Banking Regulation

Contributing editor
Richard K Kim

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GETTING THE DEAL THROUGH

GETTING THE
DEAL THROUGH

Banking Regulation 2018

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CONTENTS

Preface

Banking Regulation 2018

Eleventh edition

Getting the Deal Through is delighted to publish the eleventh edition of *Banking Regulation*, which is available in print, as an e-book, and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes a new chapter on Ghana and Monaco.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Richard K Kim of Wachtell, Lipton, Rosen & Katz, for his continued assistance with this volume.

GETTING THE DEAL THROUGH

London
March 2018

United Kingdom

Selmin Hakki and Ben Kingsley

Slaughter and May

Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The banking sector is regulated for prudential purposes by the Prudential Regulation Authority (PRA), which is part of the Bank of England, the UK central bank. A committee of the Bank of England, the Prudential Regulation Committee (PRC), is responsible for exercising the functions of the Bank in its role as the PRA. The Financial Conduct Authority (FCA) is the conduct regulator for the banking sector and coordinates closely with the PRA. The Financial Policy Committee (FPC), which operates from within the Bank of England, acts as the macro-prudential regulator for the UK financial system.

The work and purpose of the regulators are defined in legislation by the Financial Services and Markets Act 2000 (FSMA 2000). The PRA's general statutory objective is to promote the safety and soundness of PRA-authorised persons. That objective is to be advanced primarily by first seeking to ensure that the business of PRA-authorised persons is carried on in a way that avoids any adverse effect on the stability of the UK financial system, and second seeking to minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system. The PRA will soon be required to advance its general objective in ways that reflect its regulatory role in respect of ring-fenced banks (see question 6 for further details on ring-fencing). The PRA's strategy is determined in relation to its objectives, and reviewed from time to time. The PRA published a paper setting out its approach to banking supervision in March 2016. At the time of writing, it is consulting on its approach to authorising and supervising international banks in light of the UK's withdrawal from the EU.

The FCA must, so far as is reasonably possible, act in a way that is compatible with its strategic objective and advances one or more of its operational objectives. The FCA's overarching strategic objective is ensuring that the financial markets function well. The FCA's operational objectives are:

- securing an appropriate degree of protection for consumers;
- protecting and enhancing the integrity of the UK's financial system; and
- promoting effective competition in the interests of consumers in the markets for regulated financial services.

The FCA set out its approach to advancing its objectives in a document published in December 2015.

The FPC has primary responsibility to protect and enhance the resilience of the UK's financial system. This involves identifying, monitoring and taking action to reduce systemic risks. It also has a secondary objective to support the economic policy of the government. Alongside the PRC, the FPC contributes to the design and calibration of the stress testing framework for banks. It also has the power to direct the regulators to take action including setting a counter-cyclical capital buffer for the UK and adjusting sectoral capital requirements for UK firms in certain areas.

2 Summarise the primary statutes and regulations that govern the banking industry.

The primary statute governing banking in the UK is FSMA 2000. Extensive amendments were made to FSMA 2000 by the Financial Services Act 2012 that established the PRA, FCA and FPC as regulatory bodies. Further changes were made by the Financial Services (Banking Reform) Act 2013 (FS(BR)A 2013) to implement key reforms such as ring-fencing requirements for the banking sector and the introduction of the Senior Managers Regime and the Certification Regime (see question 8).

Under FSMA 2000, it is a criminal offence for a person to engage in 'regulated activities' in the UK unless he or she is authorised to do so or is exempt from the authorisation requirement. Regulated activities are defined in secondary legislation.

Accepting deposits is a regulated activity where such deposits are lent to third parties, or where any other activity is financed wholly or to a material extent out of capital or interest on deposits. Banks must therefore obtain authorisation under FSMA 2000 to accept deposits.

Other regulated activities that may be relevant to banks for the purposes of the UK financial services regime include:

- dealing in investments as principal;
- dealing in investments as agent;
- arranging deals in investments;
- managing investments;
- safeguarding and administering investments (ie, custody); and
- providing investment advice and mortgage lending.

Investments include:

- shares;
- debentures (including *sukuk*);
- public securities;
- warrants;
- futures;
- options;
- contracts for differences (eg, swaps); and
- units in collective investment schemes.

The primary regulatory framework for consumer credit activities is also set out in FSMA 2000 and in the Consumer Credit Act 1974 (as amended).

A Special Resolution Regime (SRR) to facilitate the orderly resolution of banks in financial difficulties is set out in the Banking Act 2009 (BA 2009) and comprises pre-insolvency stabilisation options, a bank insolvency procedure and bank administration procedure. An insolvency regime that applies to investment banks (including banks carrying on investment banking activities) is set out in the Investment Bank Special Administration Regulations 2011 (see question 19, among others).

3 Which regulatory authorities are primarily responsible for overseeing banks?

The PRA is the principal regulator of banks and is responsible for both authorisation and prudential supervision. The FCA regulates banking for conduct of business purposes. Both the PRA and the FCA have disciplinary and enforcement powers. Since 1 April 2014, the FCA has also been responsible for the regulation of consumer credit. The FCA has competition powers to enforce prohibitions on anticompetitive behaviour in relation to the provision of financial services, which are exercised concurrently with the powers of the UK Competition and Markets Authority (CMA). The Bank of England, together with the UK

Treasury, has a role in operating the SRR for failing banks (see questions 13 and 19). As discussed, the FPC acts as a macro-prudential regulator responsible for identifying and taking action to reduce systemic risks. The Payment Systems Regulator regulates retail payments systems. Its powers are cast broadly and impact not only on payment systems themselves, but also banks that participate in them.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are not insured by the UK government but by the Financial Services Compensation Scheme (the Scheme). The Scheme is an independent body set up under FSMA 2000. The PRA and the FCA are responsible for determining the rules within which the Scheme operates, including the persons eligible to make a claim, and the level of compensation. The Scheme is free to consumers and protects deposits as well as covering insurance policies, insurance broking, investment business and mortgage advice. It is funded by the financial services industry through levies collected by the FCA.

The Scheme pays compensation, up to certain limits, to eligible customers of financial services' firms that are unable, or likely to be unable, to pay claims against them. The maximum compensation sum payable in relation to a protected deposit is currently £85,000, subject to certain exceptions. The rules for compensation relating to deposit claims under the Scheme are based on, and implement, EU legislation. Among other things, banks are required to develop a single customer view – a means of identifying all depositors that would be eligible if the bank were to default – which would provide the Scheme with the information required to meet claims within a target time frame of seven days from default. Deposits that are eligible for compensation under the Scheme are treated as preferential debts and are given a higher priority within the class of preferential debts than other deposits, ranking ahead of unsecured non-preferred creditors on an insolvency.

At the height of the global financial crisis in 2008 and 2009, the UK government adopted a number of emergency measures in the banking sector, including liquidity assistance, recapitalisations and an asset protection scheme. Major UK banks were required to increase their Tier 1 capital significantly. RBS Group plc (RBS) and Lloyds Banking Group (LBG), unable to raise additional capital externally, received government capital injections. RBS benefited from a second capital injection at the time of its accession to the UK government's asset protection scheme in 2009. The government's support to banks also included the nationalisation of failed mortgage lenders Northern Rock and Bradford & Bingley.

The total current level of government support provided to banks has fallen significantly from its peak level. In August 2015, the government began the process of selling RBS shares back to the private sector. It still owns about 71.5 per cent of total voting rights. LBG returned to full private ownership in May 2017. Following a good bank, bad bank split, the viable part of Northern Rock's business was sold to Virgin Money in November 2011. The closed mortgage books of Bradford & Bingley and Northern Rock are managed by UK Asset Resolution Limited, a holding company established by the government, which is pursuing a strategy of reducing its balance sheet, while creating value for the taxpayer and ensuring continued fair treatment of customers.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

There are a number of relevant considerations. The directors of a bank must act in a way that they consider is most likely to promote its success. While directors can take into account a bank's membership of a wider group, they are not entitled to subordinate the interests of the bank to those of other group companies, such as by lending to an insolvent parent or sister company.

If a bank is a member of a group whose shares are listed on the London Stock Exchange, the Listing Rules impose requirements in respect of 'related party transactions'. Group companies are related parties.

The PRA also restricts large exposure (LE). A LE is an exposure of 10 per cent or more of a bank's Tier 1 and Tier 2 capital (after deductions from capital) to a single counterparty or a group of connected clients. A firm's total exposure to the rest of its group is limited to 25 per cent of its eligible capital (Tier 1 plus a portion of Tier 2). Banks can apply to the PRA, subject to conditions being met, to assign a 0 per cent risk weight for exposures to certain UK entities within their consolidation group. These exposures are exempt from the LE limit. All the entities included in this permission are referred to as a firm's core UK group. A bank can also apply to the PRA to increase its total exposures to certain cross-border group entities from 25 per cent to 100 per cent of its own eligible capital. These entities are referred to as the non-core LE group. Total exposures from a firm's core UK group to its non-core LE group are limited to 100 per cent of eligible capital. The PRA is currently consulting on proposed changes and clarifications to this regime. Under the ring-fencing regime (see question 6), a ring-fenced bank will be required treat intragroup exposures to entities outside the ring-fenced bank sub-group as equivalent to third-party exposures.

As for permissible and prohibited activities, a bank may not carry on insurance business because EU directives restrict writing insurance to firms authorised to do so and prohibit them from carrying on any other activity. A bank may, however, own an insurance subsidiary.

Ring-fenced banks will be prohibited from carrying out certain activities, referred to in FSMA 2000 as 'excluded activities', which equate broadly to investment and wholesale banking activities that are considered to pose a risk to the provision of 'core' retail deposit-taking services, because they may impose losses on the bank or they may make the bank's resolution more complicated (see question 6). Most essential banking services provided to individuals and small and medium-sized enterprises (SMEs) will in practice be undertaken by ring-fenced banks. Although most wholesale market activities will be prohibited for ring-fenced banks, limited wholesale market activities in respect of funding, hedging and liquidity will be permitted. Ring-fenced banks will also be permitted to offer 'simple' derivative products to SMEs and individuals for hedging purposes.

6 What are the principal regulatory challenges facing the banking industry?

A recent area of focus for many of the larger UK banking groups has been the development of retail banking ring-fencing planning arrangements, the requirements for which were introduced through FS(BR)A 2013. We expect the ring-fencing and structural reform agenda to continue to dominate the regulatory landscape for affected banks. The ring-fencing regime will require certain UK banking groups with significant retail and SME banking operations to 'ring fence' certain core deposit-taking activities for retail and SME depositors in a legal entity that will not be permitted to carry on certain specified wholesale and investment banking activities. Compliance with the requirements involves significant business model, operational and legal reorganisations, which will need to be carried out by 1 January 2019. A number of UK banks are currently in the process of restructuring their businesses to comply with the requirements through the use of a ring-fencing transfer scheme, for which an application must be made to court. Court direction hearings began in 2017 and continue into 2018.

Banks are being forced to devote greater resources to enhancing the security, vigilance, and resilience of their cybersecurity defences. This is becoming one of the more important sources of legal, regulatory and reputational risk for banks. PRA interest in cybersecurity was further heightened by an attack in November 2016 on Tesco Bank, which affected approximately 40,000 accounts (with money being removed from approximately half of these).

For some time, digital technologies have been playing an increasingly important role in creating new opportunities and challenges for banks. Although fintech has arguably yet to materially change the competitive landscape, the banking sector is increasing its investment, participation and collaboration in this area.

The UK's departure from the EU raises significant uncertainty for the UK's banking industry. At the time of writing it is difficult to predict how the regulatory framework applying to banks will change in the medium to long term. Many banks are preparing for the possibility that the UK will no longer remain a member of the EU single market becoming, for regulatory purposes, a 'third country'. Some banks are therefore considering or accelerating restructuring plans for their EU business or seeking deposit-taking licences in multiple jurisdictions. In the meantime, banks are expected to continue to comply with requirements derived from EU law and to continue implementing legislation that is yet to come into effect in the period of negotiations for a UK–EU settlement.

7 Are banks subject to consumer protection rules?

There are numerous pieces of legislation providing for the protection of UK consumers covering areas such as the supply of goods and services, unfair contract terms and distance selling. Banks must comply with these generally applicable measures as much as any other business. Among other things, this legislation implies certain terms into consumer contracts for:

- goods and services;
- protecting consumers from unfair or unclear contractual terms;
- mandating how businesses must contract with consumers under certain circumstances (such as distance selling); or
- supplying certain types of services (such as consumer credit).

Key strands of consumer protection law in the UK were consolidated by the Consumer Rights Act 2015, which deals with:

- unfair terms in consumer contracts;
- rights and remedies in relation to contracts for goods and services;
- extended powers of, and remedies that can be imposed by, enforcement authorities; and
- enabled consumers to bring private collective actions against anticompetitive behaviour by businesses.

Further to secondary legislation implementing EU Consumer Rights Directive 2011/83/EU, there is a ban in the UK on excessive payment surcharges attached to certain methods of payment and rules on distance and doorstep selling.

One of the FCA's objectives is to ensure an appropriate degree of protection for all consumers. Towards the end of 2017, the FCA published an Approach to Consumers paper which is intended to explore its approach to regulating for retail consumers. As regulated firms, banks are subject to the FCA's Treating Customers Fairly (TCF) regime, which requires them to pay due regard to the interests of their customers and to treat them fairly. This is an overarching principle that applies to every aspect of a bank's business, but is supported by more specific FCA rules mandating how banks should deal with customers when providing certain services such as investment advice. The FCA enforces the TCF regime and can fine or publicly censure banks that breach TCF requirements, as well as requiring them to offer consumer redress where appropriate.

The FCA, in conjunction with the CMA, has competition powers to enforce prohibitions on anticompetitive behaviour in relation to the provision of financial services. It can also carry out market studies and refer markets to the CMA for in-depth review. Recent work in this context includes an investigation into the supply of retail banking services to personal current account customers and SMEs. The FCA has also explored competition in investment and corporate banking.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The PRA's and FCA's policy for supervising banks and banking activity has hardened since the global financial crisis and reflects a more cautious and stability-focused approach to bank supervision. We see no reason for this approach to soften in the near term.

As noted in question 6, the implementation of ring-fencing for banks – the regime separating critical banking services from wholesale and investment banking services – will remain a top priority. The ring-fencing regime will be implemented in the UK from 1 January 2019.

Banks have been required to hold increasing levels of capital and liquidity resources in recent years. The capital and prudential regime for banks continues to evolve with reforms set out in the proposed EU Capital Requirements Directive V (CRD V) (adopted by the European Commission in November 2016) amending the Capital Requirements Regulation (EU) No. 575/2013 (CRR) and the Capital Requirements Directive 2013/36/EU (CRD IV). The reforms include the introduction of Basel III measures into EU law, such as the leverage ratio and the net stable funding ratio, the implementation of the total loss absorbing capacity standard and revisions intended to improve lending to SMEs and to infrastructure. A new package of Basel measures, referred to as Basel IV, was agreed in December 2017. The impact of these will vary from bank to bank.

UK regulators continue to indicate that they want to open up competition in the UK banking industry to new banks. In January 2016, the PRA and FCA launched the New Bank Start-up Unit, a joint initiative, giving information and support to newly authorised banks and those thinking of becoming a new bank in the UK.

Following the global financial crisis, during which senior individuals in banks were blamed for mismanaging their businesses, regulators continue to scrutinise senior management responsibility. The Senior Managers regime replaced the Approved Persons regime for banks on 7 March 2016 and was accompanied by a new certification regime for other important bank staff and a new set of conduct rules. The underlying policy is aimed at supporting a change in culture at all levels in banks and other firms through a clear identification and allocation of responsibilities to individuals responsible for running them, and is considered to be an important element of the PRA's approach to the ongoing assessment of the adequacy of management and governance at firms. We expect the shift in regulatory focus from the collective responsibility of a bank's board to the individual responsibility of directors and senior managers in the banking sector to continue.

Over the next few years, particular importance will be placed on the way in which regulatory policy responds to the development and commercialisation of new financial business models and technology and its impact on banks and fintech. Bank investment in fintech will continue to be heavy, both on own account and through incubators and other sponsored investment arrangements. Banks are looking at the digitisation of all aspects of their back, middle and front office operations, both in the wholesale and retail sphere, with particular emphasis on customer interface and market infrastructure. Innovative uses of technology are bringing benefits to the risk management of banks, as recognised by UK regulators. We expect the use of artificial intelligence and algorithmic solutions in areas such as advice and investment management to continue gaining traction. See also the impact of Brexit in question 6.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The PRA applies the principle of proportionality in its supervision of firms (proportionality being judged in terms of the threats that firms can pose to the PRA's primary objectives). It divides the firms it supervises into five categories of 'potential impact', and the frequency and intensity of supervision applied to firms varies in line with this. The PRA also varies the resource it applies to firms based on their proximity to failure and resolvability. Judgements about a firm's proximity to failure are captured by its position within the PRA's Proactive Intervention Framework (PIF) (see question 14). Other factors, including the complexity of the firm's business and organisation, are also relevant to the level of supervision exercised.

The PRA gathers and analyses information from banks on a regular basis (eg, through regulatory returns). It may request additional, firm-specific data (eg, management information or forecasts). It also requires firms to participate in meetings with supervisors at a senior and working level. The PRA also conducts onsite testing or inspections of a particular area. The stress testing regime allows the PRA to examine the potential impact of a hypothetical adverse scenario on the health of the banking system and the largest firms within it. As noted in question 1, the PRA has published a document setting out is approach to bank supervision in which further details can be found.

The FCA makes its conduct assessment of firms through the firm systematic framework (FSF). This enables the FCA to assess whether a firm is being run, currently and prospectively, in a way that results in the fair treatment of customers, minimises risks to market integrity, and does not impede competition. The FSF is the means by which the FCA conducts structured assessments of firms across all sectors. Common features of the FSF involve:

- business model and strategy analysis, which includes consideration of sectoral risk; and
- the TCF regime, which examines consumer culture and control systems.

The FCA will engage directly with priority firms (including retail banks) on an annual basis as well as carrying out cross-sectoral and thematic reviews to address broad areas of concern.

Both the PRA and FCA have demonstrated a proactive and interventionist approach to their supervisory roles. Enforcement issues are addressed in questions 10 and 11.

10 How do the regulatory authorities enforce banking laws and regulations?

If the PRA or FCA identify a breach of their rules or principles they may bring enforcement proceedings. In particular, the FCA aims to intervene early to tackle potential risks to consumers and market integrity before they crystallise. Sanctions include:

- withdrawal of authorisation;
- fines;
- banning orders; and
- public disclosure of non-compliance ('naming and shaming').

The PRA and FCA also have powers to prosecute certain criminal offences (eg, insider dealing, market manipulation, or carrying on a regulated activity without authorisation) the PRA or FCA (as relevant). In 2017, the FCA pursued a number of criminal prosecutions, though generally fewer criminal cases are pursued in comparison with regulatory action.

The PRA and FCA are required to cooperate closely in taking enforcement action, although the PRA may veto enforcement action by the FCA if this may threaten the stability of the UK's financial system, or cause the failure of a PRA-authorised person in a way that would adversely affect financial stability. In most cases, including insider dealing and money laundering, the FCA is the authority responsible for prosecuting financial services offences.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

In previous years fines have been levied by the PRA and the FCA on banks in respect of:

- failings to be open and cooperative with the regulator;
- anti-money laundering (AML) control failures;
- failings in assessing, maintaining and reporting financial resources; and
- on individuals in respect of failures to exercise due skill, care and diligence in carrying out their roles.

Other recent themes in enforcement that we have addressed in previous editions of this publication have been the attempted manipulation of financial benchmarks and failings in payment protection insurance complaints' handling processes. Enforcement outcomes under the senior managers regime and certification regime are likely to emerge in due course. We also expect banks to be a prime target of enforcement action in relation to new criminal offences for any entity that fails to prevent the facilitation of (UK or foreign) tax evasion by its associated persons, which came into force on 30 September 2017 pursuant to the Criminal Finances Act 2017.

In terms of the most recent enforcement action, in January 2018, the FCA imposed a financial penalty of £250,000 on former RBS interest rate derivatives trader, Neil Danziger, and prohibited him from performing any function in relation to any regulated financial activity. It found that Mr Danziger was knowingly concerned in RBS's failure to observe proper standards of market conduct.

In October 2017, Merrill Lynch International was fined £34,524,000 by the FCA for failing to report 68.5 million exchange traded derivative transactions between 12 February 2014 and 6 February 2016. This was the first enforcement action under the European Markets Infrastructure Regulation against a firm for failing to report details of trading in exchange traded derivatives.

In March 2017, the FCA fined Christopher Niehaus, a former investment banker, £37,198 for sharing client confidential information over WhatsApp. The FCA found that Mr Niehaus failed to act with due skill, care and diligence.

In February 2017, the PRA imposed a fine of £17,850,000 on the Bank of Tokyo-Mitsubishi UFJ Limited and a fine of £8,925,000 on MUFG Securities EMEA for failing to be open and cooperative with the PRA in relation to an enforcement action into the former entity by the New York Department of Financial Services. The PRA emphasised that the timely and accurate provision of information by firms is crucial to the PRA's ability to supervise firms effectively and to meet its statutory objectives. In January 2017, the FCA fined Deutsche Bank AG disgorgement of £9,076,224 and a penal element of £154 million in relation to failures in its AML control framework between 1 January 2012 and 31 December 2015. The financial crime risks were highlighted by 'mirror trades' arranged by the bank's Russia-based subsidiary and booked to the bank's trading books in London.

Resolution

12 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

See question 19. The Bank of England has responsibility for the resolution of a failing bank, and their group companies, under BA 2009. A number of stabilisation powers are exercisable in relation to a bank under BA 2009 pursuant to the SRR. The aim of the SRR is to provide a mechanism for resolving failing firms that would only be used in situations where failure is imminent, and the other powers of the relevant UK authorities to address the situation are insufficient. The tools available include the transfer of all or part of a bank to a 'bridge bank' owned by the Bank of England or the temporary public ownership of a bank or a bank's holding company. The administration procedure for investment banks (to the extent that they are not authorised deposit-taking institutions) is governed by separate secondary legislation. The Bank of England published a document setting out its approach to resolution in October 2017.

Bank nationalisation is very uncommon in the UK; occurring only to protect the stability of the financial system. Non-systemic banks are subject to insolvency proceedings (mainly bank insolvency and administration, see question 19). Northern Rock was nationalised on 22 February 2008. Bradford & Bingley was nationalised on 28 September 2008, although the deposits and branch network were simultaneously sold to the Santander Group. On 28 March 2009, the Bank of England acquired the commercial lending and poorer quality mortgage portfolio of the Dunfermline Building Society. The deposits and branch network were sold to the Nationwide Building Society. Previous nationalisations include Johnson Matthey Bankers, in 1984 and the Bank of England itself, in 1946. The government's shareholding in LBG and RBS is discussed in question 4.

In all these cases, depositors' interests were fully protected. As noted in question 4, on a bank insolvency, deposits protected by the Financial Services Compensation Scheme are 'super-preferred' in the creditor hierarchy. Employees may be protected under employment law where a business unit is transferred, or if redundancies are made. There are, however, no specific protections under BA 2009. Certain employee claims rank as preferred debts if a bank is wound up.

Under BA 2009, if the Treasury decides to take a bank or bank holding company into public ownership, it must pay compensation if shareholders suffer a loss compared to the position they would have been in had the failed bank been subject to insolvency proceedings (referred to as the 'no creditor worse off' safeguard). No account is taken of any financial assistance provided by the Bank of England or the Treasury in valuing the shares in the bank. The independent valuer appointed after the nationalisation of Northern Rock concluded that the value of the shares, after stripping out assistance provided by taxpayers, was nil and that no compensation was payable. An appeal to the Upper Tribunal was dismissed in 2011. An attempt to challenge the basis of compensation was dismissed by the European Court of Human Rights in 2012 as manifestly ill-founded, where it considered that it was entirely legitimate for the UK to decide that, had the Northern Rock shareholders been allowed to benefit from the value created through the provision of state support, this would encourage the managers and shareholders of other banks to seek and rely on similar support, to the detriment of the UK's economy. The independent valuer appointed in respect of Dunfermline Building Society concluded that the treatment of creditors whose claims were transferred to Nationwide, as well as those creditors whose claims remained behind, was no worse than it would have been had Dunfermline entered insolvency proceedings. Accordingly, no compensation was payable.

In March 2015, the Treasury published a Code of Practice on the use of tools under the SRR. This is supplemented by the Bank of England document referred to above.

13 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

The PRA requires UK banks and banking groups to develop recovery and resolution plans (colloquially referred to as 'living wills').

A recovery plan comprises a series of measures that the bank or its group could take to turn the business around following adverse trading conditions, and postulates a range of options that the bank could take to return to adequate levels of liquidity and capital. Recovery options may include:

- disposals;
- raising new equity;
- elimination of dividends;
- liability management; or
- sale of the firm.

Recovery plans are developed by banks but their adequacy is evaluated by the PRA.

Banks are also required to produce a resolution pack, a document setting out information required by the appropriate resolution authorities to enable them to draw up a resolution plan and to resolve the firm if it fails. The resolution data and analysis provided by firms is intended to identify significant barriers to resolution, to facilitate the effective use of the powers under the BA 2009 and so reduce the risk that taxpayers' funds will be required to support the bank's resolution. An executive director of the bank must be nominated to have responsibility for the recovery plan and resolution pack and for overseeing the internal processes in relation to these documents.

The PRA expects a bank's recovery plan as well as the processes for producing resolution proposals to be subject to oversight and approval by the board or a senior governance committee and subject to review by the audit committee. Firms must nominate an executive director who has overall responsibility for the firm's recovery and resolution plan as well as overseeing governance arrangements.

As discussed in question 9, as a firm comes under increasing stress, the PRA will assess its 'proximity to failure', which is captured by the firm's position within the PRA's PIF, which is designed, in part, to guide the Bank of England's contingency planning as resolution authority. The PIF assessment is derived from a firm's ability to manage the following risks it may face:

- external context;
- business risk;
- management and governance;
- risk management and controls; and
- capital and liquidity.

There are five PIF stages denoting a different proximity to failure at a given point in time, and every bank will be allocated to a particular stage. If a firm migrates to a higher risk category (ie, the PRA determines that the firm's viability has deteriorated) the intensity of supervision will increase. The five PIF categories are:

- low risk;
- moderate risk;
- risk to viability absent action by the firm;
- imminent risk to viability of the firm; and
- the firm is in resolution or being wound up.

The firm's senior management will be expected to ensure appropriate remedial action is taken to reduce the likelihood of failure, while the PRA has stated that the regulatory authorities will ensure appropriate preparedness for resolution. The appropriate remedial actions that a firm may be required to take include drawing on the menu of options set out in the firm's approved recovery plan. The PRA has additional statutory powers to change the management or board composition, restrict capital distributions and leverage and set tight liquidity or capital requirements. When a firm is deemed to have entered resolution, the PRA may draw on a wide array of powers as set out in the SRR.

The PRA's framework for recovery and resolution plans is based on parts of Directive 2014/59/EU (BRRD) establishing a framework for the recovery and resolution of credit institutions and investment firms, which entered into force on 2 July 2014. The UK implemented the BRRD through a combination of changes to primary and secondary legislation, new PRA and FCA rules and amendments to the Treasury's SRR Code of Practice (see question 12).

14 Are managers or directors personally liable in the case of a bank failure?

Bank failure does not automatically result in liability for the directors. The personal liability of directors in the case of insolvency is discussed in question 25. In addition, depending on the circumstances, directors may be at risk of the following:

- disciplinary action: if the directors are responsible for breaches of the PRA or FCA rules they may be subject to regulatory sanctions in the normal way, which may include fines as well as banning orders;
- civil liability: directors owe fiduciary duties to the company. In particular, they are required to promote the success of the company, to exercise independent judgement and to exercise reasonable care, skill and diligence. Failure to comply with these duties exposes the directors to civil liability to the company;
- a range of criminal offences may be relevant to misconduct prior to or in the course of insolvency proceedings. These include theft, fraud, false accounting, fraudulent trading, transactions in fraud of creditors, conspiracy to defraud and misconduct in the course of winding-up and so on. Generally, these offences require proof of dishonesty; and
- disqualification: directors of an insolvent bank may be disqualified if their conduct makes them unfit to be concerned in the management of a company.

The failure of LBG and RBS demonstrates that errors of commercial judgement are not in themselves sanctionable, unless either the processes and controls that governed how those judgements were reached were clearly deficient, or the judgements were clearly outside the bounds of what might be considered reasonable. The FSA report into the failure of RBS considered options for change and concluded that there was a strong argument for new rules, which would ensure that bank executives and boards place greater weight on avoiding downside risks. In January 2016, the PRA fined and prohibited senior individuals who held positions at the Co-operative Bank from holding a significant influence function in a PRA-authorised firm for breaches related to the running of the Co-operative Bank and, in particular, for not exercising due skill, care and diligence in carrying out their roles. The regulator concluded that their actions posed an unacceptable threat to the safety and soundness of the Co-operative Bank.

As discussed in question 8, the new regulatory framework for senior individuals in UK banks and branches of foreign banks operating in the UK came into effect on 7 March 2016. One aspect of this framework is the senior managers regime, which replaced the approved persons regime in respect of individuals with key management responsibilities in banks and holds individuals performing a 'senior management function' to account for their areas of responsibility. A certification regime also applies to bank employees who could pose a risk of significant harm to the firm or any of its customers (eg, staff who give investment advice). The framework includes a code of conduct, which replaced the Statements of Principle and Code of Practice for Approved Persons, and apply to all individuals who are approved by the PRA or FCA as senior managers, or who fall within the PRA's certification regime.

Where a senior manager is found to have committed misconduct, the disciplinary powers available to the regulators include the power to impose an unlimited fine and to ban the person from performing particular types of function (or any function) in a regulated firm.

Of particular note is section 36 of the FS(BR)A 2013, which introduced a criminal offence relating to decisions taken by senior managers that cause a bank to fail. The offence is in relation to a decision that causes a financial institution to fail for conduct that takes place on or after 7 March 2016. It is committed when a senior manager takes a decision (or fails to prevent the taking of a decision) that leads to the failure of the bank or another firm in the same group, and at the time of taking the decision is aware that it may lead to failure, and his or her conduct falls far below what would have been reasonably expected of a person in his or her position. In order for liability to be established, the bank, or a firm in the group, must fail. Failure includes where the firm enters insolvency or the stabilisation options listed in question 12. The offence is punishable on indictment with up to seven years' imprisonment. It has been suggested by the PRA and the FCA that prosecution of this offence will likely be rare, as it requires (among other things) the financial institution to fail and for a senior manager's conduct to fall significantly below what could reasonably be expected of someone in the position.

15 Describe any resolution planning or similar exercises that banks are required to conduct.

See question 13 on the requirement for banks to produce a resolution pack, a document setting out information required by the appropriate resolution authorities to enable them to draw up a resolution plan.

The Bank of England is required to develop a resolution plan for each UK bank setting out the actions that would be taken if a firm failed. It identifies a preferred resolution strategy for each firm, which depends on, among other things, the firm's systemic relevance and its structure. It completes resolvability assessments for each firm, which identify any barriers to implementing that firm's preferred resolution strategy and achieving its statutory objectives. If necessary, it can require firms to take action to remove these barriers to make them 'more resolvable'.

Capital requirements

16 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Many of the regulatory capital requirements for UK-authorised banks on a solo and consolidated basis are determined according to CRD IV – comprising the CRR and the CRD, which entered into force on 1 January 2014 and is implemented in the UK mainly through the PRA and FCA rules. The CRD IV itself implements at the EU level Basel III, replacing the previous Basel Accord at EU level.

In short, the capital resources that a bank is required to maintain can be constituted by a mixture of common equity Tier 1 capital, additional Tier 1 capital and Tier 2 capital. With the exception of common equity Tier 1 capital, however, the proportions of each of these types of capital that the total capital can comprise are restricted. The CRR contains detailed legal and technical requirements for eligibility of capital instruments. Instruments categorised as additional Tier 1 capital are, broadly, perpetual subordinated debt instruments or preference shares with no incentive to redeem and that will automatically be written down or converted into common equity Tier 1 upon the bank's common equity Tier 1 ratio falling below a specified level.

Banks have a choice between a standardised approach to credit risk and advanced internal ratings-based approaches. Many of the smaller banks opt for, or are required to, use the standardised approach, which imposes capital charges on exposures falling into particular classes (eg, corporate, retail, mortgage, interbank and sovereign lending). The capital charge generally depends on the external credit rating of the borrower. The requirements also cover credit risk mitigation (collateral, guarantees and credit derivatives) and securitisation.

Banks may seek regulatory approval to use their own internal models to calculate capital requirements for credit risk, including credit risk mitigation and securitisation. Where a firm is to use an internal model in calculating its regulatory capital requirements, the PRA will expect the model to be 'appropriately conservative'.

Banks are required to assess themselves, the adequacy of their capital (a process known as the Internal Capital Adequacy Assessment Process, or ICAAP), which is then subject to review by the PRA (the Supervisory Review and Evaluation Process (SREP)). This usually results in the PRA providing individual capital guidance to the firm and setting a capital planning buffer. In addition, the PRA requires banks to carry out stress testing and scenario analysis, including 'reverse stress testing' identifying circumstances in which a bank would no longer be viable, to assess the UK banking system's capital adequacy. According to the Bank of England, the 2017 stress test showed that, for the first time since the launch of stress tests in 2014, no bank needed to strengthen its capital position and that the UK banking system is resilient to deep, simultaneous recessions in the UK and global economies, large falls in asset prices and a separate stress of misconduct costs.

The countercyclical capital buffer is a tool that enables the FPC to adjust the resilience of the banking system such that banks are required to have an additional cushion of capital with which to absorb potential losses. The UK rate will be 1 per cent with effect from 28 November 2018.

The quantitative capital requirements under the CRD and CRR are supplemented by the obligation, introduced by the BRRD, for banks to satisfy at all times a minimum requirement for own funds and eligible liabilities (MREL), as specified by the Bank of England on a case-by-case basis. The Bank of England has published its Statement of Policy, which sets out its approach to setting loss-absorbing capacity requirements for all financial firms. UK banks will be subject to interim MREL requirements from 1 January 2020, with final requirements coming into force in 2022.

As noted in question 8, the capital and prudential regime for banks continues to evolve, with reforms set out in the proposed regulation amending the CRR and the proposed directive amending CRD IV. A final package of rules comprising Basel IV was agreed in December 2017.

17 How are the capital adequacy guidelines enforced?

The PRA enforces compliance. Banks are required to submit periodic returns and must notify the PRA of any failure to hold adequate capital. The ICAAP and SREP are a continual process, although the PRA can require a bank to hold a specified amount of capital.

18 What happens in the event that a bank becomes undercapitalised?

The bank will need to notify and agree with the PRA a remedial programme to bring it back into compliance. The terms of such a programme will depend on the circumstances, and cannot be described in generic terms, but are likely to include raising new capital, a reduction of exposures (including divestment of assets or businesses), or both. If a bank is unable to agree with the PRA on how to remedy the situation, the PRA may revoke the bank's authorisation. Additional powers to deal with failing banks have been enacted in BA 2009, the Investment Bank Special Administration Regulations 2011 (SI 2011/245) (for banks carrying on investment banking business) and FS(BR)A 2013 (see question 19).

19 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The SRR is described in question 12, having originally been put in place by the BA 2009 and enhanced subsequently.

The SRR consists of the following pre-insolvency stabilisation options for banks:

- the transfer of all or part of a bank to a private sector purchaser (PSP);
- the transfer of all or part of a bank to a bridge bank owned by the Bank of England;
- the transfer of a bank or a bank's holding company into temporary public ownership (TPO);
- the asset separation tool, which allows assets and liabilities of the failed bank to be transferred to a separate asset management vehicle, with a view to maximising their value through an eventual sale or orderly wind-down; and
- a bail-in to absorb the losses of the failed firm, and recapitalise that firm (or its successor) using the firm's own resources.

A stabilisation power may only be exercised if the PRA is satisfied that:

- the bank is failing, or is likely to fail, to satisfy the threshold conditions for authorisation under FSMA 2000; and
- having regard to timing and other relevant circumstances, it is not reasonably likely that action will be taken to satisfy those conditions.

In exercising any of the stabilisation powers, or the insolvency procedures, the authorities must have regard to a number of specified objectives. These are:

- continuity of banking services and critical functions in the UK;
- protection and enhancement of the stability of the UK financial systems;
- stability of the UK banking system;
- protecting depositors;
- protecting public funds and client assets; and
- avoiding unjustified interference with property rights.

These objectives are to be balanced as appropriate in each case. The Treasury has published a code of practice about the use of powers under the SRR, which is intended to be read alongside the Bank of England's approach document relating to bank resolution, most recently updated in October 2017.

The Bank of England can exercise the PSP or bridge bank powers if it is satisfied (after consultation with the Treasury and the PRA) that it is necessary having regard to the public interest in the stability of the UK financial systems, the maintenance of public confidence in the stability of the UK banking systems or the protection of depositors.

The Treasury may only exercise the TPO power if it is satisfied (after consultation with the Bank of England and the PRA) that either the exercise of the power is necessary to resolve or reduce a serious threat to the stability of the UK financial systems or that it is necessary to protect the public interest where the Treasury has previously provided financial assistance to a bank.

The stabilisation powers are supplemented by a broad range of powers to transfer shares or property (including foreign property) as well as overriding contractual rights that could interfere with the transfer.

In addition, there is a bank insolvency procedure providing for the orderly winding-up of a failed bank. It facilitates the Financial Services Compensation Scheme (the Scheme) in providing payout to depositors or transfer of their accounts to another institution. The Bank of England, the PRA or the Secretary of State may apply to the court to make a bank insolvency order. An order may be made if:

- the bank is unable, or is likely to be unable, to pay its debts;
- winding up the affairs of the bank would be in the public interest; or
- winding up the bank would be 'fair' (this has the same legal meaning as the phrase 'just and equitable' in the Insolvency Act 1986 (IA 1986)).

To be eligible for the bank insolvency procedure, the bank must have depositors eligible to be compensated under the Scheme. Once a bank insolvency order is made the liquidator has two objectives. The first is to work with the Scheme to ensure, as soon as is reasonably practicable, that accounts are transferred to another bank, or that eligible depositors receive compensation under the Scheme (see question 4). Once this objective has been accomplished, the task of the liquidator is to wind up the affairs of the bank. The general law of insolvency applies with some modifications to bank insolvency and the liquidator has similar powers to access the bank's assets and, once the eligible deposits have been transferred, or compensation paid, creditors will receive a distribution in accordance with their rights.

Other insolvency proceedings remain possible (eg, administration or liquidation), although no application can be determined until the PRA has decided not to apply for a bank insolvency order. A resolution for voluntary winding up has no effect without prior approval of the court.

The SRR also includes a bank administration regime, which puts the part of a failed bank that is not transferred to the bridge or private sector purchaser (known as the residual bank) into administration. The purpose of bank administration (which should not be confused with administration under the IA 1986) is principally to ensure that the non-sold or transferred part of the bank continues to provide services to enable the purchaser or bridge bank to operate effectively. Once the Bank of England notifies the bank administrator that the residual bank is no longer required, the bank will proceed to a normal administration where the objective is either to rescue the residual bank as a going concern or, if this is not possible, to achieve a better result for the bank's creditors as a whole than in a winding-up.

Insolvency procedures for banks carrying on an investment banking business are set out in SI 2011/245 (as amended by the Investment Bank (Amendment of Definition) and Special Administration (Amendment) Regulations 2017 (SI 2017/443)).

20 Have capital adequacy guidelines changed, or are they expected to change in the near future?

Yes. There has been a sequence of major reforms to the international prudential framework for capital requirements as set by the Basel Committee on Banking Supervision. Basel III reforms were finalised in December 2010 and aimed to address perceived weaknesses in Basel II and to reduce the probability and severity of future financial crises.

Basel III has been implemented into EU law by CRD IV, which came into force on 1 January 2014. The main prudential requirements are set out in the CRR, which is directly applicable in the United Kingdom.

The main changes included:

- improving the quality of capital through new definitions of core Tier I capital, non-core Tier 1 capital and Tier 2 capital;
- raising the minimum common equity Tier 1 capital ratio to 4.5 per cent and imposing a further capital conservation buffer of 2.5 per cent resulting in an effective minimum common Tier 1 ratio of 7 per cent;
- increasing the Tier 1 capital ratio (including the capital conservation buffer) from 4 to 8.5 per cent and the minimum total capital ratio (including the same buffer) to 10.5 per cent;
- abolishing innovative Tier 1 capital and Tier 3 capital. Tier 1 capital has been simplified with sub-categories removed;
- adopting a harmonised approach to deductions from capital, with most deductions being made from common equity;
- introducing new and more stringent requirements in respect of counterparty credit risk on derivatives, repos and securities financing transactions that will significantly increase the capital requirements for these transactions;
- adopting a leverage ratio as a non-risk-based measure to curtail excessive growth in banks' balance sheets;
- enabling regulators to impose an additional capital buffer in the case of excessive credit expansion where local conditions justify this;
- introducing two new liquidity standards: a liquidity coverage ratio designed to enable banks to withstand a short-term liquidity stress, as well as a net stable funding ratio requiring banks to have a minimum amount of stable funding based on the liquidity characteristics of their assets and activities over a one-year horizon; and
- addressing the risks posed by financial institutions that are systemically important.

As noted in question 8, a long, complex legislative procedure is now under way as the Council of the EU and the European Parliament broker an agreement on the final shape of the CRD V, adopted by the European Commission in November 2016. As the implementation of these rules by banks is still several years away, there is some uncertainty as to how and when the requirements will be applied. For UK banks, Brexit adds an additional layer of complexity when considering the impact of the proposals.

In December 2017, the Basel Committee published its final documents on the reform of Basel III, commonly referred to as Basel IV. These reforms comprise, among other things, changes to the standardised approach for credit risk, internal models, and the final calibration and design of the output floor that will be set at 72.5 per cent. The new rules will take effect in 2022 and have a five-year implementation period.

Ownership restrictions and implications

21 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Much of the UK's controllers' regime reflects provisions that were originally introduced by the Acquisitions Directive (2007/44/EC), which imposes obligations on controllers, and potential controllers, of firms authorised under EU financial services legislation and is implemented in the UK through provisions of FSMA 2000.

In short, a person who decides to acquire or increase control over a UK-authorised bank must notify and obtain consent from the PRA in advance. Failure to do so is a criminal offence with the maximum penalty being an unlimited fine. The PRA must consult the FCA before coming to a decision on whether to approve a proposed change of control. The Acquisitions Directive tightened the assessment criteria for objections to a change of control (see question 28).

The PRA has 60 working days from receipt of the notice to approve the acquisition of control (with or without conditions), or to object. This period may be interrupted by up to 20 days where the PRA requires further information.

The thresholds for notifying the PRA of the acquisition of control are 10, 20, 30 and 50 per cent of the shares or voting power. The definition of 'control' is complex and a number of the terms used in that definition are extended beyond their normal meaning or are subject to

Update and trends

We expect regulatory policy for banks to continue to respond to developments in fintech. Banks have also shown themselves willing to adopt a range of strategies to collaborate in the fintech and emerging tech sphere, including by way of venture capital-style investment, incubator and accelerator programmes and the establishment of innovation centres. We do not envisage a decline in these efforts.

The Basel Committee's review programme continues to keep capital issues at the top of the regulatory agenda. Banks will need to assess and respond to the effect of the Basel IV reforms on their individual capital structures and prepare for amended capital calculations across all risk types. Reliance on internal models will need to be moderated.

Finally, the UK's withdrawal from the EU is preoccupying the UK's banking industry. Many UK banks are considering or accelerating restructuring plans for their EU business or seeking deposit-taking licences in multiple jurisdictions. Without agreements as to equivalence, Brexit will also affect elements of financial services infrastructure, such as access to clearing houses or payment services, or the provision of custody services to certain clients.

exceptions. For example, even if a person does not fall within the specific percentages of shares or voting power set out above, he or she may be deemed to be a controller, or to have increased his or her control, if his or her relationship with the firm amounts to 'acting in concert' with others.

A parallel regime exists in respect of the reduction of control, where a person is required to notify the PRA of any reduction in control to below 50, 30, 20 and 10 per cent of the shares or voting power. Failure to notify is an offence, although there is no requirement for PRA consent to the reduction of control.

The Acquisitions Directive was supplemented with Level 3 Guidelines published by the Committee of European Banking Supervisors, the Committee of European Insurance and Occupational Pensions Supervisors and the Committee of European Securities Regulators (together, the Level 3 Committees). The Level 3 Guidelines updated on 1 October 2017 contain guidance on important general concepts such as the meaning of the term 'acting in concert' and the process for determining acquisitions of indirect holdings. They also contain useful information in relation to the assessment criteria for a proposed acquisition.

22 Are there any restrictions on foreign ownership of banks?

No. Aside from sanctions imposed by the United Nations, the European Union and the United Kingdom on specified persons and countries.

23 What are the legal and regulatory implications for entities that control banks?

There are no restrictions on the business activities of a parent or acquirer of a UK bank, or on those of affiliates of a UK bank, although such activities will be taken into account as part of the PRA's assessment of the acquisition. A bank may be owned or acquired by a company whose business is wholly non-financial in nature. Directors, officers and employees of a holding company of a UK bank whose decisions or actions are regularly taken into account by that bank's governing body must be approved by the PRA.

The PRA carries out the consolidated supervision of banking groups. Consolidated supervision applies at the level of the highest EEA group company whose subsidiaries and participants (basically a 20 per cent holding) are banks or engage in broadly financial activities. The PRA will not normally undertake worldwide supervision of a group headed by a parent outside the EEA.

The practical effects of consolidated supervision applying will depend on the individual group's structure. However, the following points may be noted:

- the group will need to hold adequate capital to cover the exposures and off-balance-sheet liabilities of all members of the group (and not just regulated entities), including the parent and its subsidiaries and participations; and
- limits on large exposures will apply.

24 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Where a banking group is subject to consolidated supervision, the PRA will apply its prudential rules to the group as a whole (see question 23). It will not, however, directly regulate non-authorised entities in the group.

Each regulated firm (including banks) will need to meet the regulatory requirements applicable to it on a stand-alone basis. This includes, but is not limited to, capital adequacy and liquidity.

FSMA 2000 enables the PRA to give 'directions' to the UK parent of a UK bank or investment firm (a qualifying parent undertaking). A direction may require the parent undertaking to take specific action or to refrain from taking specified action. Before giving such a direction the PRA is obliged to consult the FCA. In April 2013 the PRA published a statement of policy with respect to the giving of directions which includes the following non-exhaustive list of possible directions that the PRA may give:

- a requirement to meet specific prudential rules applied at the consolidated level;
- a requirement to improve the system of governance or controls at group level or in relation to (UK or non-UK) subsidiary undertakings, or both;
- a restriction on dividend payments or other payments regarding capital instruments to conserve capital;
- a requirement to move funds or assets around the group to address risk more appropriately;
- a requirement for the group to be restructured;
- a requirement to block or impose restrictions on acquisitions or divestitures;
- a requirement to ensure continuity of service is provided between group entities;
- a requirement to include other entities within the scope of consolidated supervision (including shadow banking entities);
- a requirement to raise new capital;
- a requirement to take steps to remove from office directors of the parent that the PRA does not regard as fit and proper;
- a requirement to remove barriers to resolution; and
- a requirement to issue debt suitable for bail-in.

The exercise of the PRA's direction-making power may be appealed to the Upper Tribunal.

As discussed in question 13, banks are required by the PRA to draw up recovery and resolution plans. A recovery plan might include provision for group support in specified circumstances. Under BA 2009, the Treasury may bring the holding company of a bank into temporary public ownership if certain conditions are met.

25 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

In question 19, we have referred to the pre-insolvency stabilisation powers as well as the bank insolvency procedure and bank administration procedure available to resolve banks under the SRR. A controlling entity or individual is not liable for the debts of an insolvent subsidiary, although it might be required (by PRA direction) to recapitalise an undercapitalised subsidiary before insolvency (see question 24). Liability depends on the application of general rules of insolvency law, which also apply in a bank insolvency or bank administration. The following are the main circumstances in which a shareholder or parent may incur liability. These powers are also relevant to proceedings under SI 2011/245 (as amended).

Transactions at an undervalue

If a company has entered into a transaction at an undervalue and at the time the company was unable to pay its debts, or became unable to do so as a result of the transaction, in the two years prior to the onset of insolvency, the court has wide powers to set aside the transaction. There is a presumption of insolvency if the transaction is with a controller or parent.

Preferences

If a company does anything that puts the controller or parent in a better position in the event that the company goes into insolvent liquidation in the two years prior to the onset of insolvency, the court may set aside the preference if the company was insolvent or became insolvent as a result.

Fraud on creditors
The court has broad powers to set aside transactions entered into for the purpose of putting assets beyond the reach of creditors or otherwise prejudicing the company's creditors.

Shadow directorship
A controller or parent may be a shadow director if the directors of the company are accustomed to act in accordance with its directions. A shadow director may incur personal liability for fraudulent trading and wrongful trading. Fraudulent trading requires proof of dishonesty and is also a criminal offence.

A director is responsible for wrongful trading if a company goes into insolvent liquidation and at some time before the commencement of the winding-up the director knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation, and the director failed to take every step with a view to minimising the potential loss to the company's creditors as he or she ought to have taken. A director that is guilty of wrongful or fraudulent trading may be ordered to contribute such amount to the company's assets as the court thinks proper.

Disqualification
The court has powers to disqualify company directors (including shadow directors) found guilty of misconduct for up to 15 years. In particular, a director of an insolvent company may be disqualified if his or her conduct makes him or her unfit to be concerned in the management of a company. See also question 14 for the criminal offence in FS(BR)A 2013 relating to decisions taken by senior managers that cause a bank to fail.

Piercing the corporate veil
The courts may pierce the corporate veil, so as to impose liability on a parent company for the debts of its insolvent subsidiary in limited circumstances. These include where the subsidiary was used as a device or façade, thereby avoiding or concealing any liability of the company's controllers. In *Ben Hashem v Ali Shayif* [2009] 1 FLR 115, Munby J said: 'The common theme running through all the cases in which the court has been willing to pierce the veil is that the company was being used by its controller in an attempt to immunise himself from liability for some wrongdoing which existed entirely dehors the company.' The Court of Appeal emphasised that '[t]he rationale is that a wrongdoer cannot benefit from his dishonest misuse of a corporate structure for improper purposes' (*Petrodel Resources Ltd & Ors v Prest & Ors* [2012] 3 FCR 588).

Changes in control

26 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

See question 20. Approval may also be required under UK or EU competition law. Where a bank's shares have been admitted to trading on a regulated market (eg, the main market of the London Stock Exchange), a person whose holding of voting rights in the bank reaches, exceeds or falls below every 1 per cent above 3 per cent must notify that bank.

27 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The place of incorporation or nationality of an acquirer is not relevant. There is no difference in the process for approval.

28 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

See question 21. The PRA may only object to an acquisition on the basis of the following matters (or the submission of incomplete information):
- the reputation of the acquirer;
- the reputation and experience of any person who will direct the business of the UK bank;
- the financial soundness of the acquirer, in particular in relation to the type of business that the bank pursues;
- whether the bank will be able to comply with applicable prudential requirements;
- whether the PRA and FCA can effectively supervise the group including the target; or
- whether there are reasonable grounds to suspect money laundering or terrorist financing in connection with the proposed acquisition.

The Level 3 Guidelines, referred to in question 21, provide detail on the interpretation of these assessment criteria. The PRA must also take into consideration any representations made to it by the FCA in relation to the above matters. The FCA can, however, only direct the PRA not to approve the acquisition if it has reasonable grounds to suspect money laundering or terrorist financing in connection with it.

29 Describe the required filings for an acquisition of control of a bank.

The first step is normally an informal approach to the PRA. This is followed by submission of the required information. A prospective controller is recommended to use the PRA prescribed forms.

Completion of the forms can be time-consuming and requires supporting documentation such as group structure charts, CVs for individual controllers, proof of funding and a business plan. The business plan is required to contain at least the following:
- a strategic developmental plan;
- estimated financial statements for the target firm or firms for three years; and
- information about the anticipated impact of the acquisition on the target firm.

Having received the notice, the PRA can require additional information or documents if it considers this necessary and may carry out interviews. Where a proposed new or increased controller is regulated elsewhere in the EU or European Economic Area (EEA) the PRA must consult the relevant home-state regulator. The same applies if a UK bank is controlled by a parent company located in another EU or EEA state. It should be emphasised that 'control' does not stop at the level of the acquirer and can pass all the way up the corporate chain to the ultimate beneficial owners.

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30 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The PRA has 60 working days from the date on which the regulator deems the application for approval to be complete to approve an acquisition, although the process may be shortened where the controllers are already known to the PRA. It facilitates approval for the acquirer to discuss a proposed acquisition with the PRA informally in advance. This enables the PRA to identify potential issues and request any further information before the formal notification is submitted. Up to the 50th working day of the assessment period, the PRA may pause the assessment period for up to 20 working days (or 30 working days in certain circumstances) in order to seek further information from the applicant. If approval is granted, the prospective controller must complete the acquisition within one year, or such shorter period as the PRA specifies. The PRA will consider requests for extension of the approval if required.

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Renewable Energy
Restructuring & Insolvency
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