3. The Bank of England

3.1. Historical background

The Bank of England (BoE) was founded in 1694 with the divisions from Charles Montagu and from the plan of the Scotsman William Paterson as a private bank. By managing one or another set of governments' accounts, goldsmiths and silversmiths deposits via security it became increasingly powerful over time. The Bank has the monopoly to issue notes and acted as guardian of the gold standard, the bedrock of the international financial system since 1844. Until the Second World War the Bank was still private. On 1st May 1946 it was nationalised and became a CB under the control of the HM the Treasury. From then until 1998 the Bank was officially under Treasury control and the Treasury could give the Bank directions ‘in the public interest’ what it is still may now. However, in fact this prerogative was never implemented and the Bank manage to maintain discrete independence. The Treasury, in effect the Chancellor defines what is mean by ‘price stability’ and the BoE is responsible for maintaining

24 Cf. Richard Roberts (23), 101. Howard Davies and David Green, (21), 11. The Banking Act (BA) 1844 gave the BoE a monopoly on the issue of banknotes.
price stability.\textsuperscript{26} The BoE exercised for many years an informal supervisory authority over the UK banking system based less on rules than on “moral suasion”.\textsuperscript{27}

Until 1970s the finance and banking system in the UK was still deregulated. At the time many international banks opened their offices in London and the system has to be changed as per the new demand. With the BA 1979 (enacted in compliance with the EC First Banking Directive) the legislation authorised the BoE with banking supervision. These were later expanded in the BA 1987.\textsuperscript{28} This changed in 1997, when Parliament voted to give the Bank operational independence with a clear remit to pursue price stability. The responsibility of BoE for micro level supervision was stripped by creating the Financial Services Authority (FSA). The BoE lost its priority to regulate the banking sector and became a new task to maintain financial and economic stability in general.\textsuperscript{29}

\textsuperscript{26} W. Clarke, (n 25), 21.
\textsuperscript{28} The BA 1987 allowed the BoE to control advertising for deposits by licensed institutions and deposit takers and it had investigative powers to explore any breaches of restriction on acceptance of deposit and defining its meaning. The BoE has authority to require an institution to provide any information necessary in order for it to carry on with any of their duties under the Act. See also SCF Finance Co. Ltd Masri (No 2) [1987] QB 1002.
\textsuperscript{29} G. Tett, Fool’s Gold, (Abacus 2012), 182.
3.2. Banking Act 1998

The BA 1998 regulated more clearly the relationship between the Treasury and the BoE. The Act established a Monetary Policy Committee (MPC) as a committee of the Bank with the Governor as a chairman, to formulate and implement monetary policy.\textsuperscript{30} The Treasury could give recommendation to the Bank or to the MPC with respect to monetary policy in public interest and by extreme economic circumstances.\textsuperscript{31} The system worked in the way that the Government sets the inflation target and the MPC organise its implementation.\textsuperscript{32}

3.3. The Financial Services Modernisation Act 2000

A central goal of the FSMA 2000 was to maintain the financial stability in the UK. The FSMA took the banking supervision from the BoE and gave it to the independent new created FSA. The FSA became very powerful in terms of scope, powers and discretion. Its four regulatory objectives were: market confidence, public awareness, consumer protection and reduction of financial crime. In discharging its general responsibility, the function of the FSA was focused on three aspects.

\textsuperscript{30} S 13 BA 1998.
\textsuperscript{31} S 19(1)(2) BA 1998.
\textsuperscript{32} Nevertheless, the role of the Treasury was not used as a possible option in the FC 2007, when the bank used its obligation as a LLR too late in order to support other banks and the stability of the system as a whole.
Firstly, its scope was cross-sectorial, covering the whole financial sector, extending to banking, insurance and investment markets.

Secondly, it regulates both the prudential and conduct of business aspects of those markets.

Thirdly, it has had enormous influence: authorising firms, legislating, monitoring, investigating and enforcing supervisory regime.

The idea for single agency model was from the former British Prime Minister Gordon Brown, and represented the view that nowadays all markets come together and financial institutions meanwhile become active at the same time on different markets. Therefore, an independent body should collect information and observe all these markets. The FSA cooperated together with the BoE and the Treasury in order to guarantee financial stability in the UK. In this regard there was established a Financial Services and Market Tribunal (s 134 FSMA 2000). The so called "tripartite system" involving the Treasury, the BoE and the FSA which were responsible for the financial stability in the UK. The tripartite committee was "a vehicle for communication and exchange of views". The division of re-

---

33 The Tribunal was an independent first-instance tribunal to which certain decisions of the FSA may be referred. One of the reasons for the establishment of the Tribunal was the requirement in Article 6 of the European Convention on Human Rights, that person has the right to a hearing before an independent tribunal.

sponsibilities between the "tripartite authorities" was set out in a Memorandum of Understanding (MoU). According to s 2 MoU, the BoE was responsible for the stability of the monetary system through its monetary policy function. The Bank oversaw the whole financial system infrastructure, regarding the payments systems.

The role of the FSA according the FSMA 2000 was to perform micro-prudential supervision of financial intermediaries. It supervised financial markets, securities listing, clearing and settlements systems. The authority performed conduct-of-business supervision. Regarding the macro-prudential supervision, the FSA's role was un-


37 Under s 2A of the BA, the objective of the Bank is to protect and to enhance the stability of the financial system in the UK. In pursuing this object the Bank is required to work with the other relevant bodies including the Treasury and the FSA.
clear. It had extensive delegated “legislative” powers, as it is entitled to make rules and issue requirements as to the financial standing and conduct of authorised persons. It also gained wide powers of investigation and discipline.

The Treasury, the third party of the tripartite committee was responsible for "the overall institutional structure of financial regulation and the legislation which governs it." It had no responsibility for the activities of the FSA and the BoE, but if a financial problem arises with potentially system-wide consequences, the FSA and the BoE together can decide whether the Treasury needs to be alerted, according s 5 MoU.

The FSMA 2000 reforms should therefore, not be overstated, but be viewed as a further step in the evolution of banking regulation, rather than in its revolution.

3.4. Banking Act 2008 and 2009

The Banking (Special Provisions) Act 2008 was the first regulatory response from the British Government in the face of the credit crunch. This emergency legislation was enacted in order to allow the Government to own temporarily banks which were collapsing, such as Northern Rock. The BA 2009 implemented later the following Capi-

---

38 S 3 MoU. The FSA’s responsibilities as "the authorisation and prudential supervision of banks, building societies, investment firms, insurance companies and brokers, credit unions and friendly societies".
40 S 4 MoU.
tal Requirements Regulation and Directive CRR/CRD IV. For this purpose created was a special Recovery and Resolution Mechanism (RRM) with special tools. Inside the BoE there was introduced a Financial Stability Committee (FSC). In order to enhance the stability of the financial systems of the UK, a Special Resolution Unit (SRU) was created inside of the BoE, which had to conduct the resolution of the distressed banks. The SRU planned for and implemented a Special Resolution Regime (SRR) established under the BA 2009.

### 3.5. The Financial Services Act 2010

The FSA 2010 was the third and final piece of major legislation implemented by the UK Labour Government in the face of the financial crisis. The Act introduced changes in: Financial Stability Objective, Consumer Education Body, Living Wills.

Regarding the first change, the Act introduced a new duty which required that the FSA consider and review its financial stability objective in consultation with the Treasury (s 1(3) FSA 2010). It allowed the FSA to implement enforcement power in light of this new objective, as opposed being constrained to its previous objective of ensur-
ing protection of consumers. The Act required, that the FSA implement rules requiring each authorised persons to prepare, and keep up-to-date a recovery plan.\textsuperscript{43} It regulated the remunerations and the bonuses paid to employees of banks and stabilised the financial system.

### 3.6. Financial Services Bill 2012

The Financial Services Bill (FSB) 2012 had to deliver fundamental changes in the UK financial regulation. Under the previous regime, financial stability in the UK was overseen by a tripartite system. One problem with this system was that the monetary policy and the supervision was split in two different institutions and neither one of them was responsible for the leadership.\textsuperscript{44} There was an ‘under-lap’ of function with no single institution having ‘responsibility, authority or powers’ to monitor the financial system as a whole and to take necessary action to deal with any systemic threats.\textsuperscript{45} For instance, the BoE had a separate Financial Stability Division, with the FSA having a parallel function monitoring market exposures. Moreover, there appeared to be little contact between these two and with no direct reporting at the Tripartite Committee level. Furt-

\textsuperscript{43} S 7(1) FSA 2010.


\textsuperscript{45} Cf. Para. 1.6. Marcus Killick, (n 45), 369. Because the pre-crisis structure left a gaping underlap between the BoE responsible for monetary policy and the FSA for the regulation of individual financial firms, with neither adequately focused on the systemic risks.
thermore, the Tripartite Authorities acted not quickly enough to save some financial institutions. In addition, the system had not ensured "financial stability-in particular by failing to identify the risk posed by the rapid and unsustainable increase in debt in the economy." The new Government identified significant failings in the previous regime.

Firstly, the BoE, while having statutory responsibility for financial stability, had only limited tools to deliver it and failed to use the tools it had.

Secondly, the FSA had regulatory tools for delivering financial stability, but with such a wide mandate including consumer protection, public awareness, market confidence and reduction of financial crime it was not sufficiently focused on stability issues. In this regard, the purpose was to separate prudential and conduct supervision, requiring different skills and approaches.

Thirdly, the linkage between financial institution supervision and systemic stability issues had fallen between the institutional cracks. The July 2010 White Paper referred to ‘inherent weaknesses and contradictions’ in the earlier Tripartite Committee model involving the BoE, the Treasury and the FSA. While the concentration of regulatory authority

46 Group of Thirty (), 41.
47 HM Treasury, "A new approach to financial regulation" (February 2011), Summary: Intervention and options.
48 Ibid., para.1.11.
49 See Speech by Lord Adair Turner, FSA City Banquet at the Mansion House, London.
50 Marcus Killick (44), 369.
51 CM 7874, para. 1.5.
within the FSA is referred to, the effect of the new regime was to create an even more powerful CB responsible for regulatory, macro-prudential and monetary policy. The underlying policy objective of the new regime were to restore the position of the BoE as the key financial regulator for the UK financial system. In this regard the FSB 2012 shaped a new regulatory framework. The existed system provides for a shared responsibility for financial stability between the Treasury, the BoE and the FSA was replaced with a new system based on the twin picks model. According the Act, inside the BoE a Financial Policy Committee (FPC)\textsuperscript{52} was created and the existing FSA was split into two agencies the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA).\textsuperscript{53} The new reform established:

### 3.6.1. The Financial Policy Committee

The FPC inside BoE became responsible for the development and implementation of macro-prudential policy in the UK. The task of the FPC in this regard is to identify, monitor and take action to remove or reduce systemic and any kind of risk and to protect and enhance the resilience of the financial system.\textsuperscript{54} The specific functions of the Committee are to monitor the financial system's stability,

---

\textsuperscript{52} See s 9B of the BoE Act.

\textsuperscript{53} Cf. s 1a(1) and 2 a FSMA under s 5 FSB 2012, also Schedules 1za and 1zb FSMA. The constitutional provisions which governed the FSA under Schedule 1 FSMA are amended to apply to the FCA and PRA.

\textsuperscript{54} Clause 9c(2), (3) and (5) FSA 2000.
provide directions, make recommendations and prepare reports. The FPC has to exercise its functions with a view of contributing to the achievement by the BoE of its Financial Stability Objective.\(^{55}\)

The Treasury and Parliament would be given additional oversight powers in respect of the macro-prudential activities of the FPC. The Bill provided for mechanisms that defines the relationships between the Treasury, the Bank, the PRA and the FCA in the event of crisis in the financial system.\(^{56}\) The Treasury may make recommendations to the FPC at any time in writing with the FPC confirming whether it accepts the recommendations and any action to be taken.\(^{57}\) Directions can be issued to the FCA or PRA on macro-prudential measures and the FPC may make recommendations within the Bank, to the Treasury or FSA and PRA.\(^{58}\)

### 3.6.2. The Prudential Regulation Authority

The Prudential regulation were transferred to the BoE through its subsidiary, the new PRA. The PRA become responsible for the micro-prudential supervision of all firms subject to ‘significant prudential regulation’ including banks and other deposit-takers such as building societies and credit unions, broker-dealers and insurers and friendly societies.\(^ {59}\) The general function of the PRA is to promote

---

55 Clause 9c(1) of the FSB.
56 Recital 12 FSB 2013.
57 Clause 9 d FSB.
58 Clause 9g-1, m, n, o and p FSB.
59 CM 7874, para. 3.12.
the safety and soundness of the financial system and to ensure that the adverse effect of any failure is minimised. In this regard, the PRA works closely with FPC within the BoE and the FCA. The PRA second objective is to ensure safe competition. This secondary objective is only applicable when the PRA is advancing in its primary objectives and does not operate as a stand-alone objective. Nevertheless, this goal overlaps with the object of the UK Competition Authority.

As a part of BoE, the PRA’s is connected to the BoE’s other functions including its role as LLR, its work on market oversight and infrastructure, prudential policy, financial sector resilience and the exercise on resolution power. By the supervision international active financial institutes the PRA had to work actively with other national authorities together in supervisory colleges (SCs).

### 3.6.3. The Financial Conduct Authority

The need to have a separate FCA was justified on the basis of attempting to avoid ‘in-built tensions’ between different regulatory objectives and focusing on the interests of consumers and market participants in a separate ‘conduct

---

60 The Prudential Regulation Authority’s approach to banking supervision June 2014, 7.
61 Although in principle the PRA gives the general guidelines and the Competition Commission can enforce them.
62 PRA (60), 16.
63 The PRA would generally be responsible for firms holding $ 9tn in assets and EEA firms with $ 2tn in assets or other systemically important institutions.
regulatory system’. The FCA become principally responsible for ensuring confidence in financial services. In addition to its strategic objective, the FCA is assigned three operational objectives of consumer protection, market integrity and efficiency and choice. It become power to issue rules governing the conduct of all financial firms and the authorisation of ‘non-prudential firms’.

### 3.7. Financial Services Act 2012

The Financial Services Act (FSA) 2012 expanded greatly the responsibilities of the BoE, and implemented most of the FSB 2012 proposals.

The FPC replaced the Financial Services Committee (FSC), by the BoE. The FPC became authorised to make recommendations to the PRA and the FCA on a comply or explain basis, and to direct both the PRA and the FCA. The Committee has powers in relation to the sectoral capital requirements and responsibility for decisions on the countercyclical capital buffer (CCB) applied to certain financial institutions in the UK.

A firm-specific regulation of financial institutions that manage significant risks on their balance sheets will be carried out by an operationally independent subsidiary of the BoE, the PRA. The PRA has to work closely with the FCA and to observe and conduct prudential regulation for big

---

64 CM para. 4.3.
65 CM paras. 4.4 and 4.6.
66 S 1b(2) and (3) FSMA.
67 The tool is implemented in the UK via the Capital Requirements Directive. Directive 2013/36/EU.

https://doi.org/10.5771/9783828867659-29
Generiert durch IP ‘54.70.40.11’, am 28.08.2020, 17:36:49.
Das Erstellen und Weitergeben von Kopien dieses PDFs ist nicht zulässig.
banks, investment firms, security houses and insurance companies. Moreover, it can enforce credit institutes for recovery and resolution plan, a special resolution regime. In this regard, inside the BoE a SRU was created which has to work closely with the Treasury by putting distressed financial institutions under the BA 2009 SRR.

The FCA carries out the prudential regulation of firms not regulated by the PRA. It became a multifunctional authority conducting issues across the entire spectrum of financial services. Its operational objectives become: facilitating efficiency and choice in the financial market; protecting and enhancing the integrity and confidence of the financial system and securing an appropriate degree of protection for consumers, fighting financial crimes.

### 3.8. The Financial Services Act 2013

The FSA 2013 seeks to introduce structural and cultural changes, giving the government more power to ensure financial aid to institutions that are not able to absorb losses. The Act introduced a ‘bail-in’ tool according to Part 3, s 17 FSA 2013 as an additional stabilisation option to the pre-existing RRM from the BA 2009. Banks were required to

---

68 It complied with the Independent Commission on Banking (chaired by Sir John Vickers) and the recommendations made by the Parliamentary Commission on Banking Standards.

69 The purpose of the bail-in tool is to recapitalise the entity and to ensure the continuity of all service and transactional arrangements. The PRA must consider that any other action cannot be taken to avert the failure. In addition, the BoE must determine that it is in public interest to use the bail-in tool.
have loss absorbing capacity, in addition to the levels of capital required by the Basel III-Regime and the CRD IV. The FSA implemented a special administration for operators of certain infrastructure systems,\(^70\) restricts the powers of persons other than the BoE in relation to the insolvency of infrastructure companies. The Act ensured that the PRA strictly separates, or ring-fences banks' retail from investment activities. It finally introduced a cap for payday loans, higher sanctions for financial crimes, and implemented a financial services compensation skim.

### 3.9. Assessment

Since its foundation the BoE has assumed a very important role within the UK economy. The two main objectives of the Bank are to ensure the financial stability of the national economy and act as a financial regulator. Along with its monetary function, the Bank took its "old new role" as a bank regulator after the global financial crisis and the UK credit crunch. Thus, the BoE became responsible for the key financial areas: macro-prudential; monetary; liquidity policy; LLR; resolution; payments clearing and settlements. In this regard, the Bank developed into a super-authority concentrating and centralising power, rather than counter-balancing this power between different authorities, as in the previous regime between the monetary policy by the BoE and the supervision by the FSA. Moreover, authorising the BoE as prudential regulator of all financial institutions, there is still a risk to repeat the mistakes with the

\(^70\) Part 6 s 111ff. FSA 2013.
FSA, as a single authority responsible for many tasks.71 One problem of the previous system was that there were not clear responsibilities for the UK financial regulation authority and the tasks seem to be fragmented with the new reform.72 The twin-peaks supervision becomes in some cases hard to distinguish between prudential and conduct-of-business supervision.73 The effectiveness of supervision would not be improved with the increase in the number of involved agencies, but the costs of the conducted supervision would probably increase.74 There is also no clear synchronisation between the authorities which are not under the supremacy of one body.

Furthermore, combining the Bank's responsibility for monetary policy with the financial supervision could create further problems.

The Bank's reputation would be at risk from failures in either activity. The different objects of both functions could lead to errors in prudential supervision, potentially damage monetary policy-credibility.

In addition, the BoE becomes responsible not only for the banking supervision what is its entire nature in comparison to other CBs such as the ECB but for the whole financial sector including security firms and insurance companies. In this respect it raises the question how well it is able to segregate commercial from investment banking.

72 Ibid.
73 Ibid.
74 Cf. Debates in the House of Lords (Q 518), (Q 552); Lord Turner Lord Myners views, Economic Affairs Committee (n 34).
Another issue is that to some extent the functions of the PRA and the FCA by the recovery and resolution procedure (RRP), regulating prudential standards and promoting healthy competition, overlapped themselves. The last role also cover the tasks of the UK Competition Commission.

Therefore, the new reforms authorising the BoE with more power and functions which are spread between different bodies should be differentiated more precisely in order to avoid previous mistakes with one super-authority.