Retail banking market investigation: provisional findings report

Appendix 3

Appendix 3.1: Regulatory framework applicable to the retail banking industry in the UK

Regulatory framework applicable to the retail banking industry in the UK

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Introduction

1. This appendix 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 appendix also provides a description of some of the key initiatives currently being carried out by UK financial industry regulators, the UK government and the EU, affecting the retail banking industry.

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 and expansion in the retail banking market, please refer to Section 10 and Appendix 10.1 on barriers to entry and expansion.

3. This appendix is split into four main parts:

   - An overview of the bodies that regulate the retail banking industry in the UK, and how legislation affecting the banking industry is developed at both EU and UK level.

   - Some of the current and recent regulatory and government initiatives (UK, international and EU) affecting the retail banking industry.

   - The application of consumer law to the retail banking industry.

   - An overview of previous CC reviews of the retail banking industry that gave rise to remedies.

Part I: UK regulatory authorities – overview

4. In July 2010, in response to the financial crisis, the government outlined 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 (HMT) 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.

5. Following the consultation, a White Paper was published in June 2011,[1] including a draft Financial Services Bill, which came into force as the FS Act on 1 April 2013.

6. The FS Act implemented 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.

7. 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 PRA, which was established by the FS Act, and conduct regulation by the FCA, which replaced the FSA. The roles performed by the PRA and FCA respectively are considered in greater detail in this appendix in paragraph 18 onwards and paragraph 89 onwards.

8. In addition to the changes to the regulatory framework brought about by the FS Act, the FSBRA enacted a number of further reforms related to the UK's banking sector. In particular, FSBRA gave HMT and the relevant regulators,

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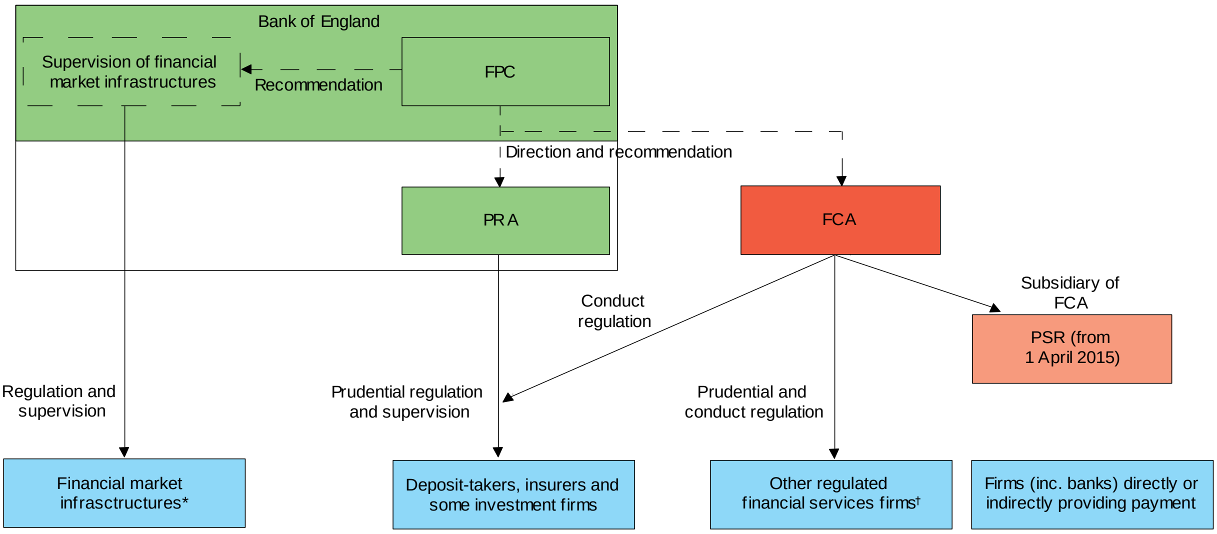
[1] A new approach to financial regulation: the blueprint for reform.

primarily the PRA, powers to implement some of the recommendations made by the ICB[2] – in particular, the ICB's recommendations for ring-fencing requirements for banks (see paragraph 173 onwards of this appendix).

9. It also provided for the establishment of the PSR. The role of the PSR is considered in detail in this appendix from paragraph 125 onwards.

Figure 1: Overview of regulatory landscape



Source: PRA.
*Excludes regulation of trading platforms, which is the responsibility of the FCA.
†Includes asset managers, hedge funds, exchanges, insurance brokers and financial advisers.
Note: FPC = Financial Policy Committee

The Bank of England

10. 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.

11. 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 FPC.

[2] The ICB 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.

- Monetary policy (eg setting interest rates, decisions on quantitative easing) – the Monetary Policy Committee.[3]

- Safety and soundness of banks and other financial institutions – the PRA.

12. The FS Act established both the FPC and the PRA, and gave each of these bodies new responsibilities for the supervision of financial institutions.

13. The BoE also plays a role in the regulation of payment systems, which is discussed further at paragraph 83.

The Financial Policy Committee

14. 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 BoE, the CEO of the FCA, five external members and a non-voting HMT member. The FPC has a secondary objective to support the economic policy of the government.

15. 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 (CRD IV) and the Capital Requirements Regulation (CRR) (see further at paragraph 51).

16. 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.

17. 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

18. The PRA is responsible for the prudential regulation and supervision of all deposit-taking institutions (banks, building societies and credit unions),

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[3] The activities of the Monetary Policy Committee are not relevant to the CMA's investigation so are not discussed further in this appendix.

insurers and major investment firms. The PRA works alongside the FCA creating a 'twin peaks' regulatory structure in the UK,[4] 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.[5] The PRA's most significant supervisory decisions are taken by its Board – comprising the Governor of the BoE, the CEO of the PRA, the Deputy Governor for Financial Stability, the Deputy Governor for Markets and Banking, the Deputy Head of the PRA, and five independent non-executive members. The Board is accountable to Parliament.

19. The PRA derives its responsibilities and powers from the FSMA (as amended by the FS Act)[6] and the relevant EU Directives and directly applicable EU Regulations, for which it is a competent authority (eg the Capital Requirements Directive (CRD) and the CRR – see further at paragraph 51).

20. 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.

21. 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.

22. 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-

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[4] The FCA is a separate institution and not part of the BoE.
[5] A BoE Bill was announced in the Queen's Speech on 27 May 2015, including a proposal to bring the PRA within the BoE, ending its status as a subsidiary, and creating a new committee of the BoE to be known as the Prudential Regulation Committee. The government recently consulted on these proposals. The Bank of England Bill: Technical Consultation closed on 11 September 2015.
[6] References to FSMA in this appendix are to be read as references to the FSMA as amended by the FS Act.

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.[7]

23. One of the PRA's key functions is the authorisation of new banks, which is considered in detail below.

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

24. A firm can only carry on a regulated activity in the UK if it is authorised or exempt.[8] Firms based in the 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.

25. 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.

26. The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001[9] 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.

27. The Financial Services and Markets Act 2000 Regulated Activities Order 2001 also lists other regulated activities, for which FCA authorisation is required, such as consumer credit lending.

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[7] The obligation on the PRA is only to facilitate competition, not to behave as a competition advocate, promoting competition in markets.
[8] Section 19, FSMA. This is referred to as the 'general prohibition'.
[9] Financial Services and Markets (Regulated Activities) Order 2001.

Application process

28. As a dual-regulated entity, a firm seeking authorisation as a bank will have its application considered by both the FCA and the PRA.[10] 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.

29. Following publication of the ICB's report in 2011, HMT 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[11] 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 the new bank liquidity premium; and
- a changed authorisation process to ease business start-up (the so-called 'mobilisation' approach – see further at paragraph 31).

30. 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.[12] Applicants are currently required to pay a fee of up to £25,000 for authorisation.

31. The FCA has published a guide[13] 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

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[10] The term 'FCA-authorised firm' means a financial firm (ie an insurance firm) that is regulated solely by the FCA, and the term 'PRA-authorised' means a firm that is dual-regulated by the FCA (for conduct purposes) and the PRA (for prudential purposes). All firms which accept deposits within the UK must be PRA-authorised, therefore all banks are PRA-authorised.
[11] FSA (2013), *A review of requirements for firms entering or expanding in the banking sector*.
[12] 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.
[13] The FCA's guide to authorisation as a bank.

approach would be used for the subsidiarisation[14] 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.

32. The authorisation process for applicants applying to be a bank or building society is separated into three stages:

33. Pre-application.[15] 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.

34. Assessment. The PRA and FCA will assess new applications against the threshold conditions (see further at paragraph 36) 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

[14] For example, where banks regulated in other jurisdictions seek to convert pre-existing branches in the UK to legal subsidiaries.
[15] A full description of the process for applying for PRA authorisation is set out on the PRA's website: BoE guide to authorisation process.

mobilisation option (Option B), this authorisation will include a restriction on the activities they can carry on until fully mobilised.

35. 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

36. 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-authorised firm, the PRA and FCA are responsible for separate threshold conditions. The PRA and the FCA’s threshold conditions are set out in statute,[16] 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.
- Resolvability[17] of the applicant firm (relevant to the PRA's assessment of an applicant bank, building society or credit union).[18]

Granting or refusing a firm's application

37. The PRA and the FCA are required by statute to assess an application within six months from the date they receive a complete application.[19] For dual-regulated firms, the FCA must also give consent within the same timeframe.

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[16] Set out in Schedule 6 to FSMA, as amended by the Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013.
[17] 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.
[18] Firms judged to be resolvable are eligible for lower capital requirements.
[19] If the application is judged incomplete on receipt, the statutory deadline for assessment is 12 months from the date of receipt, however the regulators have given a voluntary undertaking to reach a decision on incomplete

38. 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.

39. 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).[20]

Ongoing compliance: PRA Rulebook and the Fundamental Rules

40. Firms must ensure they are compliant with all applicable PRA rules and directly applicable EU regulations,[21] including the Fundamental Rules[22] 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.
- 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 cooperative way, and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.

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applications within six months of submission, provided that the missing information is sent reasonably promptly after submission.

[20] The appeal body for decisions in financial services cases made by the FCA, PRA, The Pensions Regulator, BoE, HMT or Ofgem.

[21] 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.

[22] BoE policy statement outlining Fundamental Rules.

- Fundamental Rule 8: A firm must prepare for resolution[23] so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services.

41. The Fundamental Rules are supported by more detailed rules, contained in the PRA Rulebook,[24] 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

42. 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[25] online system.

Supervision and intervention by the PRA

43. 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.

44. 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.

45. The PRA works closely with the FPC, which is able to make recommendations and give directions to the PRA. The PRA also cooperates closely with the rest of the BoE on, for example, market intelligence and oversight of critical financial infrastructure, and with the BoE's Resolution Directorate on resolution planning, contingency planning for firm failure and operational resilience.

46. The FS Act requires the PRA to investigate and report to HMT on events which indicate possible regulatory failure.

[23] 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.
[24] PRA Rulebook.
[25] GABRIEL website.

Regulatory capital framework

Basel Accords I, II & III

47. 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 BCBS, a committee made up of representatives of banking supervisory authorities from major economies and banking hubs, providing a forum for regular cooperation 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.

48. Basel I – issued by the BCBS in 1988 – set out for the first time minimum capital adequacy requirements for banks (see further at paragraph 55). 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.

49. Basel II defined the 'three pillars concept' underlying effective banking regulation, which divides types of regulation into three categories:

(a) Pillar 1: minimum capital requirements.

(b) Pillar 2: supervisory review.[26]

(c) Pillar 3: market discipline.

50. 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 CRD IV (see further below) imposes the standards set out in Basel III on EU member states, and that Directive has been transposed into UK law by the PRA,[27] which will also be responsible for ongoing compliance with its requirements.

Basel II also introduces a net stable funding ratio (NSFR). Taking effect from 1 January 2018, the NSFR reduces funding risk over a longer time horizon by requiring banks to fund their activities with sufficiently stable sources of

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[26] In the UK, this is reviewed by the PRA and FCA (as appropriate).

[27] The provisions of the CRD 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 CRR is directly applicable to firms, so did not need to be transposed into UK law.

funding to mitigate the risk of future funding stress. The BCBS published standards[28] for the NSFR in October 2014.

The EU Capital Requirements Directive IV

51. The 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.

52. CRD IV comprises:

- the 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 CRD, which must be implemented through national law, and which makes changes to rules on corporate governance, remuneration and introduces capital buffers.

53. 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.

54. In December 2013 the PRA published a policy statement[30] setting out its rules and supervisory statements in order to transpose CRD IV into UK law.

Capital adequacy, leverage and liquidity requirements

55. 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. As explained above, these requirements derive from the Basel Accords via CRD IV.

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[28] NSFR standards.

[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.

56. 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*

57. 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.

58. Tier 1 capital is formed of two types of capital:

(a) 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.

(b) 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.

59. 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'.

60. 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*

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.

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

63. In calculating the CAR, a bank's 'Capital Resources' (ie the numerator) comprises CET1, AT1 and Tier 2 capital (as explained at paragraph 59).

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 risk[31] 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 investments in low-risk sovereign debt (ie debt of EEA nations).

65. In order to apply a risk weight to each asset it holds, a bank has two approaches available:

- SA – using standardised risk weights set out in CRD IV.[32]
- IRB – 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.

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[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.

[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 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 appendix, has not responded.

[33] For more detail on IRB, see BCBS (2005), *An Explanatory Note on the Basel II IRB Risk Weight Functions*.

66. As an example, using the SA, 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.

- *Pillar 2: supervisory review*

68. On 29 July 2015, the PRA issued a policy statement[34] on how it will assess capital adequacy under a new framework for the Pillar 2 regime, which will come into force on 1 January 2016.

69. The policy statement sets out changes to rules and supervisory statements and finalises a separate statement of policy: *The PRA's methodologies for setting Pillar 2 capital*.[35] The policy statement is relevant to banks, building societies and PRA-designated investment firms.

70. The Pillar 2 capital framework for the banking sector 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 CRD IV.

71. The new framework requires PRA-regulated firms to carry out an Internal Capital Adequacy Assessment Process in accordance with the PRA's Internal Capital Adequacy Assessment rules. These require firms to have in place sound, effective and comprehensive strategies and processes to assess and maintain, on an ongoing basis, the amounts, types and distribution of financial resources they consider adequate to cover the nature and level of the risks to which they are or might be exposed. The PRA expects a firm's Internal Capital Adequacy Assessment Process to be the responsibility of a firm's management body and to be an integral part of the firm's management process and decision making. The PRA's methodologies inform the PRA's setting of Individual Capital Guidance alongside supervisory judgement and a firm's own assessment.

- *Leverage ratio*

72. 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

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[34] Assessing capital adequacy under Pillar 2 - PS17/15.
[35] Statement of Policy - The PRA's methodologies for setting Pillar 2 capital.

leverage ratio limits banks' ability to expand their operations in just one asset class.[36] The leverage ratio places a floor on the minimum capital that banks must hold.

73. An FPC consultation[37] 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.

74. In summary, the leverage ratio measures Tier 1 capital over the Leverage Exposure Measure,[38] which is a measure of assets not weighted for risk:

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

75. The FPC's consultation explains (page 14 onwards) that below a certain average risk weight[39] (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.[40] The leverage ratio requirement will consequently have a relatively greater impact on certain types of banking business models that attract relatively low-risk weights.[41]

76. The leverage ratio can be described as a guardrail against risks arising from errors in the SA and IRB described above, as well as unforeseeable events, and to prevent unsustainable bank balance sheet stretch (eg in a particular asset class).

77. Following on from the publication of the FPC's consultation paper, on 6 April 2015 the Statutory Instrument[42] giving the FPC the Power of Direction

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[36] For example, a bank might wish to focus on riskier loans, as these have the potential to be more profitable than other asset classes. In conjunction with the capital adequacy ratio, the leverage ratio requirements would act to constrain the bank's ability to focus its operations too heavily on such loans. However, absent the capital adequacy ratio the leverage ratio may incentivise institutions to have high-risk rather than low-risk portfolios, as it is not sensitive to risk weight.

[37] FPC review of leverage framework.

[38] The Leverage Exposure Measure is very similar to total accounting assets.

[39] Average risk weight is measured as risk-weighted assets/total assets.

[40] 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 p16 of the FPC's review of the leverage ratio, October 2014).

[41] 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 p26 of the FPC's review of the leverage ratio, October 2014).

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

over the leverage ratio framework came into force. Under that Statutory Instrument, the FPC can make a direction to the PRA to impose a minimum leverage ratio on banks.

78. On 1 July 2015, the FPC directed the PRA to implement a UK leverage ratio framework, as follows:

- A 3% minimum leverage ratio requirement that is to apply immediately to UK global systemically important institutions (G-SIIs)[43] and major UK banks and building societies on a consolidated basis.

- A G-SII additional leverage ratio buffer that is to apply to UK G-SIIs identified by the PRA, also on a consolidated basis. The rate of the G-SII additional leverage ratio buffer is to be calibrated at 35% of a relevant firm's G-SII buffer rate. This buffer will be phased in from 2016, alongside the risk-weighted G-SII buffer.

- A countercyclical leverage ratio buffer that is to apply immediately to UK G-SIIs and major UK banks and building societies on a consolidated basis. The rate of countercyclical leverage ratio buffer is to be calibrated at 35% of a relevant firm's countercyclical capital buffer rate, and rounded to the nearest 10 basis points. It comes into force on the same timescale as the minimum leverage ratio requirement.

79. The PRA issued a consultation paper[44] the same day, setting out how the PRA intends to achieve the new leverage ratio framework. The consultation is relevant to PRA-regulated banks and building societies with consolidated retail deposits equal to or greater than £50 billion. The consultation closed on 12 October 2015 and the PRA is currently considering responses. It has stated that it will publish a policy statement, finalised rules and supervisory statements by the end of 2015.

- *Liquidity requirements*

80. Basel III introduced a new liquidity[45] ratio, which came into force within the EU on 1 October 2015. The 'Liquidity Coverage Ratio' requires a bank to hold

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[43] Defined in the consultation paper as 'G-SIIs and other major domestic UK banks and building societies, including ring-fenced bodies (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. Current UK G-SIIs are: HSBC; Barclays and RBS. The list of G-SIIs is updated annually.
[44] PRA consultation paper: Implementing a UK leverage ratio framework.
[45] 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

sufficient high-quality liquid assets to cover its total net cash outflows over 30 days.

81. In June 2015 the PRA issued[46] a policy statement setting out the PRA's final rules and supervisory statement to accommodate the introduction of the new liquidity coverage ratio. The rules came into force on 1 October 2015.

- *Capital adequacy buffers*

82. 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:

- Conservation buffer: a buffer of 2.5% CET1 to RWA.

- Countercyclical buffer: the size of this buffer alters through economic cycles, based on policy decisions made by the FPC and PRA.

- Global systemically important institutions buffer: imposed on G-SIIs,[47] providing extra protection in the event of a crisis.

- 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). HMT has exercised the discretions allowed by the CRD to enable the application of this buffer only to ring-fenced bodies (RFBs) to protect 'core services' (following the ICB's recommendations, see further at paragraph 284) and large building societies.

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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.

[46] PRA policy statement: CRD IV: liquidity.

[47] On 27 February 2015, in accordance with the CRD, the PRA disclosed the 2014 list of UK headquartered G-SIIs and their respective subcategories. The PRA also disclosed the applicable G-SII buffers. These are: HSBC (2.5%); Barclays (2%) and RBS (1.5%). 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.

- Capital planning buffer: this is a Pillar 2 buffer (referred to as 'Pillar 2B'),[48] 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.[49]

The BoE's role in payment systems supervision

83. 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).[50]

84. Payment systems are not automatically supervised by the BoE, and there is no authorisation process. HMT 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.

85. Current recognised payment systems are:[51]

    - Bacs,[52]
    - CHAPS,[53]
    - CLS,[54]
    - CREST,[55]

[48] 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).
[49] From January 2016 the capital planning buffer will become the PRA buffer, which must be met with CET1 capital.
[50] Part 5 (Interbank Payment Systems) of the Banking Act.
[51] BoE - payment systems
[52] 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 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.
[53] CHAPS offers same-day sterling fund transfers. It tends to be used for high-value transactions, such as property purchases (including residential mortgages).
[54] CLS (originally Continuous Linked Settlement) is a specialist US financial institution that provides settlement services to its members in the foreign exchange market.
[55] 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.

- LCH.Clearnet Ltd,[56]
- Visa Europe,[57]
- FPS,[58] and
- ICE Clear Europe.[59]

86. For recognised payment systems, the international CPMI-IOSCO principles for financial market infrastructure form the basis for oversight and supervision.[60] These Principles apply to financial market infrastructures (ie including payment systems) that facilitate the clearing, settlement, and recording of monetary and other financial transactions.

87. 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.

88. The BoE has entered into a joint memorandum of understanding (MoU)[61] with the FCA, PRA and PSR, covering payment systems regulation.

The Financial Conduct Authority

89. The FCA replaced the FSA on 1 April 2013. It is accountable to HMT and Parliament, but operates independently of government and is funded entirely by the firms it regulates. The Board of the FCA is appointed by HMT,[62] and

[56] LCH.Clearnet is a European independent clearing house that serves major international exchanges, as well as a range of over-the-counter 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.
[57] Operated jointly by Visa Europe and Visa UK.
[58] 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.
[59] 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.
[60] 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*. These principles are part of a set of 12 key standards that the international community considers essential to strengthen and preserve financial stability.
[61] MoU outlining how the PSR will interact with the BoE, the FCA and the PRA.
[62] Jointly with BIS in the case of two of the non-executive director positions.

sets FCA's strategic aims and policy, but day-to-day decisions and staff management are the responsibility of the Executive Committee.

90. The FCA's strategic objective is to ensure that the relevant markets function well. To support this, it has three statutory objectives:[63]

- to secure an appropriate degree of protection for consumers;
- to protect and enhance the integrity of the UK financial system; and
- to promote effective competition in the interests of consumers.

91. The FCA is responsible for the prudential regulation of those financial services firms not supervised by the PRA, such as asset managers, PSPs (except those that are also credit institutions) and independent financial advisers.

92. The intensity of the FCA's approach to supervising the conduct of firms will differ depending on the firm's size and other factors, such as the nature of its business. The supervision approach includes:

- a sector-based risk assessment approach to identify, analyse and prioritise conduct risks;
- a firm-specific continuous conduct assessment approach for larger firms and a programme of sector/market-based assessment for smaller firms;
- ongoing monitoring of products to ensure firms treat customers fairly and do not compromise consumer interests;
- risk-based processes to respond quickly and decisively to significant events or problems that threaten the integrity of the industry; and
- ensuring firms compensate consumers when necessary.

93. 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;

[63] Set out in section 1B FSMA.

- responding quickly and decisively to events or problems that threaten the integrity of the industry; and
- ensuring firms compensate consumers when necessary.

The FCA Handbook

94. Firms regulated by the FCA are bound by the rules contained in the FCA Handbook.[64] The Handbook was developed out of the FSA Handbook, which was split between the FCA and the PRA to form the FCA Handbook and the PRA Rulebook.[65] The FCA Handbook contains rules applicable to banks, and sits alongside those provisions that are imposed and monitored only by the PRA. Dual-regulated firms have to attend to the provisions of both the FCA Handbook and the PRA Rulebook.

Concurrent competition powers of the FCA

95. 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 must, so far as is compatible with acting in a way that advances its consumer protection or integrity objectives, discharge its general functions (broadly: making rules or codes, giving general guidance and determining its general policy and principles) in a way that promotes competition in the interests of consumers. The FCA has concurrent powers with the CMA to:

    - enforce the competition law prohibitions under Chapters I and II of the Competition Act 1998 (CA98) and Articles 101 and 102 of the Treaty on the Functioning of the European Union in relation to the provision of financial services; and
    - conduct market studies and make market investigation references to the CMA under the EA02, for detailed review of a particular financial services market.

96. The same concurrent powers, and a competition objective, were also granted to the new PSR (see further at paragraph 143).

97. The FCA's concurrent competition law powers vested 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

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[64] FCA Handbook.
[65] PRA Rulebook Online.

sector regulators make greater use of their competition powers, the FCA is required to consider whether it would be more appropriate to use its CA98 powers before using certain of its regulatory powers.

98. The procedures set out in the Competition Act 1998 (Concurrency) Regulations 2014[66] (the Concurrency Regulations) and the CMA's guidance[67] on the concurrent application of competition law to regulated industries also became 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.

99. The FCA and CMA entered into a memorandum of understanding (MoU) on 12 June 2014,[68] setting out the framework for cooperation 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 vested on 1 April 2015.

100. In January 2015, the FCA issued for consultation[69] 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 approach to selecting CA98 investigations, conducting and concluding investigations (including settlements). The FCA is currently considering feedback from this consultation. The FCA also published an amendment to the Supervision Manual (part of the FCA Handbook) to reinforce the obligation that FCA-regulated firms are required to notify the FCA of any competition law infringements that have or may have occurred.

101. In July 2015 the FCA published guidance on market studies and market investigation references.[70] This explains how the FCA will conduct market studies under either its FSMA powers or under the EA02, 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.

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[66] The Competition Act 1998 (Concurrency) Regulations 2014.
[67] *Regulated industries: Guidance on concurrent application of competition law to regulate industries (CMA10)*.
[68] MoU between CMA and FCA.
[69] FCA consultation on concurrency.
[70] FCA guidance.

102. The FCA and the CMA must consult each other before exercising any of their concurrently held functions under the EA02 or CA98, and must not exercise the same functions in relation to the same matter if the other has already exercised those functions.

103. 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

104. In the UK, the Money Laundering Regulations 2007 (MLR) provide the legal framework requiring banks and firms in specified sectors to detect and prevent money laundering. The FCA is the competent authority for supervising compliance with the MLR for most credit and financial institutions. The Joint Money Laundering Steering Group (JMLSG) is an industry-led body that gives practical assistance in the interpretation of the MLR and defines good industry practice. It is made up of the leading UK trade associations in the financial services industry.

105. The MLR are the UK's implementation of the EU’s Third Money Laundering Directive. The European directive primarily implements recommendations made by the Financial Action Task Force (FATF). FATF is an inter-governmental policy making body to set standards and promote effective implementation of anti-money laundering (AML) measures.

106. The FCA Handbook provides some detail about the systems and controls that banks must ensure are in place. These are high level, affording banks a wide discretion as to how to implement them in practice. In addition to the AML rules set out in the Handbook, the FCA also sets out what firms can do to reduce their financial crime risk and brings together all its guidance on financial crime, from thematic reviews and other work.[71] The MLR require the FCA to have regard to guidance issued by the JMLSG when deciding whether a firm has failed to comply with a requirement of these regulations. 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

[71] *Financial Crime: A guide for firms*, April 2015.

- are comprehensive and proportionate to the nature, scale and complexity of a firm's activities.

107. 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.

108. A firm should ensure that its AML systems and controls include:

- 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 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.

109. 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 (SAR) to the National Crime Agency where they know or suspect that a person is engaged in, or attempting, money laundering. Having reported a SAR the bank must be mindful of not committing 'tipping off'.[72]

110. Firms must ensure that they are able to demonstrate the extent of their customer due diligence (CDD) measures is appropriate in view of the risks of

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[72] Section 333 of the Proceeds of Crime Act 2002 provides that a person commits an offence if they know or suspect a SAR has been filed and that they make a disclosure that is likely to prejudice any investigation which might be conducted following the making of that SAR.

money laundering and terrorist financing. All firms that 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, who should act as a focal point for the firm's AML activity.

Identification requirements

111. The need for banks to identify and verify customers through CDD is the aspect of money laundering compliance that is most likely to affect the opening of new accounts.

112. Regulation 7 requires banks to undertake CDD on new customers and under certain circumstances existing customers. This includes identifying the customer and understanding the purpose and intended nature of the business relationship. It is, however, left to the individual bank to 'determine the extent of CDD measures on a risk-sensitive basis depending on the type of customer, business relationship, product or transaction'. Banks are nonetheless required to demonstrate to the FCA that the extent of the measures adopted is appropriate in view of the risks of money laundering.

113. For PCAs, identification is normally the customer's name, date of birth and address.[73] For verification of this information much weight is placed on identity documents such as passports, driving licences and utility bills. It is, however, possible to be reasonably satisfied as to a customer's identity based on other evidence. However firms must apply enhanced CDD measures where they believe there is a risk of commission of money laundering/terrorist financing.

114. For business customers banks need to gather more information. This is summarised in paragraph 5.3.125 of the JMLSG guidance:

> To the extent consistent with the risk assessment … the firm should ensure that it fully understands the company's legal form, structure and ownership, and must obtain sufficient additional information on the nature of the company's business, and the reasons for seeking the product or service.
>
> This includes details of the business and, for unlisted companies, names of all directors, individuals who control or own over 25% of voting rights or who otherwise exercise control over the management of the company. These should then be verified as for personal customers. Companies with limited publically

[73] JMLSG guidance, paragraph 5.3.59.

available information may, but will not necessarily, require the application of a more rigorous CDD process.

115. The MLR also require banks to apply enhanced CDD in a number of circumstances. This includes where the customer is ‘not physically present for identification purposes’. Consistent with its risk-based approach the MLR do not specify measures required when conducting enhanced customer due diligence. Banks must, however, take ‘specific and adequate measures to compensate for the higher risk’.

Reliance on existing due diligence

116. Regulation 17 of the MLR provides for a bank to rely on the CDD measures undertaken by another bank. The logic behind this is expressed in the JSMLG guidance: ‘several firms requesting the same information … not only does not help in the fight against financial crime, but also adds to the inconvenience of the customer’.

117. There are, however, two conditions placed on this:

(a) The party being relied upon must provide both its consent to being relied upon and, as soon as reasonably practicable, any information about the customer including copies of identification and verification data obtained during CDD.

(b) A bank that does not undertake its own CDD but relies on another party’s remains liable for a failure of that party to apply the measure properly.

Future changes

118. FATF published revised standards in February 2012. These form the basis of a new set of European AML directives – the Fourth Money Laundering Directive (4MLD) – which came into effect on the 25 June 2015 and must be implemented into UK law within two years. HMT anticipates laying a replacement to the MLR in autumn 2016 with the intention that they come into effect by the end of the two-year implementation period. 4MLD is a minimum harmonisation directive which allows the UK to implement 4MLD in a way that is more stringent or specific. Consultation on draft implementing regulations is due to begin later this year or early in 2016.

119. The implementation of 4MLD is unlikely to result in a significant change to the money laundering framework as it applies to the opening of current accounts. The recitals to 4MLD emphasise the need for a risk-based approach and the need to take into account the characteristics of smaller entities made subject

to the directive. This is already a feature of money laundering regulation in the UK.

120. One minor change is that 4MLD provides that enhanced customer due diligence is not required in non-face-to-face verification where there are 'certain safeguards, such as electronic signatures'. This may help provide certainty for firms applying a risk-based approach.

121. 4MLD also includes provisions relating to the sharing of information regarding beneficial owners. Member states will be required to keep central registers of the ultimate beneficial owners of corporate and other legal entities, which are accessible to authorities, financial intelligence units, entities subject to the 4MLD including banks, and persons with a legitimate interest.[74]

Other relevant AML initiatives/considerations

122. On 28 August 2015 the Better Regulation Executive launched an evidence gathering exercise on the implementation of the AML regime. The intention is to gather evidence from businesses, industry groups and supervisors (eg FCA) in the various sectors where the money laundering regime applies. The focus is on how the AML regime is applied. Findings are due to be published at the end of the year.

Immigration provisions

123. Under the Immigration Act 2014 and subsequent Immigration Act (Bank Account) Regulations 2014, banks and building societies are prohibited from opening bank accounts for people who are known not to have leave to remain in or to enter the UK, unless they have undertaken a status check that indicates the individual concerned is not a 'disqualified person'.[75] The FCA has a duty to monitor and enforce compliance with this prohibition.

124. To ensure they are complying, banks and building societies can carry out an immigration status check with a specified anti-fraud organisation or data-matching authority before opening a new current account.

Payment Systems Regulator

125. FSBRA also created a new economic regulator, the PSR with concurrent competition powers in relation to the participation in payment systems. In April

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[74] BIS has been consulting on how to implement this in the UK.
[75] Under the Immigration Act 2014 and subsequent Immigration Act (Bank Account) Regulations 2014 a 'disqualified person' is a person who is in the UK, who does not have the required leave to enter or remain in the UK, and whom the Home Secretary considers should not be permitted to open a current account.

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.

126. FSBRA provides that the PSR will regulate those domestic payment systems that are designated by HMT. HMT 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.

127. Following consultation,[76] on 19 March 2015 HMT designated interbank and card payment systems for regulation by the PSR from 1 April 2015, which are:

- Bacs,
- CHAPS,
- FPS,
- LINK,[77]
- C&C (Cheque & Credit),
- Northern Ireland Cheque Clearing,
- MasterCard,[78] and
- Visa Europe.

128. For each designated system, all the 'participants' in that payment system will fall under the PSR's regulatory remit.[79] Participants in a payment system include the operator that manages or operates that system, the PSPs (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.

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[76] HMT consultation on designation of payment systems.
[77] LINK is a shared interbank network of 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.
[78] Operated by MasterCard Inc.
[79] Save for functions falling to the FCA's regulatory remit under the Payment Services Regulations 2009.

129. The PSR has published a series of guidance documents[80] setting out how it intends to act, the expectations it has and the procedures and processes it will typically follow.

PSR's relationship with other financial regulators

130. Sections 98 to 102 of FSBRA[81] 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 coordinate the exercise of their relevant functions. Relevant functions means, in relation to the PSR, its functions under Part 5 of FSBRA; in relation to the BoE, its functions under Part 5 of the Banking Act; and in relation to the FCA and the PRA, their respective functions under FSMA.

Power of veto

131. 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 coordinate exercise of functions

132. The PSR, the BoE, the PRA and the FCA are under a general obligation contained in FSBRA to coordinate 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 coordinate 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.

133. The PSR has entered into a memorandum of understanding[82] with the BoE, FCA and PRA, setting out how it expects the statutory duty to coordinate to

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[80] PSR's written guidance.
[81] Sections 98–102 FSBRA.
[82] MoU on statutory cooperation between regulators.

apply. The duty to coordinate will reduce the likelihood that the veto powers will be used.

Interaction with Payment Services Regulations

134. PSPs are currently covered by the 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 2009 are dealt with in greater detail at paragraph 265.

The PSR's general duties

135. 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:[83]

- 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.
- 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.
- The service-user objective – to ensure that payment systems are operated and developed in a way that takes account of, and promotes, the interests of those who use, or are likely to use, services provided by payment systems.

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

The PSR’s regulatory powers

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

Directions

137. 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

138. 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

139. 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 PSP in relation to the system (section 56 FSBRA); and
- any PSP with direct access to a system to enter into an agreement with the applicant to enable the applicant to become a PSP 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

140. 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 PSP'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 PSP (ie varying an agreement relating to existing direct access to the system).

- The PSR may vary the terms and conditions relating to the PSP's participation in the payment system (including fees or charges payable under the agreement) for any agreement between a PSP with direct access to a regulated payment system and another person for the purpose of enabling that other person to become a PSP (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.

141. 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

142. The PSR has the power to require a person who has an interest in the operator of a regulated payment system, or an infrastructure provider in relation to such a 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 HMT. It is enforceable by civil proceedings brought by the PSR. The Small Business, Enterprise and Employment Act 2015 (SBEEA) 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

143. The PSR, like the FCA, has enforcement powers under Chapters I and II of the CA98 and market study and market investigation reference powers under Part 4 of the EA02, as far as these powers relate to participation in payment systems. These powers will be exercised concurrently with the CMA.

144. 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 CA98 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 EA02 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.

145. The PSR has had competition powers under the EA02 to conduct market studies and make market investigation references to the CMA since 1 April 2014, and it obtained its competition powers under the CA98 on 1 April 2015. In August 2015, the PSR published guidance relating to the exercise of its concurrent competition powers under both the EA02[84] and the CA98.[85]

Legislating for the banking industry

The position in the EU

146. 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.[86]

147. The European Parliament may also request the European 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

[84] PSR's market studies guidance.
[85] PSR's CA98 guidance.
[86] 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.

reports on banking and financial services. A Member in the European Parliament may also initiate a proposal.

Committees and expert groups

European Supervisory Authorities

148. The European System of Financial Supervision consists of the European Systemic Risk Board (ESRB) and the three European Supervisory Authorities: the European Securities and Markets Authority based in Paris, the EBA based in London and the European Insurance and Occupational Pensions Authority based in Frankfurt.

149. The ESRB monitors and assess potential threats to financial stability that arise from macro-economic developments and from developments within the financial system as a whole.

150. ESMA contributes to the work of the ESRB, by providing data and undertaking stress tests in close coordination with the fellow European Supervisory Authorities and the ESRB.

151. The EBA was established in January 2011 as an independent EU authority. The EBA has assisted the European Commission in the development of the European Single Rulebook in banking.[87] 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 EBA works to ensure effective and consistent prudential regulation and supervision across the European banking sector. Its overall objectives are to maintain financial stability in the EU and to safeguard the integrity, efficiency and orderly functioning of the banking sector.[88]

DG FISMA

152. The DG FISMA is one of the Directorates-General and specialised services that make up the European Commission.

153. DG FISMA is responsible for initiating and implementing policy in the area of Banking and Finance. It is based in Brussels and works under the political authority of EU Commissioner Jonathan Hill, and is managed by Director General Olivier Guersent.

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[87] European Single Rulebook in banking.
[88] EBA website.

High Level Expert Group on reforming the structure of the EU banking sector

154. In 2011 the European Commission set up a High Level Expert Group (also named the Likaanen Group after its chairman), intended to emulate the UK's ICB. 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

155. 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 European Commission submitted a proposal[89] 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

156. The European Banking Committee was set up by the European Commission in November 2003. The Committee provides advice to the European 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 EBA.

Expert Group on Banking, Payments and Insurance

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

The position in the UK

HM Treasury

158. HMT 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 HMT.

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[89] European Commission proposal for a regulation on structural measures improving the resilience of EU credit institutions.

HM Treasury Select Committee

159. The HMT Select Committee is appointed by the House of Commons to examine and hold to account the expenditure, administration and policy of HMT, HM Revenue & Customs, and associated public bodies, including the BoE, FCA and PSR.

160. 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

161. The 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 FSBRA gave HMT and some regulators power to implement several recommendations made by the ICB including its recommendations on ring-fencing requirements (see further at paragraph 173).

Parliamentary Commission on Banking Standards

162. The Parliamentary Commission on Banking Standards (Parliamentary Commission) was established in July 2012, as a joint parliamentary committee chaired by Andrew Tyrie MP. The Parliamentary 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 were incorporated into FSBRA.

Department for Business Innovation and Skills

163. 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 HMT in drafting and consulting on secondary legislation applicable to the banking industry.

Part II: Current and recent EU and UK Initiatives affecting the banking industry

164. The following section summarises current and recent key initiatives and actions 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.

165. Of these initiatives, the CMA considers Midata, PSD2, the Payment Accounts Directive (PAD) and open APIs to be of particular relevance to the issues it is considering. Many of the developments discussed below, and their potential impact on competition in the sector, are considered in more depth in other sections of the report, in particular:

- Midata, PSD2, PAD and APIs are considered in Section 7 of this report.
- Some of the PRA initiatives are considered in Section 10 on barriers to entry and expansion.

Current PRA initiatives

166. The following is a list of current key projects relevant to the retail banking sector being undertaken by the PRA. The PRA is providing UK input on a number of international initiatives:

Pillar 2: supervisory review

167. On 29 July 2015, the PRA issued a policy statement[90] on how it will assess capital adequacy under a new framework for the Pillar 2 regime, which will come into force on 1 January 2016. Please refer to paragraph 68 for further information.

Total Loss Absorbing Capacity for systemically important firms

168. On 10 November 2014, the FSB[91] published a consultation on a proposed standard for 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 47 onwards).

169. 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.

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[90] BoE policy statement.
[91] The FSB is an international body that monitors and makes recommendations about the global financial system.

170. The TLAC standard proposed by the FSB will apply to G-SIBs no earlier than 1 January 2019. Within the EU, equivalent TLAC standards (known as minimum requirements for own funds and eligible liabilities – MREL) will apply from 1 January 2016, and will be set on a case-by-case basis for each banking entity in the EU.[92]

Risk weightings in capital adequacy requirements: IRB and SA review

171. The PRA is feeding into a BCBS exercise to review the IRB and SA. The BCBS published a consultation paper on 22 December 2014[93] 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%. In April 2015 the BCBS published comments received in response to the consultation, but as at the date of publication of this appendix has not published its response.

172. The BCBS is also consulting[94] 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. As at the date of publication of this appendix, the BCBS has yet responded to the consultation, but has stated that it 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

173. The PRA is responsible for the implementation of the ICB recommendations. Please see paragraph 284 onwards for a detailed consideration of the new ring-fencing regime.

DG FISMA consultation on CRR and CRD IV

174. DG FISMA is currently consulting[95] on the potential impact of the CRR and CRD IV on bank lending to the economy. The PRA is feeding into this exercise. The consultation closed on 7 October 2015.

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[92] See EBA's recent consultation.
[93] BCBS consultation on revisions to SA risk-weights.
[94] BCBS consultation on a standardised floor for IRB.
[95] DG FISMA consultation on the possible impact of the CRR and CRD IV on bank financing of the economy.

Current and recent FCA initiatives

175. The following is a list of projects currently being undertaken by the FCA, or which have recently been concluded, which are relevant to the retail banking sector.

Current Account Switch Service review

176. On 12 March 2015, the FCA published its findings on its review of the effectiveness of CASS.[96]

177. 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 that 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 the following measures to address these points:

Awareness and confidence

- Given the relatively low levels of awareness of and confidence in CASS, the FCA recommends that Bacs develops proposals to:
  - raise awareness of the service, such as a targeted marketing campaign or greater prominence of the service in branches;
  - identify ways to raise confidence levels in the service via the marketing campaign (for example by publicising customers' positive experiences); and
  - refining the targets around consumer confidence to better reflect customers' concerns (such as an error-free switch).

Redirection service

- The FCA recommends that Bacs develops a proposal to mitigate the risk of the end of the redirection service undermining confidence in CASS, and that Bacs considers the technical feasibility of an unlimited extension to the redirection service.

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[96] FCA's review of the Current Account Switching Service and account number portability.

Other operational issues

- The FCA found evidence of a problem experienced by some consumers requesting an overdraft on a new current account to which they plan to switch, whereby the switch takes place before the customer has received approval for their new overdraft.

- The FCA has contacted relevant PCA providers to understand exactly which providers are affected, and begin developing a solution with those banks and building societies that have not already addressed these issues.

178. In considering its effect more broadly, the FCA found that there has been only 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 new current account products.

Study of account number portability

179. Alongside its review of CASS, the FCA also gathered evidence on other measures that may help make switching current accounts simpler and easier for consumers, including account number portability.

180. The FCA found that being able to keep bank account details (ie account number and sort code) 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.

181. The FCA found that the evidence gathered indicates that further work to quantify the potential benefits and costs of account number portability would be appropriate and has provided the PSR the evidence it gathered in relation to account number portability to consider, alongside other possible innovations in payment systems, as part of the PSR's future programme of work.

Cash savings market study

182. The FCA carried out a market study to examine, among other things, the extent to which consumers' choice of savings provider is influenced by where

they hold their PCAs. The FCA published its final findings and proposed remedies on 20 January 2015.[97]

183. The FCA concluded that the cash savings market is not working well for many consumers, and recently consulted on a more detailed package of remedies aimed at:

- 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 current accounts and savings with different providers in one place; and
- 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.

184. In July 2015 the FCA issued a feedback statement and consultation paper[98] summarising the responses it received on the proposed remedies, giving further information on the proposed remedies, and setting out intended next steps. The consultation closed on 12 October 2015.

Credit card market study

185. The FCA published its credit card market study terms of reference on 25 November 2014.[99] The study is intended to ascertain whether the market is working well and in the interests of consumers. The FCA has stated that it plans to publish its interim report outlining its initial findings and details of actions it may consider in autumn 2015.

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[97] FCA Cash savings market study report.
[98] FCA (2015), *Cash savings remedies: Part 1: Feedback on proposed remedies, Part 2: Discussion & Consultation paper*.
[99] FCA credit card market study.

Monitoring of overdrafts

186. 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 paper[100] on the impact of annual summaries, text alerts and mobile banking apps on consumers.

187. As a result of its analysis, the FCA concluded that annual summaries provide no measurable benefit for customers, in terms of reducing overdraft charges, encouraging more active management of balances or encouraging switching. 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.

188. On 28 July 2015, the FCA published its findings[101] on a thematic review of whether consumers are protected in the event of fraudulent or other unauthorised transactions on their current account and/or credit card by provisions in the Payment Services Regulations 2009, the Consumer Credit Act 1974 and, in some cases, the FCA Handbook.

189. The review found that firms are generally meeting their legal obligations and are making a good effort to deliver fair outcomes for their customers. Firms tend to err on the side of the customer when reviewing claims and the FCA did not find evidence of firms declining claims on the basis of customer 'non-compliance' with prescriptive security requirements in the terms and conditions.

Packaged bank accounts.

190. 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.

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[100] FCA paper on annual summaries, text alerts and mobile banking apps.
[101] FCA thematic review: Fair treatment for consumers who suffer of unauthorised transactions.

Project Innovate.

191. 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. The FCA has to date pursued its aim in two main ways:

- The Innovation Hub helps innovative businesses gain access to fast, frank feedback, including informal steers, on the regulatory implications of their concepts, plans, and choices.
- The FCA has tackled structural issues that innovators told the FCA impede the progress of their propositions towards the market.

192. In July 2014 the FCA announced the next steps for Project Innovate which include:

- provision of end-to-end support to new market entrants from initial pre-authorisation support to dedicated supervisory support, normally for one year;
- international engagement with foreign regulators; and
- proactive engagement with large incumbents.

Market study into investment and corporate banking

193. On 22 May 2015, the FCA published terms of reference[102] for a market study into investment and corporate banking. This followed the FCA's review of wholesale markets, launched in June 2014. The FCA heard evidence of potential competition issues in investment and corporate banking services. The market study is examining whether there are areas of investment and corporate banking services where competition may not be working well. It is focusing on three key issues within primary market and related activities:

- Choice of banks and advisers for issuing clients.
- Limited transparency in the provision of services.
- Practices of bundling and cross-subsidisation of services.

194. The FCA aims to publish an interim report around the end of 2015/beginning of 2016, and a final report in spring 2016. The interim report will set out those

[102] FCA terms of reference for investment and corporate banking market study.

areas which the FCA considers raise concerns, and those areas in which it has found few or no problems.

SMEs as users of financial services

195. Towards the end of 2015, the FCA intends to publish a discussion paper on the treatment of SMEs as users of financial services under the current framework of financial regulation, which will include a review of the treatment of firms' dealings with SMEs throughout the FCA Handbook. The paper will seek evidence on outcomes for firms' SME customers and stakeholders' views regarding the remit of the Ombudsman Services.

Sharing of SME credit information

196. The Small Business, Enterprise and Employment Act contains measures aimed at improving access to SME credit information and helping to match SMEs seeking finance with alternative finance providers. Detailed provisions will be set out in regulations that will require the FCA to monitor and enforce relevant requirements. The FCA consulted on its proposed approach to its duties under the regulations in the summer of 2015.[103]

Other FCA projects

197. 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.

198. The FCA carried out a thematic review of mobile banking and payments and published its review on 11 September 2014.[104,105]

199. Further to the announcement in its Business Plan 2015/16 of its intention to review whether there are any barriers to competition in the mortgage sector, on 7 October 2015, the FCA published a Call for Inputs[106] asking those with an interest in the mortgage sector to help the FCA identify potential areas where competition may not be working well and could be improved.

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[103] FCA Consultation Paper.
[104] FCA (2014), *Thematic Review: Mobile banking and payments (TR14/15)*.
[105] Please note that there are also European developments in this area such as the proposed PSD2 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.
[106] Call for Inputs.

Current PSR initiatives

200. In May 2015 the PSR launched two market reviews.[107] The first aims to assess the ownership and competitiveness of infrastructure provision in payment systems in the UK and consider whether the current provision of infrastructure services in UK interbank payment systems delivers a good outcome for service users. The second aims to assess indirect access to payment systems, and whether competition is working well for service users. The reviews are each expected to take 12 months.

201. HMT has indicated in a recent consultation paper on the application of the EU Interchange Fee Regulation (IFR) that it intends to designate the PSR as the competent authority to monitor and enforce the IFR in the UK (discussed further in paragraph 279). 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.

202. Ahead of its launch on 1 April 2015, the PSR published a policy statement alongside its planned programme of policy work. This work included the establishment of a Payments Strategy Forum (a new strategy setting process for the payments industry), and 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.

UK government initiatives and actions

The Midata project

203. 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 programme was launched by BIS in 2011 as part of the government's consumer empowerment strategy 'Better Choices: Better Deals'. 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.[108]

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[107] Terms of reference of PSR market reviews.
[108] BIS (2012), *Better Choices: Better Deals: Report on progress on the Consumer Empowerment Strategy*.

204. Since its launch the Midata initiative has been on a voluntary basis, though BIS has said it intends to keep this position under review.

205. Led by HMT the most recent progress has been made in the PCA market where a number of retail banks have signed up to the Midata initiative, allowing their customers to download their own transactional data (eg transactions, interest, charges) for their current account(s) over the previous 12 months which they can then upload to the Gocompare.com price comparison website (PCW), to compare and identify the best value account for them based on their actual banking behaviour.

Open API standard in banking

206. The government has announced[109] its intention to deliver an open API standard in UK banking. HMT 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.

Project Verde – TSB state aid divestiture

207. In November 2009, the European Commission approved, under state aid rules, a restructuring plan for LBG, following the bail-out of LBG by the UK government in January 2009.

208. To ensure that LBG re-emerged as a stable, profitable bank, the restructuring plan envisaged measures to re-focus on core activities within the historical risk profile of Lloyds TSB.

209. 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, code-named Verde, and subsequently re-branded as TSB. Under the restructuring plan, the divested entity was to have a 4.6% market share in the PCA market, gained through a network of at least 600 branches. The deadline for the divestment was 30 November 2013.[110]

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[109] Call for evidence on API in banking.
[110] European Commission, 'State aid: Commission approves restructuring plan of Lloyds Banking Group' (IP/09/1728) (18 November 2009).

210. The Co-op planned to acquire TSB, but pulled out in April 2013. As no other buyer could be found, LBG established TSB as a standalone bank.

211. As a result of the Co-op's withdrawal seven months before the divestment deadline of 30 November 2013, 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, to improve TSB's ability to compete and the viability of the divestment process.

212. The European Commission accepted the UK's requests, and was satisfied that TSB's viability and competitiveness would not be endangered. Overall, the European 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.[111]

213. The new TSB Bank began operations on 9 September 2013. TSB Banking Group plc was listed on the London Stock Exchange in June 2014, at which time LBG sold 38.5% of TSB's ordinary shares in issue. On 26 September 2014, LBG announced that it had sold a further 11.5% of TSB's shares. As a result, LBG held approximately 50% of TSB's shares. On 20 March 2015, LBG announced that it had agreed to sell a 9.99% interest in TSB to Sabadell (this has now taken place), and had also entered into an irrevocable undertaking to accept the offer in respect of its entire remaining 40.01% shareholding in TSB. The sale of the stake in TSB has been approved by the European Commission from a merger control perspective and on 30 June 2015 the acquisition was approved by the PRA and FCA.

Project Rainbow – RBSG state aid divestiture

214. In December 2009 the European Commission approved, under state aid rules, a restructuring plan for RBSG, which had also been bailed out by the UK government in October 2008.

215. Under the restructuring plan, RBSG was required to divest certain insurance, merchant acquiring and commodity trading operations and also (through Project Rainbow) a part of its UK retail, SME and mid-corporate banking operations based around the RBS branch network in England and Wales and the NatWest branch network in Scotland. The Rainbow entity was initially

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

required to have a 5% market share in the SME and mid-corporate banking markets.[112]

216. RBSG initially sought to divest Rainbow to a buyer with existing banking operations in the UK retail and SME market but an agreed sale to Santander fell through in October 2012. In 2013 RBSG established Rainbow as a standalone bank, in due course to be branded as Williams & Glyn, the name of a high street bank that was absorbed by RBSG around 30 years ago. RBSG was unable to meet the committed deadline for the divestment.

217. The UK government requested a postponement of the Rainbow divestment, and in April 2014, the European Commission granted RBSG an extension to the end of 2016 to begin any IPO of Williams & Glyn, and required the disposal to be completed by the end of 2017. The revised agreement contained provisions intended to ensure the viability and competitiveness of the Williams & Glyn business would be preserved until divestment.

218. RBSG has stated[113] that Williams & Glyn will begin operating by the end of 2016.

219. On 28 May 2015, the CMA announced that it had been requested by the Chancellor of the Exchequer to advise on the implications for competition of the latest proposals for divestment by RBSG of Williams & Glyn as a new UK retail bank.

Small Business, Enterprise and Employment Act 2015

220. The SBEEA received royal assent on 26 March 2015 and comes into force at staggered periods over 2015 and onwards. It 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.

221. The SBEEA contains provisions on access to finance for SMEs, and from an SME banking perspective, these are the most significant provisions contained

[112] European Commission, 'State aid: Commission approves impaired asset relief measure and restructuring plan of Royal Bank of Scotland' (IP/09/1915) (14 December 2009).
[113] RBSG information on Williams & Glyn launch.

in the SBEEA. The SBEEA 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.

222. The SBEEA includes a range of measures intended to improve the ability of SMEs to access finance generally. The SBEEA 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 CRAs, and requiring those CRAs to ensure equal access to that data for all lenders;
- obliging banks that refuse to grant finance to a customer to offer the customer a referral to an online finance platform. These platforms will give alternative finance providers the opportunity to offer viable businesses the finance they need;
- 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.

223. These measures are designed to improve the ability of newer 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.

224. On 7 September 2015, the HMT laid before Parliament the Small and Medium Sized Businesses (Credit Information) Regulations 2015[114]. 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.

225. At the same time, the HMT laid before Parliament the Small and Medium Sized Businesses (Finance Platform) Regulations 2015[115]. The draft regulations impose a duty on banks 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). The regulations are currently being considered by Parliament and are therefore still subject to change.

226. The British Business Bank, acting as HMT's agent, has invited expressions of interest from CRAs and finance platforms that wish to be designated by the

[114] Draft Regulations.
[115] Draft Regulations.

HMT to receive SME data from banks under the powers contained in the SBEEA. The ultimate aim is for new finance platforms to be created so that lenders can find viable businesses that are looking for a loan, but have been rejected by a designated bank first time around.

227. The legislation also addresses restrictions that may be included in business contracts preventing the assignment of debts. This is intended to tackle barriers to the ability of SMEs to access invoice finance and other forms of receivables financing.

228. Much of the detail, and therefore the potential impact of these provisions, is left to the regulations that may be made under section 1 of the Small Business, Enterprise and Employment Act 2015. On 6 December 2014, BIS published a consultation and draft regulations (the Business Contract Terms (Restrictions on Assignment of Receivables) Regulations 2015 (Draft Restrictions on Assignment of Receivables Regulations) on the proposal to nullify the ban on invoice assignment. BIS is currently analysing responses to the consultation.

229. The SBEE also introduces cheque imaging, which will allow banks to exchange images of cheques in order to clear them, rather than having to exchange the physical cheque. Banks that offer this service will allow businesses the option of depositing cheques remotely via a smartphone or tablet thus enabling a faster clearing cycle, meaning businesses receive their funds more quickly. Secondary legislation to implement this change is expected to be in place by July 2016.

Funding for Lending Scheme

230. The BoE and HMT launched the 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 HMT Bills in exchange for eligible collateral. The FLS scheme has been extended until January 2016.

Improved compensation arrangements through the Financial Services Compensation Scheme

231. The Financial Services Compensation Scheme (FSCS) is a statutory fund of last resort for customers of financial services firms, run by an independent body set up under FSMA, which in the case of insolvency of banks, building societies or credit unions will automatically refund savings in an individual

account up to £75,000[116] within seven days.[117] A hierarchy of creditors exists, with priority given to households and small business depositors under the FSCS.[118]

EU initiatives

The Payment Accounts Directive (PAD)

232. 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 PAD[119] was adopted 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 alternative payment account switching services permitted by the directive are compliant with the requirements in the PAD.

233. The PAD has three main aims:

- to make it easier for consumers to compare the fees charged on payment accounts by banks and other payment services providers (PSPs) in the EU;
- to establish quick and easy procedures for switching from one payment account to another, with a different bank or PSP; and
- to enable all EU consumers, irrespective of their country of residence in the EU or financial situation to open a payment account that allows them to perform essential functions.

234. The PAD applies to payment accounts through which consumers are able to:

- place funds in a payment account;
- withdraw cash from a payment account; and
- execute and receive payment transactions, including credit transfers, to and from a third party.

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[116] £150,000 for joint accounts. See FSCS publication on compensation limits.
[117] This builds on the Deposit Guarantee Schemes Directive (Directive 2014/49/EU), which sets a €100,000 limit which was originally translated to an FSCS compensation limit of £85,000 for individual accounts. However, from 1 January 2016 this limit will change to £75,000 due to material changes in the exchange rate since the original limit was set.
[118] See Part 2 of the FSBRA.
[119] Directive 2014/92/EU.

235. This covers most PCAs. Business accounts fall outside the scope of the PAD, unless they are held as a personal account.

Fee information

236. Banks will be legally required 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.

237. Banks will be required to provide consumers two new standardised documents, which are:

- a pre-contractual fee information document; and
- a statement of fees (at least annually).

238. The statement of fees must include at least the following information:

- the unit fee charged for each service and the number of times the service was used;
- the total amount of fees incurred for each service, each package of services provided and services exceeding the quantity covered by the packaged fee;
- the overdraft interest rate applied and the total amount of interest charged relating to the overdraft (where applicable);
- the credit interest rate and the total amount of interest earned; and
- the total amount of fees charged for all services.

239. Where a payment account is offered as a packaged account, PSPs need to inform customers whether the account can be bought separately, and if so, provide customers separate information on the costs and fees of the different products and services when purchased separately.

Standardised terms

240. Member states will establish a provisional list of at least ten to 20 of the most representative services linked to a payment account and subject to a fee. Member states will have regard to services that are most commonly used by

consumers in relation to their payment account and generate the highest cost for consumers.[120]

241. Each member state must submit its list to the European Commission and the EBA by 18 September 2015. Based on the lists of all member states, the EBA will develop EU standardised terms and definitions. Following the adoption of the EU standardised terms and definitions, each member state must integrate these into their provisional national list.[121]

242. Payment providers will be required to use the standardised terminology in the pre-contractual fee information document and statement of fees. A glossary of at least the EU standardised terms, including their definitions, should be made available to consumers on request.

Comparison websites

243. The PAD requires member states to ensure that consumers have access, free of charge, to at least one independent PCW comparing fees charged by PSPs, for at least those services included in each national list of ten to 20 of the most representative banking services.[122]

244. Member states may choose to require the comparison website also to compare other information, such as customer service levels or number of branches.[123]

Payment account switching

245. Banks must put in place a switching service for payment accounts held in the UK and falling within the scope of the PAD. The PAD stipulates the duties on both the old and new bank conducting the switch, including maximum periods within which certain elements of the switching process must be completed.

246. Member states can maintain or put in place switching arrangements that depart from the PAD provided they are not less beneficial for consumers. The

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[120] Both overall as well as per unit. See Articles 3 and 4 of the PAD.
[121] This will mean that some terms and definitions contained on the provisional national list may have to be replaced, while others will remain unchanged. See Article 3 of the PAD. If none of the services that appear in the UK's provisional list of services linked to a current account are also common to at least a majority of member states, and do not appear on the EBA's list of EU standardised terms, then the changes to terminology required in the UK will be minimised. However, if all the services that appear in the EBA's list are in use in the UK, then the change required will be more burdensome. Please see HMT, 'Implementation of the EU payment accounts directive', (23 June 2015).
[122] Article 7 of the PAD. Recital 23 of the PAD specifies that the 'comparison website should compare the fees payable for services contained in the list of most representative services linked to payment accounts, integrating Union-level terminology'. See also Regulation 12 of the draft Payment Accounts Regulations 2015.
[123] HMT has indicated that it is unlikely that the Payment Accounts Regulations will require the PCW to compare factors other than price.

UK's CASS exceeds most of the standards in the PAD and the European Commission has confirmed that member states would not need to establish a new account switching service if, subject to certain conditions set out in Article 10(1) of the PAD, existing account switching schemes guarantee comparable rights to consumers. CASS in its current form would therefore be compliant with Article 10(1) of the PAD.

Basic bank account (BBA) provision

247. Anyone legally resident in the EU will have a right to open a 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.

248. The 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.

Implementation of PAD

249. The PAD came into force on 17 September 2014 and member states must transpose most of its provisions into national law by 18 September 2016.

250. HMT has recently carried out a consultation on draft Payment Accounts Regulations, which will implement the Directive in the UK. The consultation closed on 3 August 2015 and HMT is analysing feedback.[124]

251. Member states have discretion to extend the PAD's application in a number of areas. The UK government's starting position is not to extend the application of the PAD beyond what is strictly required. The exceptions to this are the provisions on payment accounts with basic features (ie BBAs) and the switching services CASS, where UK policy is more developed than that set out in the PAD. As a result the government intends to implement the PAD in such a way as to preserve the UK's existing BBA policy and CASS as far as possible, while creating the necessary legal certainty for consumers required by the PAD.

Fee information

252. The draft regulations set out which information must be provided in the pre-contractual fee information document and the statement of fees, as well as

[124] HMT PAD consultation.

some requirements on how the information must be presented. These requirements do not go further than the provisions in the PAD.

253. The draft regulations clarify that where a payment account is offered as a packaged account, PSPs need to inform customers whether the account can be bought separately from the same provider, and if so, provide customers separate information on the costs and fees of the different products and services when purchased separately. PSPs would not be obliged to inform consumers of similar additional services offered by other providers.

Standardised terms

254. The FCA has undertaken work to establish the UK's provisional list of services as described in paragraph 239. The FCA published a feedback statement[125] on 15 September 2015. This statement summarised the feedback received on its call for input[126] earlier this year and explained how this feedback was used to finalise the provisional UK list of services and the terms and definitions for these services.

255. The FCA submitted this list to the European Commission and the EBA. The EBA will standardise the terms and definitions for the services that appear on the lists of at least a majority of EU member states. The EBA will consult publicly on its proposed EU standardised terms and definitions.

Comparison website

256. The PAD requires that consumers have access to at least one PCW. In the UK, this comparison website will be operated by the Money Advice Service, the UK's independent body charged with enhancing the public's understanding of financial matters. Separately, HMT has stated that 'the government will press ahead with its Midata programme, which will allow consumers to use their own personal account usage data to generate comparisons that are more meaningful to them'.[127]

Switching services

257. CASS exceeds most of the PAD requirements for a switching service.

258. As competent authority for this part of the PAD, the PSR will consider applications from operators of alternative switching services and make a

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[125] FCA feedback statement.
[126] FCA call for input.
[127] HMT, 'Implementation of the EU payment accounts directive', (23 June 2015).

determination on whether any alternative arrangements meet the criteria set out in Article 10(1) of the PAD. Although it may be possible for other switching services to emerge over time, the government expects that for the foreseeable future the only switching service in the UK will be CASS.

259. Any PSPs offering payment accounts falling within the scope of the PAD which is not a member of CASS will be required to provide a switching service for their customers that at least meets the requirements in the PAD. Other switching services (eg the Bacs ‘partial only’ switch) may continue to be offered alongside either CASS or a PAD-compliant switching service.

Basic bank accounts

260. The UK already had provision for BBAs prior to the introduction of the PAD, 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 costs to the banking industry of £300 million.

261. 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-op 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.

262. The Parliamentary Commission recommended in its report of 12 June 2013 that the major banks come to a voluntary agreement on minimum standards for the provision of BBAs, including access to the payment system and money management services, and free use of the ATM network, within 12 months of the date of the report.

263. On 15 December 2014 HMT published its revised BBA agreement with nine[128] UK banks. From the end of 2015, participating banks will offer BBAs that are fee-free for standard operations, including a failed payment, removing the risk that customers run up unintended overdrafts. BBA customers will be offered services on the same terms as other PCAs, including access to all the

[128] Barclays, the Co-op, HSBC, LBG, National Australia Group, Nationwide, RBSG and TSB.

standard over-the-counter services at bank branches and at the Post Office, and access to the entire ATM network.

264. The government has concluded that the voluntary agreement does not fully implement the PAD and that secondary legislation is necessary to achieve this. In particular, the government considered that the 2014 agreement did not establish a clear legal right of access to a BBA and a route to challenge a bank's decision not to grant that access with sufficient legal certainty. The draft Payment Accounts Regulations seek to achieve this.

The Payment Services Directive (and Payment Services Regulations 2009)

265. The PSD[129] 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. 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 PSPs and their customers. The Payment Services Regulations 2009[130] implement the PSD.

266. 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 PSP. As between a consumer and their bank, the information will almost always be provided through the bank's terms and conditions (framework contract).

267. Under a framework contract, information has to be provided about the PSP, 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.

268. The PSD is a maximum harmonisation directive; however, several provisions of the PSD leave a margin of discretion to member states.

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[129] Payment Services Directive (2007/64/EC).
[130] Payment Services Regulations 2009 (SI 2009/209).

Proposed Second Payment Services Directive

269. The European Commission published a proposal for the PSD2[131] in July 2013. The proposed directive will repeal the current PSD.

270. Like the current PSD, the PSD2 is a maximum harmonisation directive. In June 2015 political agreement was reached on the final text of the PSD2. The PSD2 may be adopted in September 2015, however two member states have raised concerns with the directive. If adopted, member states will be required to transpose the directive into national law within two years. It is therefore expected that the PSD2 will need to be implemented by the end of 2017.

271. The PSD2 aims to update the current framework on payment services, extending its scope to PSPs that were previously unregulated, and to improve the transparency and security of payment services. The updated rules aim to stimulate competition to provide payment services and foster innovative payment methods, especially for online payment services. [132] Some of the changes brought about by the proposed PSD2 are described below.

272. The PSD2 contains proposals to remove or restrict a number of exemptions under the PSD. Independent ATMs are still exempted under the PSD2, but they will be required to provide customers with information on withdrawal charges prior to the transaction and on the customer's receipt.

273. The PSD2 proposes to introduce new rules aimed at increasing competition by facilitating the use of third party PSPs. The proposals include an obligation on banks to allow customers who have an online account to use new payment initiation[133] and account information[134] services provided by third party PSPs. Banks will also be required to provide appropriate access and information to third party PSPs acting for payers, and to treat payment orders transmitted through the services of third party PSPs in a non-discriminatory way.

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[131] 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.
[132] European Parliament, 'Updating payment service rules: MEPs do deal with the Council' (05 May 2015).
[133] A payment initiation service is defined as a 'payment service enabling access to a payment account provided by a third party payment service provider, where the payer can be actively involved in the payment initiation or the third party payment service provider's software, or where payment instruments can be used by the payer or the payee to transmit the payer's credentials to the account servicing payment service provider' (the account holder's bank). Essentially, a payment initiation service provider enables a payment by populating the transaction details and confirming that the payer has sufficient funds in his/her account to complete the transaction. The payment initiation service provider will not receive or handle customer funds at any stage and will not provide a statement of account balance; it will simply give a yes or no answer as to whether the payer has sufficient funds to complete the payment. Payment initiation services, such as Zapp and Apple Pay, offer more innovative and often cheaper ways of paying for goods online without the need for a credit or debit card.
[134] An account information service is defined as a 'payment service where consolidated and user-friendly information is provided to a payment service user on one or several payment accounts held by the payment service user with one or several account servicing payment service providers'. This includes services that enable users to have a consolidated view of their online bank accounts.

274. The EBA will develop regulatory technical standards which will provide how banks will need to allow third party payment providers access to accounts. To offer these services, third party PSPs that do not execute fund transfers themselves, but offer predominantly online banking based payment initiation or account services, are required to be licensed or registered and supervised as payment institutions.

275. The PSD2 requires banks to apply strong customer authentication measures where a user accesses their online account or initiates a payment transaction. PSPs will be liable for unauthorised payment transactions. Where a third party PSP is involved, each provider will take responsibility for the respective parts of the transaction under its control.

276. The information and transparency conditions pre-contract and before and after a transaction are maintained in the PSD2. The PSD2 will require all framework contracts to include a condition that the payer may require the information to be provided or made available periodically at least once a month free of charge and in an agreed manner. Under the current PSD this is optional. The PSD2 maintains the option for member states to require PSPs to provide information on paper or another durable medium at least once a month free of charge.

277. The PSD2 introduces a derogation from the information requirement for low value payment instruments and e-money payments. For payment transactions that do not exceed €30 or that either have a spending limit of €150 or store funds that do not exceed €150, PSPs must provide the payer only with information on the main characteristics of the service, including liability and charges levied. Member states may double or decrease these amounts for national payment transactions. For prepaid payment instruments, member states may increase the amount to €500.

278. As under the current PSD, the PSD2 provides that where the user is not a consumer, the user and the PSP may agree that the transparency and information requirements do not in whole or in part apply. Member states may again provide that the provisions are applied to micro enterprises in the same way as consumer.[135,136]

Interchange Fee Regulation

279. The IFR 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

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[135] Article 54(3) of the PSD2.
[136] The UK has adopted this approach under the current Payment Services Regulations 2009.

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.

280. The IFR also set out the rules that can be imposed on such card schemes. The IFR, combined with the PSD2, aim to foster competition, innovation and security in the payment systems industry. The IFR was passed by the European Parliament on 10 March 2015, and came into force on 8 June 2015. The PSR has been designated as the competent authority for enforcing the terms of the regulation within the UK.

281. On 27 July 2015 HMT issued a consultation paper[137] setting out the government's proposed steps to meet the UK's obligation to put in place an adequate and efficient regulatory regime to supervise compliance with the IFR. It also seeks views on exercising the national discretions the IFR affords to member states; namely the way in which member states apply and set caps to interchange fee rates, and, based on an assessment of market shares, the application of a time-limited exemption period of up to three years to three-party card systems that use issuers or acquirers. The consultation closed on 28 August 2015.

Bank Recovery and Resolution Directive

282. The Bank Recovery and Resolution Directive (BRRD) establishes a recovery and resolution framework for EU credit institutions and investment firms. As of 1 January 2015 all member states have to apply a single rulebook for the resolution of banks and large investment firms, as prescribed by the BRRD. 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.

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[137] HMT interchange fee regulation consultation.

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

283. 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-authorised firms.

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

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

285. 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 HMT setting out the detail of the ring-fencing regime, specifying which entities will be RFBs and the activities and services that RFBs can, and cannot, carry out.

286. The primary and secondary legislation will be supported by ring-fencing rules to be made by the PRA,[138] 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.

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

Purpose of ring-fencing

288. 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, among 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

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

can be resolved in an orderly manner, thereby avoiding taxpayer liability and ensuring the continuous provision of necessary retail banking services.

Core services

289. 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.

290. 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

291. The only firms that will fall within the definition of a ring-fenced body are those that carry out core activities.[139]

292. The only activity currently designated as a core activity under FSBRA is the regulated[140] 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.[141]

Ring-fenced bodies[142]

293. 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

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[139] The ICB Report referred to these activities as ‘mandated activities’.
[140] For example, regulated by the PRA under Part 4A FSMA.
[141] FSBRA includes extensive detail on the definition of ‘core deposits’, but for the purposes of this appendix 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.
[142] Currently the only UK banks that would meet the threshold requiring them to ring-fence their retail activities are HSBC, Barclays, Santander’s UK arm, the Co-op, LBG and RBS. However, this list is subject to change, as

section on authorisation by the PRA, paragraph 24) will be a 'ring-fenced body', 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.

294. Under current proposals, the only firms that will be ring-fenced bodies 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

295. Certain exemptions from the ring-fencing requirements are available, which are:

- firms that are exempt from ring-fencing because of their form, eg building societies and credit unions;
- firms that are exempt as a consequence of the operation of powers under the special resolution regime;[143]
- situations where a firm's operations are small enough to fall within the de minimis exemption for small banks;[144] and
- situations where a firm has structured its operations so that it does not accept core deposits.

Excluded activities

296. 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

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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.

[143] For failing banks which are being 'bailed in', see government consultation on bail-in powers.

[144] 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.

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.

297. 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

298. The new regime will also allow HMT 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

299. 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

300. 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.

301. The requirements concerning the legal, operational and economic separation of RFBs will primarily be set out in PRA rules and supervisory statements.

302. 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.

303. In October 2014, the PRA issued its first consultation paper[145] on rules and policy proposals relating to the ring fence. On 27 May 2015, the PRA issued a policy statement[146] providing feedback on the responses received to that consultation paper, and some amendments to the draft rules and supervisory statements included therein. The policy statement covers three areas:

- legal structure arrangements of banking groups subject to ring-fencing;
- governance arrangements of ring-fenced bodies; and
- arrangements to ensure continuity of services and facilities to ring-fenced bodies.

304. The PRA does not consider that the responses to the consultation necessitate major changes to its proposed approach to implementing ring-fencing, however it has made a number of amendments to the draft rules and supervisory statements published therein, mainly to add clarity and certainty. Updated 'near final' versions of the rules and supervisory statements are included in the policy statement.

305. The government has stated its intention for ring-fencing to take effect from 1 January 2019. The PRA intends to undertake a further consultation during 2015, and to publish final rules and supervisory statements covering the policies proposed in these two consultations during the first half of 2016, to provide firms with sufficient time for implementation.

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[145] PRA consultation on ring-fencing policy proposals.
[146] PRA policy statement on ring-fencing.

Legal structure

306. 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.[147]

307. In its consultation paper, the PRA set out policy proposals 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 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'.[148]

308. 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.

309. 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.

310. On 15 October 2015, the PRA published a further consultation paper[149] on the implementation of ring-fencing: prudential requirements, intragroup arrangements and use of financial market infrastructures.

311. The consultation paper is relevant to banks which will be required to ring-fence their core activities. The paper sets out PRA policy proposals in three areas:

- the capital and liquidity requirements applicable to a ring-fenced body and how the PRA will determine the adequacy of its financial resources;
- the management of intragroup exposures and arrangements; and
- the use of financial market infrastructures.

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[147] 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.
[148] 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'.
[149] PRA consultation paper.

312. The paper also includes a preliminary discussion on potential reporting requirements, setting out the PRA's initial thinking ahead of future consultation.

313. The PRA expects firms within the scope of ring-fencing to submit near-final plans for implementing ring-fencing by 29 January 2016 to their PRA and FCA supervisors.

314. The PRA has stated that it intends to undertake further consultation and to publish final rules and supervisory statements in 2016 to provide firms with sufficient time for implementation.

Other key elements of the ring-fencing regime

315. 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. Such a move by the PRA would require HMT consent.

Part III**: Application of consumer law to the banking industry**

316. 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 appendix. In the main, the legislation derives from EU law.

317. This appendix covers only the legislation which is applicable at the time of writing (October 2015).

318. Some consumer legislation contains enforcement provisions, but the main way it is enforced is using Part 8 of the EA02 as amended by the Consumer Rights Act 2015. This allows enforcers, 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

319. The following is a list of EU consumer directives applicable to the banking sector that have not been considered earlier in this appendix, 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

320. 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.

321. 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 Part 2 of the Consumer Rights Act 2015

322. The legislation applies to terms in consumer contracts between traders and consumers. Its requirements also apply to certain consumer notices which can be used in connection with consumer transactions. A trader is a person who is acting for purposes relating to their trade, business or profession. A term or notice is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations under the contract to the detriment of the consumer. There is also a requirement that a written consumer contract term or consumer notice is transparent.

323. 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 have a partial exemption from the fairness assessment subject to the terms being transparent and prominent. The directive is one of minimum harmonisation, allowing member states to adopt more protective consumer measures.

324. The Unfair Terms in Consumer Contract Regulations 1999 were repealed by the Consumer Rights Act 2015 but will still apply to consumer contracts entered into before 1 October 2015. The regulations are less extensive in scope and do not apply to negotiated terms or consumer notices.

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

325. 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

326. 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

327. 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.

328. Although this is a maximum harmonisation measure member states are allowed to impose or retain requirements that 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

329. 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

330. 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 goods, services, 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.

331. 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’.

332. 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

333. 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

334. Sections of the Consumer Rights Act 2015 came into force in October 2015. It made changes to legislation relating to unfair terms, and consolidates and reforms provisions relating to consumer rights in respect of goods, services and digital content.

335. The Supply of Goods and Services Act 1982 as amended by the Consumer Rights Act 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.

Part IV: Competition Commission remedies

336. Two previous reviews by the CC of the retail banking sector resulted in the implementation of remedies.

2002 report into SME banking – SME undertakings

337. Nine banks[150] (the banks) originally provided undertakings in 2002 and 2003 in order to remedy concerns outlined in the CC's 2002 report into SME banking. The undertakings required the banks to:

- compile and provide a range of price information on their services to SME customers, in a form acceptable to the CMA, and to publish this information, and to notify customers and explain charges levied on unauthorised overdrafts (transparency undertakings);

- agree upon reasonable and proportionate timescales for effecting a switch of an SME's banking services while also restricting banks from levying certain charges connected to switching. Having established these

[150] The nine banks were AIBG (known as First Trust Bank); BoI; Barclays; Clydesdale; HBOS (now part of Lloyds Banking Group (LBG)); HSBC; Lloyds TSB Bank plc (now part of LBG); Northern Bank Limited (trading as Danske Bank); and RBSG (which also includes Ulster Bank in Northern Ireland). The nine banks became eight following the acquisition of HBOS plc by Lloyds TSB plc in 2009.

timescales, banks were obligated to meet them and to report on their performance in meeting these timescales (switching undertakings);

- provide, upon a request by an SME customer, an up-to-date credit history to any specified alternative banking provider, such that the alternative provider had sufficient information in relation to the SME customer to make an informed lending decision (the provision of portable credit histories); and

- refrain from requiring (directly or indirectly) an SME customer to open or maintain a BCA with that bank as a condition for the granting of a loan or business deposit account (the bundling undertakings).[151]

2008 report into PCA banking in Northern Ireland – Northern Ireland Order

338. The Northern Ireland Order (the Order) was originally put in place in 2008 following an investigation by the CC into the PCA banking market in Northern Ireland. The Order was varied in 2011 following a review by the CC, which found that there had been a change of circumstances as a result of the coming into force of the Consumer Credit Directive and the PSD.[152]

339. The Order requires any bank that offers PCA banking services in Northern Ireland to 10,000 or more customers (or 5,000 or more customers if the bank is part of a larger group, which has 10,000 or more customers) to comply with the following information and switching requirements:

- Communicate clearly on marketing communications to PCA customers.

- Provide details of charges and interest rates to customers when selecting a PCA.

- Notify a customer at least 14 days before deducting overdraft charges and debit interest unless the customer requests to close the PCA.

- Provide information on switching to customers.

[151] These undertakings do not, however, restrict the ability of the banks to offer ‘integrated’ products featuring both a BCA and a loan and/or business deposit account provided that these products are also available separately, or for the banks to provide incentives to an SME to agree to open a BCA at the same time as that SME is granted a business loan or opens a business deposit account.
[152] The Consumer Credit Directive established a common set of rules for consumer credit providers on the form, content and manner of provision of pre-contractual and ongoing information on consumer credit agreements, including some types of overdrafts. The PSD established a common set of rules for PSPs on the form, content and manner of provision of pre-contractual and ongoing information on payment services to consumers.

- Offer an overdraft to switchers applying the usual credit assessment criteria.
- Not to apply or levy any interest/charge on an authorised overdraft facility for at least three months from the date the customer opened the PCA following a switch.
- Repay interest/charges incurred as a result of a failure of the switching process unless there is an authorised overdraft in the case of the new bank.