British Business Bank will invite expressions of interest from Credit Reference Agencies and finance platforms that wish to be designated by the Treasury to receive SME data from banks under powers contained in the Small Business, Enterprise and Employment Act 2015 (see paragraph 193). This aims to lower barriers to entry by allowing small banks and non-bank providers access to potential SME borrowers and the information held on them by the big banks, so they can compete more effectively.

EU initiatives

- *The Payment Accounts Directive*
202. The implementation of the Directive will standardise some aspects of personal current accounts related to terminology. It will also mandate firms' provision of cost information through standard templates.¹⁰⁵
203. In May 2013, the European Commission adopted a legislative proposal for a Directive to address issues it had identified in the payment accounts market, and the Payment Accounts Directive (PAD)¹⁰⁶ came into force in September 2014 to address these issues. The FCA is expected to be the lead competent authority under the PAD, with a specific limited role expected to fall to the PSR in relation to certifying that payment account switching schemes are compliant with the requirements in PAD.
204. The PAD covers three distinct, but linked areas, which are dealt with in greater detail below. These are:
- the provision of fee information to consumers;
 - payment account switching; and
 - the provision of basic bank accounts.
205. There is also a requirement on member states to have a price comparison site for payment accounts. member states must transpose most of the PAD's provisions into national law by 18 September 2016.

PAD – fee information

206. Banks will potentially have to provide more detailed information on fees to consumers than is presently the case and will have to do so in a standardised format. The PAD requires each member state to create a standard list of ten to 20 of the most representative services for which a fee might be applied. These services have to be those that are most commonly used by consumers, or which generate the highest costs for consumers.

¹⁰⁵ FCA, 'FCA's response to the CMA's consultation on its provisional decision to refer personal current accounts and SME banking' .

¹⁰⁶ [Directive 2014/92/EU](#).

207. Although the deadline for implementation of these measures is not fixed, by approximately mid-2017 firms will be required to provide consumers two new standardised documents, which are:
- a pre-contractual Fee Information Document (FID); and
 - a Statement of Fees (SoF) (at least annually).
208. Descriptions of services provided in these documents (and in any other information provided by banks to consumers) will use terminology that has been standardised at the domestic and in part, also EU level and explained in a new glossary.

PAD – payment account switching

209. Banks will have to put in place a switching service for ‘payment accounts’ held in the UK and falling within the scope of PAD. The Directive stipulates the duties on both the ‘old’ and ‘new’ bank conducting the switch, including maximum periods in which certain elements of the switching process must be completed.
210. Member states can maintain or put in place switching arrangements that depart from the Directive provided they are no less beneficial for consumers. The UK’s Current Account Switch Service (CASS) exceeds most of the standards in the Directive, and the European Commission has confirmed that member states would not need to establish a new account switching service if, subject to certain conditions, existing account switching schemes guarantee comparable rights to consumers. CASS will therefore not need to be amended to fit with the new directive.

PAD – basic bank account provision

211. Anyone legally resident in the EU will have a right to open a ‘basic bank account’ (BBA) in any EU member state. Member states can limit the entitlement to those who do not already have an account in that country. Member states can choose to require either all or ‘a sufficient number’ of banks to provide these accounts.
212. PAD stipulates some basic features that the account must have, such as ATM access and the ability to perform basic payment transactions, and stipulates that the accounts can be made available either free of charge, or for a reasonable fee.
213. The UK already had provision for BBAs prior to the introduction of PAD; they were introduced in April 2003, initiated by the Cabinet Office Social Exclusion

Unit, to allow ‘unbanked’ consumers – ie anyone who did not already have a bank account or who could not use their existing account due to a poor financial record – access to mainstream banking by making it easier for them to have an account into which they could pay wages and any benefits. There are currently an estimated nine million users of BBAs in the UK, at an estimated cost to the banking industry of £300 million.¹⁰⁷

214. However, there were no minimum standards applied to the provision of BBAs, and no guarantee of their continuing provision. So, for example, in 2012, RBS and Lloyds withdrew access for BBA holders to the LINK ATM network and the Co-operative Bank stopped offering BBAs to undischarged bankrupts. Likewise, as there was no consensus on charges, BBA holders were at risk of quickly accumulating large debts, as banks were levying charges of up to £35 per failed item.
215. The Parliamentary Commission on Banking Standards recommended in its report of 12 June 2013¹⁰⁸ that the major banks come to a voluntary agreement on minimum standards for the provision of BBAs, including access to the payments system and money management services, and free use of the ATM network, within 12 months of the date of the report.
216. On 15 December 2014 the Treasury published its revised BBA agreement¹⁰⁹ with nine¹¹⁰ UK banks. Under the terms of the revised agreement, banks are unable to levy any charges on account holders if a standing order or direct debit fails, minimising the risk that BBA customers will be forced into overdraft by fees or charges.
217. Under the revised agreement, BBA customers will be offered services on the same terms as other PCAs, including access to all the standard over-the-counter services at bank branches and at the Post Office, and access to the entire ATM network.
218. These changes must be introduced by banks within 12 months of the date of the agreement.
219. Beyond the voluntary agreement, PAD places requirements on Member States to ensure that consumers who are legally resident in the EU have a right of access to a BBA with certain characteristics and a route to challenge banks’ decisions not to grant that access before a court. The UK is required to

¹⁰⁷ See the Treasury’s [press release](#) of 14 December 2014.

¹⁰⁸ PCBC [report](#) on banking standards.

¹⁰⁹ [Revised BBA Agreement](#).

¹¹⁰ The nine banks are: Barclays; the Co-operative Bank; HSBC; Lloyds; National Australia Group; Nationwide; RBS; Santander; and TSB.

implement the requirements in PAD by 18 September 2016, and a consultation and draft regulations are expected later this year.

- *The Payment Services Directive (and Payment Services Regulations)*

220. The Payment Services Directive¹¹¹ (PSD) harmonises the regulatory regime for payment services across the EU. The aim of the directive is to make cross-border payments as easy, efficient and secure as national payments. The directive further seeks to improve competition between banks and other types of payment institutions in the provision of payment services. The directive supports the creation of a Single Euro Payment Area (SEPA). The PSD introduced an EU licensing regime for certain large payment institutions and harmonised conduct of business rules, which regulate the rights and obligations for payment service providers and their customers.
221. The Payment Services Regulations 2009¹¹² (PSRs) implement the Payment Services Directive.
222. The legislation sets out information which must be provided to payment service users, including consumers. Information has to be provided whenever a payment occurs, but different rules apply depending upon the nature of the relationship between the payment service user and the payment service provider. As between a consumer and their bank, the information will almost always be provided through the bank's terms and conditions (framework contract).
223. Under a framework contract, information has to be provided about the payment service provider, the service, charges and interest, how information will be transmitted, the safeguards and corrective measures, the length of the contract, and how it can be varied and terminated.
224. The PSD is a maximum harmonisation directive; however, several provisions of the PSD leave a margin of discretion to member state.

- *Proposed Second Payment Services Directive*

225. The European Commission published a proposal for a Second Payment Services Directive¹¹³ (PSD2) in July 2013. The proposed directive will repeal the current PSD.

¹¹¹ Payment Services Directive (2007/64/EC).

¹¹² Payment Services Regulations 2009 (SI 2009/209).

¹¹³ Proposal for a Directive of the European Parliament and of the Council on payment services in the internal market and amending Directives 2002/65/EC, 2013/36/EU and 2009/110/EC and repealing Directive 2007/64/EC.

226. PSD2 seeks to extend the scope of the PSD to payment service providers that are currently unregulated, and to improve the transparency and security of payment services. The geographical scope and currencies covered by the PSD2 are also wider than under the PSD.

227. The draft directive is currently going through the ordinary legislative procedure of the Parliament and the Council of the EU. If approved, the PSD2 must be transposed into national law within two years of its adoption.

- *Proposed Regulation on Interchange Fees*

228. The proposal for a Regulation on Interchange Fees imposes a cap on the level of interchange fees for transactions based on consumer debit and credit cards of 0.2% and 0.3% respectively. It also bans the imposition of surcharges on transactions using these types of cards. The caps reflect those accepted in the European antitrust cases against Visa and MasterCard.

229. The proposed regulation also set out the rules that can be imposed on such card schemes. The proposed regulation on interchange fees, combined with the PSD2, aim to foster competition, innovation and security in the payment systems industry.

230. The proposed regulation was passed by the European Parliament on 10 March 2015, and will come into force in October 2015. The PSR expects to be designated as the competent authority for enforcing the terms of the regulation within the UK.

- *Bank Recovery and Resolution Directive*

231. The Bank Recovery and Resolution Directive (BRRD) establishes a recovery and resolution framework for EU credit institutions and investment firms. The BRRD provides national authorities with harmonised tools and power to tackle crises at banks and investment firms early on, and to minimise costs for taxpayers. These include the following:

- Preparatory and preventative measures. The BRRD requires firms to prepare recovery plans and national authorities to prepare resolution plans. The BRRD reinforce authorities' supervisory powers to address to remove impediments to firm's resolvability.
- Early supervisory intervention. The BRRD gives authorities powers to take early action to address emerging problems.

- Resolution. The BRRD gives authorities resolution powers and tools to ensure the continuity of essential services and to manage the failure of a firm.

232. Within the UK, amendments to primary and secondary legislation were made to implement the BRRD. The PRA's rules on recovery and resolution are based on and implement parts of the BRRD. The FCA's rules on recovery and resolution implement the BRRD in relation to FCA-authorized firms.

Implementation of ICB recommendations: ring-fencing of retail banking functions

233. FSBRA set out a number of requirements intended to implement the core recommendations of the ICB, contained in the ICB Report.

234. It introduces a ring-fence around 'core deposits' (mainly retail and SME) held by UK banks, with the aim of separating certain core banking services critical to individuals and SMEs, from other banking services. The ring-fencing regime will be established through amendments to FSMA made by FSBRA, as well as statutory instruments made by the Treasury setting out the detail of the ring-fencing regime, specifying which entities will be 'ring-fenced banks' (RFBs) and the activities and services that RFBs can, and cannot, carry out.

235. The primary and secondary legislation will be supported by ring-fencing rules to be made by the PRA,¹¹⁴ intended to achieve legal, economic and operational separation between RFBs and other members of their groups (ie the parts of banking groups that fall outside the ring-fence). The FCA will also make rules relating to disclosures that non-RFBs should make to consumers.

236. Banking groups will be required to organise themselves to comply with the ring-fencing requirements by 1 January 2019.

Purpose of ring-fencing

237. The ICB made recommendations on how the UK banking system could be reformed to improve financial stability and increase competition. The ICB issued its final report in September 2011. It proposed, amongst other measures, the 'ring-fencing' of vital banking services from risks elsewhere in the financial system. This is intended to protect retail banking from risks unrelated to the provision of that service and ensure that banking groups that get into trouble can be resolved in an orderly manner, thereby avoiding

¹¹⁴ In October 2014, the PRA published its first consultation paper (CP19/14) on these rules.

taxpayer liability and ensuring the continuous provision of necessary retail banking services.

Core services

238. The ring-fence is intended to protect the uninterrupted provision of critical banking services to retail and SME depositors. These services are defined in FSBRA as ‘core services’.
239. FSBRA uses the term ‘core services’ to refer to those banking services that are considered so important that their uninterrupted provision must be protected through the ring-fence. Core services are defined as:
- facilities for the accepting of deposits or other payments into an account that is provided in the course of carrying on the core activity of accepting deposits;
 - facilities for withdrawing money or making payments from such an account; and
 - overdraft facilities in connection with such an account.

Core activities

240. The only firms that will fall within the definition of a ring-fenced body are those that carry out ‘core activities’.¹¹⁵
241. The only activity currently designated as a core activity under FSBRA is the regulated¹¹⁶ activity of accepting deposits (whether carried on in the UK or elsewhere). Furthermore, the activity of accepting deposits will only be a core activity if it relates to ‘core deposits’. Most retail customer deposits will be classed as ‘core deposits’.¹¹⁷

¹¹⁵ The ICB Report referred to these activities as ‘mandated activities’.

¹¹⁶ For example, regulated by the PRA under Part 4A FSMA.

¹¹⁷ FSBRA includes extensive detail on the definition of ‘core deposits’, but for the purposes of this paper it is sufficient to note that the overwhelming majority of deposits made into UK banks by individual and SME customers would be classed as ‘core deposits’. Examples of deposits that would not be core deposits include deposits from high net worth individuals and large companies that have chosen to deposit outside the ring-fence.

Ring-fenced bodies¹¹⁸

242. A UK institution that carries on the regulated activity of accepting deposits (see Core Activities above) for which it has a Part 4A FSMA permission (see section on authorisation by the PRA at paragraph 22) will be a 'ring-fenced body' (RFB), unless one of the following applies:
- It is a type of institution that has been exempted from ring-fencing (see institutions exempted from ring-fencing below).
 - It falls within the exemption for small banks (see further below).
 - Its deposit-taking activity is not deemed to be a core activity, because it does not relate to core deposits.
243. Under current proposals, the only firms that will be RFBs are deposit-takers, as the only activity designated in FSBRA as a core activity is the PRA-regulated activity of accepting core deposits.

Institutions exempted from ring-fencing

244. Certain exemptions from the ring-fencing requirements are available, which are:
- firms that are exempt from ring-fencing, eg building societies and credit unions;
 - firms that are exempt as a consequence of the operation of powers under the special resolution regime (SRR);¹¹⁹
 - situations where a firm's operations are small enough to fall within the de minimis exemption for small banks;¹²⁰ and
 - situations where a firm has structured its operations so that it does not accept core deposits.

¹¹⁸ Currently the only UK banks that are required to ring-fence their wholesale activities are HSBC, Barclays, Santander's UK arm, the Co-operative Bank, Lloyds Banking Group and RBS. However, any bank with deposits of £25 billion or more by 2019 could also be expected to become subject to the ring-fencing requirements in due course, which has implications for smaller banks.

¹¹⁹ For failing banks which are being 'bailed in', see [Government consultation on bail-in powers](#).

¹²⁰ The following institutions will fall within the de minimis exemption: deposit-takers that are not members of a group and whose core deposits do not exceed £25 billion; and deposit-takers that are members of a group where the sum of the average core deposit totals for each deposit-taker in the group do not exceed £25 billion. This measure is intended to prevent large banks from avoiding ring-fencing by splitting their deposits across multiple entities, each individually below the £25 billion threshold.

Excluded activities

245. RFBs are not permitted to carry out certain excluded activities. These activities are activities that the government considers can pose a risk to the provision of core services. FSBRA and the Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014 (Excluded Activities Order) specify that the following activities are excluded activities:
- Dealing in investments as principal, whether carried on in the UK or elsewhere. This includes buying, selling, subscribing for or underwriting securities or contractually based investments. This means that RFBs cannot engage in proprietary trading or hold trading assets unless there is a specific exemption allowing them to do so.
 - Dealing in commodities.
 - RFBs are also prohibited from certain conduct, such as having exposures to certain financial institutions and having non-EEA branches and subsidiaries carrying on regulated activities.
246. There are certain exemptions to the list of excluded activities, to reflect the ICB's recommendation that RFBs should be permitted to carry out certain ancillary activities that would otherwise be prohibited under the ring-fencing requirements, as well as manage the risks associated with their businesses.

Prohibitions

247. The new regime will also allow the Treasury to place specific prohibitions on RFBs, in addition to the concept of excluded activities, to capture conduct by banks that cannot easily be defined as an 'activity', such as the banning of transactions by reference to the counterparty, rather than the type of transaction. For example, the Excluded Activities Order prohibits RFBs from having exposures to other financial institutions, and from having a branch or a subsidiary in a country or territory outside the EEA, other than a subsidiary that does not carry out any activities which would be regulated under FSMA if they were carried on in the UK.

Breaches of the ring-fence

248. If an RFB carries on an excluded activity, or purports to do so, or contravenes a prohibition, the PRA may take enforcement action, such as imposing financial penalties or exposing the RFB to public censure. A breach will not however be a criminal offence, or make a transaction void or unenforceable, or give rise to a claim for breach of statutory duty.

Legal, operational and economic separation

249. FSBRA requires the PRA to exercise its power to make rules governing the legal, economic and operational independence of RFBs, ensuring that they interact with the rest of their group on a third party basis. These rules were intended to implement the ICB's recommendations on the 'height' of the ring-fence.
250. The requirements concerning the legal, operational and economic separation of RFBs will primarily be set out in PRA rules and guidance.
251. The PRA will therefore play a key role in establishing the ring-fence, by making ring-fencing rules and supervising the ring-fence. It will be required to carry out annual reviews of the operation of the ring-fence, and a review of the ring-fencing rules every five years.
252. In October 2014, the PRA issued its first consultation paper¹²¹ on rules and guidance relating to the ring-fence. The consultation closed on 6 January 2015. The PRA has stated that it intends to issue at least one more consultation paper on ring-fencing rules.
253. The October 2014 consultation paper focused on:
- general rules for all RFBs;
 - the legal structure of groups that contain an RFB (see further below);
 - the governance of RFBs; and
 - ensuring the continuity of services and facilities.

Legal structure

254. One of the most crucial aspects of the new ring-fencing regime is the legal separation of an RFB from the rest of its group, as recommended by the ICB. The effect of the definition of a 'ring-fenced body' is that an RFB must be a separate legal entity from any other entity carrying on excluded activities; a single legal entity cannot carry out core activities and excluded activities.¹²²
255. In its consultation paper, the PRA set out proposals for guidance on legal structure issues intended to supplement these legislative provisions. Its aim is to ensure that banking groups are structured so that RFBs are protected

¹²¹ [PRA consultation on ring-fencing Guidance](#).

¹²² For clarification, only 'excluded activities' must be kept outside the ring-fence; activities which are neither excluded nor core may be retained inside the ring-fence.

adequately from risks arising from other group entities. It commented that particular risks may arise if RFBs are owned by entities carrying out excluded or prohibited activities or if they own such entities. It expects that banking groups containing RFBs will instead adopt a 'sibling structure'.¹²³

256. The PRA does not intend to propose rules on legal structure issues, but will consider using existing powers to impose requirements on firms or to give directions to parent undertakings to implement its policy.
257. The PRA intends to make a supervisory statement on legal structure issues, a draft of which is set out in Appendix 1 to its consultation paper, setting out the PRA's expectations in relation to the ownership structure of banking groups containing one or more RFBs.

Other key elements of the ring-fencing regime

258. Other elements of the ring-fencing regime include the following:
- The ring-fencing transfer scheme. FSBRA introduces a ring-fencing transfer scheme, allowing all or part of a bank's business to be transferred to another body in order to comply with the ring-fencing regime without needing to obtain the consent of all those affected by the transfer.
 - Group restructuring powers. The PRA will have the power to further strengthen the ring-fence by requiring banking groups to restructure their operations if it considers that the operation of the ring-fence in a group is proving to be ineffective. This may lead to groups being required to split their retail and investment banking operations into separate banking groups.

Application of consumer law to the banking industry

259. The following section provides an overview of key consumer law relevant to the retail banking market investigation, to the extent that this has not been covered earlier in this paper. In the main, the legislation derives from EU law.
260. This paper covers only the legislation which is applicable at the time of writing (April 2015).
261. Some consumer legislation contains enforcement provisions, but the main way it is enforced is using Part 8 Enterprise Act. This allows enforcers,

¹²³ RFBs and entities that can conduct excluded or prohibited activities are expected to be structured as separate clusters of subsidiaries beneath a UK holding company. This is known as a 'sibling structure'.

including the CMA, to apply for a remedy which is similar to an injunction, known as a Part 8 Order, from a County or High Court. This remedy is flexible enough to allow enforcers to apply for an Order addressing multiple breaches of different legislation.

EU consumer law

262. The following is a list of EU consumer Directives applicable to the banking sector that have not been considered earlier in this paper, and the legislation which transposes them into UK law.

Consumer Credit Directive 2008/48/EC – Maximum harmonisation in relation to some issues – implemented by the Consumer Credit Act 1974 and FCA rules in the Consumer Credit Sourcebook

263. The Consumer Credit Directive applies to credit agreements with consumers including overdrafts (unless the credit has to be repaid within one month) and overrunning. The relevant provisions are implemented through the Consumer Credit Act and FCA rules in the Consumer Credit Sourcebook (CONC). An authorised overdraft facility is typically a regulated credit agreement, and subject to Consumer Credit Act and CONC requirements. Overrunning is also subject to specific CONC requirements. The scope of these provisions is broader than those in the Directive, as they extend to overdrafts of less than one month and to some business overdrafts.

264. The Consumer Credit Directive applies to credit agreements with consumers. The Directive fully harmonises certain aspects, so that member states can in relation to those aspects no longer apply either less or more restrictive or prescriptive consumer protection measures. Under the Directive creditors are required to provide pre-contractual, contractual and post-contractual information in a standardised form. There are rules governing the calculation of the APR which must also be given to consumers. The Directive also grants consumers the right to withdraw from the credit agreement without giving any reason within a period of 14 days after the conclusion of the contract, and the right to repay their credit early at any time, subject to a fair and justified compensation for the creditor.

Unfair Terms in Consumer Contracts Directive 93/13/EEC – Minimum harmonisation – implemented by the Unfair Terms in Consumer Contract Regulations 1999

265. The legislation applies to unfair contract terms which have not been individually negotiated in any contract concluded between a consumer and a trader, ie a person who is acting for purposes relating to their trade, business or profession. An unfair term is one which, contrary to the requirement of good

faith, causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.

266. The legislation sets out a list of terms that may be regarded as unfair. Terms that are found to be unfair under the legislation are not binding on consumers. If the unfair term can be separated from the contract, the rest of the contract may still apply. Terms relating to the main subject matter of the contract or to the adequacy of the price or remuneration payable for the goods or services supplied are not subject to a fairness assessment. The Directive is one of minimum harmonisation, allowing member states to adopt more protective consumer measures.

Electronic Commerce Directive 2000/31/EC – Some aspects are fully harmonised – implemented by the Electronic Commerce Regulations 2002

267. The legislation governs services that are provided electronically. It covers, for example, online information services and the advertisement or sale of goods or services to consumers online, by email or text message. The Directive establishes harmonised rules on issues such as transparency and information requirements.

Distance Marketing of Consumer Financial Services Directive 2002/65/EC – Minimum harmonisation – implemented by the Financial Services (Distance Marketing) Regulations 2004

268. The legislation governs the distance marketing of consumer financial services. It deals with such matters as the marketing of financial services by intermediaries, the provision of information to the consumer, the right to cancel, and unsolicited services.

Unfair Commercial Practices Directive 2005/29/EC – Maximum harmonisation – implemented by the Consumer Protection from Unfair Trading Regulations 2008

269. The legislation bans traders from using unfair commercial practices towards consumers. Certain specific practices are banned outright. Other practices are judged by the effect they have, or would be likely to have on the average consumer. Practices may be unfair where they are misleading, because of what consumers are told or because certain key information is not given to them. Aggressive practices that use harassment, coercion or undue influence are also unfair.
270. Although this is a maximum harmonisation measure member states are allowed to impose or retain requirements which are more restrictive or

prescriptive that the Directive in relation to 'financial services' as defined by Directive 2002/65/EC.

Misleading Advertisement Directive 2006/114/EC – Minimum harmonisation – implemented by the Business Protection from Misleading Marketing Regulations 2008

271. The legislation governs advertising to businesses. Advertisements to businesses must be accurate and honest, and must not make misleading comparisons with competitors, such as using a competitor's logo or trademark or comparing a product with that of a competitor which is not the same.

Consumer Rights Directive 2011/83/EC – Some aspects are fully harmonised – implemented by the Consumer Contracts Regulations 2013 and Consumer Rights (Payment Surcharges) Regulations 2012

272. The legislation governs contracts made between traders and consumers that are made on-premises, off-premises (eg doorstep sales) or at a distance. The Directive lays down what information must be provided by a trader. It increases price transparency by requiring traders to disclose the total price of the good service, or digital content. It requires cancellation rights to be given to consumers in certain circumstances. The legislation also provides rules on delivery and passing of risk, including rules of the fees for the use of certain means of payment, such as credit or debit cards. The Directive fully harmonises some aspects.
273. The Directive does not apply to contracts for financial services, defined as 'any service of a banking, credit, insurance, personal pension, investment or payment nature'.
274. The Consumer Rights (Payment Surcharges) Regulations implement Article 19 of the Consumer Rights Directive. They prohibit excessive payment surcharges where the consumer is making use of a payment method for the purpose of a contract with a trader. The contract has to be for goods, services or digital content. They do not apply to payment methods in respect of a contract for financial services.

Technical Standards Directive 98/34/EC

275. The Technical Standards Directive imposes an obligation on member states to inform the European Commission and every other member state of technical regulations and technical standards in draft before they are adopted in national law. It aims to prevent new technical barriers to trade being created. Once a measure is notified it enters a three month standstill period in which

the European Commission and the other member states can raise concerns about whether the proposed measure is a barrier to trade.

UK consumer law

276. The Consumer Rights Act 2015 came into force in March 2015. It makes changes to legislation relating to unfair terms, and consolidates and reforms provisions relating to consumer rights in respect of goods, services and digital content.
277. The Supply of Goods and Services Act 1982 is applicable to the banking sector (and it is not derived from an EU law). It implies certain terms into a contract for the supply of services. The service must be carried out with reasonable care and skill. Goods transferred as part of the service must match their description, be of satisfactory quality and be fit for purpose.