University of Reading

# *Introduction to Banking Law*

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**Chapter 21**

Introduction to Banking Law

Learning Outcomes

Studying this chapter should help you to:

- ✓ understand the nature and importance of banks within the financial system
- ✓ appreciate the importance of the role of banks in the financial system
- ✓ Start to appreciate the importance of the banker customer relationship
- ✓ An understanding of the global financial crisis.

## 1 INTRODUCTION

Banks represent important institutions within the financial system. This is particularly due to the role they play in an economy. Banking law is generally a wide concept, since it embraces many different aspects, including the configuration and nature of the banking system, the importance of banks and the legal framework. Banks are also important institutions as they can be used as an instrument or catalyst to facilitate things such as the purchase of houses, the payment of fees etc. The bank makes funds available by providing credit to customers, which helps the economy. To discharge this responsibility effectively, it is the obligation of these banks to manage the different types of risks, including operational and market risks.

Given these banks have a large responsibility, it is imperative that there is an effective regulatory system to regulate and supervise these institutions. The regulation of banks has since experienced a drastic change, as a result of the global financial crisis which occurred in 2007-2009. The crisis which started in early 2007, resulted in the Northern Rock being

nationalised followed by the near failure of Bearn Sterns in 2008. The global financial crisis of 2007-2009 was the nearest similarity to the Great Depression in 930. During this period, banks, regulators and governments globally sought to rescue banks to save them from failing.

In this chapter, we are going to lay a foundation to help you understand banking law in the UK. This will help you have a greater understanding of the topics in Chapter 22 and Chapter 23. In this initial section, we will talk about why banks are considered 'special' or 'important' institutions and the role they play within the financial system. We will also explore how a bank is defined under the law. What we discover here is that there is no single definition and that case law and statute play an integral role in the way this aspect of banking law has developed. After this, we will consider the banking business and the different types of banks that exist in the financial system These range from traditional retail banks such as Barclays Bank and Halifax, to challenger banks such as Monzo and Revoult. Finally, we will consider the global financial crisis and the impact of this on the banking system.

Banks are considered to be special institutions due to the role they play within the wider economy. These institutions carry out important tasks, such as taking deposits, providing payment facilities, providing funding for individuals, other organisations and the government. There are other factors which make banks important institutions. These include the role they play within the financial system; the manner in which they are regulated and supervised; and the risk they can pose if they fail or fall into crisis.

## 2 What is the definition of a bank?

There is no widely accepted definition of a bank. Nevertheless, statute and case law have been highly instrumental in this respect. It is important to provide some clarity in this area, as the discussion here ties in with the concepts of regulation which are discussed below and will help in the understanding of the banker customer relationship which is explored in the

subsequent chapter of this book. In terms of the banker customer relationship, being able to define what a bank is an have an impact on the duties that they have towards customers. An example of such duties could be the duty of confidentiality and the duty of the bank to honour mandates. The first important step is to discuss what the law (statute and common law collectively) recognises as a bank. One we have established this, we can then explore the activities that the bank engages in and the different banks that exist in the system.

**2.1 Statutes**

The UK law does not provide a single definition of a bank. There are however different statutes which make reference to the either 'bank', 'banker' or 'banking'. These references, coupled with the judicial approach, are helpful in adducing a definition of banking. The Bills of Exchange Act 1882 was one of the first Acts which considered the term 'banker'. It is prudent to note that the Banking Acts of 1979 and 1987 were the first Acts to deal with the licencing of banks capable of accepting deposits from the public. Under S 2 of the Act, a banker is defined as: *'a body of persons whether incorporated or not, who carry on the business of banking'.*

There are other Acts, which provide further context, including the Banking Act 2009, where a bank is defined as a:

*'UK institution which has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits.'*

It is clear that these definitions are similar and assist in providing some context to the business of banking. The several traits that appear relevant in this definition. The first, it is clear there needs to be an institution which *accepts* funds from customers which is then in turn placed in their account. Secondly, banks honour cheques or funds which are drawn by these customers. The third is that the banks are, in one way or another, regulated as seen by the definition of the Banking Act 2009. The concept of regulation is discussed in the later sections of this

chapter. Finally, such an institution carries out the business of banking. As we will see in the through the cases discussed below and in the subsequent chapter, banking business can take many forms.

## 2.2 The Common Law Approach

The courts have been instrumental in their judicial pronouncements of the characteristics of a bank. We turn to a few cases to which provide further clarity to this definition. The Irish courts in *Re Shield Estate* [1901] 1 Irish Reports 182 stated that: *'The real business of the banker is to obtain deposits of money which he may use for his own profit by lending it out again.'*

Key Case

**Joachimson v Swiss Bank Corporation [1921] 3 KB 110**

In this case, two nationals (one German and one English) were customers of bank where they held an account. During the First World War, the balance on the account was over £2,000 but the partnership between the two nationals was prohibited. Once the war came to an end, the English partner wound up the partnership and commenced proceedings for repayment of the account balance. The issue for the courts here was whether a formal demand for payment had been requested. In providing some further clarity on the banker customer relationship, Atkin LJ portrayed the banker customer contract as:

*'The bank undertakes to receive money and to collect bills for its customer's account. The proceeds so received are not to be held in trust for the customer, but the bank borrows the proceeds and undertakes to repay them. The promise to repay is to repay at the branch of the bank where the account is kept, and during banking hours. It includes a promise to repay any part of the amount due against the written orders may be outstanding in the ordinary course of business for two or three days, it is a term of the contract that the bank will not cease to do business with the customer*

*except upon reasonable notice. The customer on his part undertakes to exercise reasonable care in executing his written orders so as to note mislead the bank or facilitate forgery.'*

The case of Joachimson shed further light and his Lordship noted:

*'The bank undertakes to receive money and to collect bills for its customer's account. The proceeds so received are not to be held in trust for the customer, but the bank borrows the proceeds and undertakes to repay them. The promise to repay is to repay at the branch of the bank where the account is kept, and during banking hours. It includes a promise to repay any part of the amount due against the written order of the customer addressed to the bank at the branch...Bankers never do make a payment to a customer in respect of a current account except upon demand.'*

Lord Diplock added:

*"[w]hat I think is common to all modern definitions of banking and essential to the carrying on of the business of banking is that the banker should accept from his customers loans of money on deposit, that is to say, loans for an indefinite period on running account, repayable as to the whole or any part thereof on demand by the customer.... "*

The case of Joachimson v Swiss Bank Corporation (and Foley v Hill which is discussed below) are two important cases which you will need to include in any discussion of the bank and the customer. These cases provided the courts with the earliest opportunities to elaborate on

characteristics of the customer and those of the bank. We will first explore some more cases in this area and conclude on the importance of these cases.

In the case of *Great Western Rail Co v London and Country Banking Co Ltd* (1901) AC 413 HL, it was held that a customer needed to maintain an account with the bank or have a comparable relationship. Although the bank had regularly cashed the cheques of the rate collector, in this instance, he was not a customer since he had no account with the bank.

Another opportunity to contribute to the definition of a bank arose in the case of *Woods v Martin* 1958 1 QB 55 where it was explored whether providing advice to a customer could come under the umbrella of 'banking business' taking into consideration that the bank had presented itself as an institution capable of providing advice to customers for products and investments. It was held:

*'..the limits of a banker business cannot be laid down as a matter of law. The nature of such a business must in each case be a matter of fact and, accordingly, cannot be treated as if it were a matter of pure law.'*

The concept of 'banking business' changes and remains dependant on the context in which it is used. The customary use of the term suggests that there is acceptance of funds, into an account of which they are a customer. It may also constitute the relending of such funds for the purposes of investment, with a view to make a profit. It is important to note that banking business in one jurisdiction may be different to banking business in another. In the United Kingdom, the case of *United Dominion Trust Ltd* v *Kirkwood*(1966) 2 QB 431 (CA) provided a further opportunity to provide some understanding to what banking business constituted within the English context.

Key Case

***United Dominion Trust Ltd* v *Kirkwood* (1966) 2 QB 431**

In this case, United Dominion Trust was a finance house and it borrowed £5000 to Lonsdale Motors Ltd to enable them purchase cars. The company went into liquidation and United Dominions Trust sued the managing director of the company in a bid to recover the loan. It was argued that the finance house (United Dominion Trust) was an unregistered money lender and as such the loan was in contravention of the Moneylenders Act 1900. United Dominion Trust argued that it was a banker, and not a moneylender. The question for the court to consider in this instance was whether United Dominions Trust was indeed carrying on the business of banking.

There were some doubts that United Dominion Trust was engaging in banking business. Lord Denning provided some characteristics of a banker that one may expect to find:

*'There are, therefore two characteristics usually found in banks today (i) They accept from, and collect cheques for, their customers and place them to their credit; (ii) They honour cheques drawn on them by their customers when presented for payment and debit their customers accordingly. These two characteristics carry with them a third, namely (iii) They keep current accounts or something of that nature, in their books in which the credits and debits are entered.'*

This case is an important one in deciphering the business of banking for many reasons. The court, on evaluation of the evidence presented before it, considered that the activity between the company and United Dominions Trust, was a short-term investment and was not repayable on demand. The second consideration was that while there was no evidence that

United Dominion Trust collected cheques on behalf of their customers, there were other important traits which were of interest that should not be ignored. Lord Denning particularly commented that it was imperative to 'look at the reputation of the firm amongst ordinary intelligent commercial men. If they recognise it as carting on the business of banking, that should turn the scale. It was concluded by the Court of Appeal that the act of lending in itself does not make the institution a 'bank' although there was an agreement that the acceptance of deposits from the general public was a compulsory requirement to be recognised as a bank. This was also applied in Re Roe's Charge [1982] 2 Lloyds Rep 370. In this case however, the was a recognition of *United Dominion Trust Ltd*'s reputation and for this purpose, it was recognised as a bank. As such, the provisions of the Moneylenders Act should not be applicable in this instance.

This obiter was elaborated on in the case of *Re Roe's Legal Charge,* which addressed a similar issue on the meaning of banking business, under the Moneylenders Act 1900. In this case, the finance company has created current accounts for customers and collected cheques on their behalf. In addition to this, the finance company has provided other services which included the selling travellers' cheques, dealing in foreign exchange and providing facilities for the payment of customers' accounts of money transfer orders.

**Even though we have the examples from the statutes and the cases which we have just covered, it is important to note that there stil is not universally accepted definition of a bank.**

In relation to banking business, the courts in this instance identified some factors between *Re Roe* (the company) and an ordinary bank. The first, was that the companies banking services

was through an agency bank and not on a premise which was maintained and managed in its own name. Secondly, the number of accounts that was opened for customers by the company was less than 200 and only 58 cheques were cleared for customers during the year of 1974. Thirdly, ¾ of the deposits for the company were held and managed by shareholders and its subsidiary and associated companies. Finally, the company did not get deposits from the public by way of adverts. The courts considered two factors, which were later held to be inconsequential. The first was the limited number of items cleared through the company; and the second was the comparison of banking business between this company and a clearing bank. The main material issue was whether the banking business of the company was 'real' in relation to the terms of its entire business.

**You should now be able to identify features of a bank and identify some key cases in this area.**

## 3. The customer

We have now considered the characteristics of a bank, through the statutory definition and through case law. It is now important to consider the other party, being the customer. Similar to the difficulty in identifying the bank, the same problem presents itself here in terms of defining the customer. There is no statutory definition for a customer, although there are some provisions which refer and regulate the banker customer relationship in the Bills of Exchange Act 1882, s 75 (1). In providing context to this definition however, case law has been helpful. We will explore this in more detail below.

Previously, in order to become a customer of a bank, there was a requirement for a habitual course of dealings, meaning that the bank had to engage in some services for a person. The court considered this approach in the case of Matthews v Brown & CO (1984) 10 Times Rep 386.The position has since been overruled by the case of *Ladbrook & Co v Todd* (1914) 30 Times Rep 433 and elaborated further in the case of *Taxation* of *Commissioners v English, Scottish and Australian Bank* [1920] AC 683 (PC) and considered in the case of *Importers Co. Ltd v Westminster Bank Ltd* [1927] 2 KB 297.

Key Case

***Taxation of Commissioners v English, Scottish and Australian Bank* [1920] AC 683 (PC)**

In the case of *Taxation* of *Commissioners v English Scottish and Australian Bank* a stolen cheque was paid by a thief to an account opened by him with the defendant bank. The question at hand for the courts to consider was whether the thief had become a customer of the bank, by virtue of the singular transaction. In providing some clarity to a customer in this instance, Lord Dunedin noted:

*'..the word 'customer' signifies a relationship in which duration is not of the essence, A person whose money has been accepted by a bank on the footing that they undertake to honour cheques up to the amount standing to his credit…is a customer of the bank.. irrespective of whether his connection is of short or long standing. The contrast is between a casual service, such as for instance, cashing a cheque for a person introduced by one of their customers, and a person who has an account of his own at the bank.'*

The courts have also had to address the question of when the bank comes into existence, in order to decipher whether a person is indeed a customer. This was addressed in the case of *Ladbrook v Todd*, where the courts suggested that the relationship comes into existence when the customer agrees to open an account. In this case, the bank had opened an account for a thief who was impersonating someone else. He has deposited a cheque into the bank which was accepted. The question here for the courts was whether he was a customer of the bank and they decided he was. This was considered again in the case of *Marfani & Co Ltd v Midland Bank Ltd* [1968] 1 WLR 956. Similar to *Ladbrook,* a fraudster opened an account with the bank in the name of 'Eliaszade', who was a client of the fraudster's employer. A cheque was drawn on his employer, made payable to 'Eliaszade' into that account. In this instance, the court concluded that the banks customer was the fraudster and not the actual 'Eliaszade'. It was also clear that Eliaszade had not intended to create a banker customer relationship with this bank.

Another opportunity to explore the definition of a customer was in the case of *Stoney Stanton Supplies (Coventry) Ltd v Midland Bank Ltd* [1966] 2 Lloyds Rep 373. In this case, B has forged the signature of C's company directors with the objective of opening an account in the company's name. It was held that in this instance, the banker customer relationship was not created because of the forgery. This rendered the whole transaction null and void, notwithstanding that the account had become functional.

The aforementioned cases provide some insight into the courts approach in determining the actual moment that a banker relationship is formulated. As per *Ladbrook*, the suggestion is that this takes place once the bank agrees to open the account. This position was supported in the case of *Woods v Martins Bank* [1959] 1 QB 55. The claiming in this case had inherited a large amount of money and received poor investment advice from one of the defendant bank managers. The claimant sued to recover some of the investment he has lost, however the

question for the courts was whether he was indeed a customer of the bank and where a banker customer relationship existed at the time the advice was provided. The claimant had no account with the bank at the time of receiving the advice. He did however ask for the following to which the bank obliged; collect the outstanding balance eon an account which he held with another bank; use a large portion of this funds to make the investments as suggested by the bank manager; and to make a credit for any remaining sums to a new account, which was to be opened with the defendant bank, in his claimant's name.

Salmon J observed that the banker customer relationship came into existence at the time the account was opened in his name. He noted:

*'In my view, the defendant bank accepted the instructions contained in this letter as the plaintiffs banker, and at any rate, from the date the relationship of a banker and customer relationship existed between them. It is true that the express advice was in the first place given before 9th May, but it was implicitly repeated on that day.'*

There is one exception to the views of 'customer' and whether this is the same as someone who holds an account. In the case of *Importers Co Ltd v Westminster Bank Ltd* [1927 2 KB 297, a clearing bank, the courts acknowledge that a bank may be a customer of a collecting bank where a clearing bank accepts cheques deposited by a non-clearing bank on behalf of its customer, for the purpose of clearing.

Given the discussion of in relation to who a customer is, we may now draw two clear determinations. The first, for a banker customer relationship to come into place, the bank agrees to open an account in the customer's name. We can see this evidently from the case of *Ladbook*. It is not necessary that the customer has been dealing with the bank over a period of time. In agreeing to open an account, the bank is agreeing to accept and honour cheques

which are deposited into the account and to make payments which are payable to him. This was further supported in the case of *Libyan Arab Foreign Bank v Bankers Trust* [1989] QB 728.

The second determination is that in terms of the banker customer relationship, the bank effectively agrees to act as the customers agent in transactions. In addition, there is an implied expectation that they will exercise the same degree of skill and care necessary of a responsible banker. This is particularly evident in the case of *Woods v Martins Bank*, discussed earlier.

**4. The banker customer relationship**

The banker customer relationship can be described as being of a contractual nature. In some respects, you can consider this relationship similar to a bailor -bailee relationship, given that the customer transfers physical possession to the bank. In other words, the customer is the bailor, while the bank is the bailee. Given this contractual nature, it follows that the banker customer relationship is managed or governed by established contract law principles. In addition to this however, it is important to recognise that there are other factors that induce the relationship, such as implied terms of law, and best practice standards, introduced on a voluntary basis to help manage the banker customer relationship.

The journey of introducing these best practice standards can be traced as far back to the Banking Code which came into force in January 2001. To manage the banker customer relationship, it is important to note that there are indeed a range of sources, many of which we consider below and again in further detail in the subsequent chapter. The courts have had a number of opportunities to explore this relationship in detail and the case of *Foley v Hill* is a key case to note when discussing the banker customer relationship. In this case, the courts held that this relationship was essentially a contract relationship between the debtor/borrower and creditor.

Key Case

***Foley v Hill*** **(**1848) 2 HLC 28 (HL)

In the case of Foley, the customer deposited funds into his account held at the bank, relying on information conveyed to him that it would earn interest at a fixed yearly rate of 3%. The account received no interest to the account for six years, and the customer request an account of profits of the account. This request was on the grounds that as a customer of the bank, he was a either the banks principal, or he was the beneficiary of a trust. It was also argued that the banker -customer relationship was of a fiduciary nature, and this meant that the claim was not barred by statute.

In underscoring the debtor creditor relationship between the bank and customer, Lord Cottenham noted:

*Money placed in the custody of a banker is, to all intends and purposes, the money of the banker, to do with it as he pleased: he is guilty of no breach of trust in employing it: he is not answerable to the principle if he puts it into jeopardy, if he engages in a hazardous speculation; he is not bound to keep it or deal with it as the property of his principal; but he is of course answerable for the amount, to repay to the principal, when demanded, a sum equivalent to that paid into his hands.* '

Furthermore, it was also noted that the limitation period would run against the customer, from the date of the demand, which was unmet, as opposed to the date of the deposit. The banker customer relationship is also not altered, simply because the customer's account is overdrawn, however, the role of debtor and creditor is of course reversed as in this instance, the customer is now the one owing.

In relation to the cases of *Foley v Hill* and *Joachimson* v *Swiss Bank Corporation*, there are a few things to make note of. The first, when reflecting on the relationship, the demand from the customer is only necessary when there is an instruction for it. Payment for the principal and interest is repayable once it has been demanded. Secondly, given that withdrawals can be made from other branches and using ATM's, there is no requirement for the demand of payment to be made where the account was opened. This seems to be a reasonable approach because it would probably be impracticable in many ways if every time you needed to make a withdrawal; you could only do this at the branch where you opened the account. Thirdly, if an account is wound up, then the account balance is repayable without demand. A good case to support this is *Proven Development Sdn Bhd v Hong Kong and Shanghai Bank Corp* [1998] 6 MLJ 150. As adduced particularly in the cases of ***Foley***, the limitation period commences from the day the customer makes the demand to the bank and is then refused.

**The banker customer relationship is really important in terms of outlining the obligations from the customer to the banks.**

The two final points require slightly more discussion. From the cases of Foley and Joachimson, the contractual relationship between the bank and customer is for the most part regulated by *implied* terms. However, taking into consideration the development of modern banking there is now a requirement that when customers are opening an account, the expressly sign a mandate which includes clear and express terms of the management and operation of the account. In addition to the basic functioning of an account, if a customer wants to make use of other services provided for by the bank, for example, mobile banking, telephone banking etc, the customer will also need to sign, usually, a separate agreement for those services.

The final point is that these two key cases focus on the banker customer relationship with a view of how the account is maintained. It is important to note that these banks also provide other services, in addition to maintaining accounts. A good example of this and also overed in Chapter X is when the bank is looking after valuables for the customer. In this instance, the bank essentially becomes a 'bailee'. Other examples can also include if the bank is manging the customers investment folder. In this particular instance, the relationship has evolved from a basic banker customer relationship and now involves a mixture of agency and contract services. As a result of the potential for the relationship to evolve, it therefore follows that it is not correct to portray the banker customer relationship only as a debtor/creditor relationship. It is possible for the relationship to be of one of trustee and beneficiary – this does not necessarily include the actual movement of property a seen in the case of *Foskett v McKeown* [2001] 1 AC 102. A more recent case has now clarified the obligations of a bank and noted that they are personal and not proprietary. In the case of *First City Monument Bank Plc* v *Zumax Nigeria Limited* [2019] EWCA Civ 294, the courts noted that banking transactions will not give rise to any trust. It also noted that the correspondent banks obligation for onward payment is personal as opposed to proprietary in nature.

**Now you understand the importance of the banker customer relationship, and the relevance of both Foley v Hill case and Joachimson v Swiss Bank.**

**5. Banking business**

Now that we have explored some important aspects, for example the definition of a bank and a customer, it follows that we should explore the concept of 'banking business'. As noted in the introduction, banks are important institutions within the general financial system. Their functions and activities of banks have and continue to evolve, however, in their most basic form, banks accept deposits from customers and make payments for their customers. The deposit function of a bank is probably one of the most fundamental and key aspects. In the UK, most people will have either a basic account or a current account. These types of accounts allow for funds to be stored in and for payments to be made either to other customers or companies.

The ability of banks to accept deposits also plays another important role in relation to creation of 'credit services. The creation of this service allows banks to be in a position to provide credit to a person who may not be able to make payment for goods or services in full. An example may be the creation of a direct debit to pay gym membership, if a person cannot pay for the entire cost at once. Another example might be purchasing a house and having a mortgage if a person cannot pay for the entire mortgage in its entirety.

### 5.1 Types of financial institutions within the financial system

There are different types of banks within the financial system. These include Retail banks, clearing banks, commercial banks, investment banks, shadow banks and challenger banks. These are discussed below.

#### 5.1.1 Retail and Clearing

Retail banks are the easiest to distinguish amongst the many types of banks in the system. Some of the popular banks in this category include Halifax, Barclays Banks. Royal Bank of Scotland and National Westminster (Natwest). These banks mostly deal with processing credit and debits and they play a vital role in ensuring the effective running of the economy.

### 5.1.2 Commercial banks

Commercial banks have played a significant role in the development of commercial banking. Commercial banking is quite broad as it contains a number of different moving parts. It involves international trading which includes international payments and trading. Banks engage in the international market as it allows them to grow and encourages the development and fostering of business relationships.

### 5.1.3 Building Societies

Building societies can be described as organisations whose primary focus is deposit taking and providing mortgage lending services to people. These types of institutions, unlike retail banks, usually provide better rates. This is because there is no obligation to pay shareholders or profits (dividends). Over the years, the number of building societies has reduced drastically, the leading one being Nationwide.

### 5.1.4 Investment Banks

Investment banks are institutions which are primarily focused on providing generating profits for its clients, at a fee. Thus, they are more high end banks and not necessary for the general public. These types of banks take much higher risks than one would expect of retail, clearing or even commercial banks. This is because they are more exposed to the market and are more exposed to things such as market and commodities risk. We will look at this in some more detail, in chapter 23.

### 5.1.5 Challenger banks

A challenger bank is smaller than a traditional bank, some of which have been mentioned above. These institutions came into force after the global financial crisis in 2008, with the objective of being in a position to compete with the bigger banks. Examples of these challenger

banks include Monzo, Revolut and Starling Bank.  The interesting thing about these challenger banks are that they mostly interact with customers only using the mobile app and are generally user friendly.

**Now you understand some of the different banks we have in the banking system.**

## 6. Why do we regulate banks?

### 6.1 UK Banking structure

Before we go into why we regulate banks, it would be helpful to know the regulatory structure of the UK.  This may be described as operating on a twin peaks type model. The first is the Prudential Regulation Authority, to which the primary focus is the supervise and to ensure the safety and soundness of banks. This body authorises banks and insurers, which are fundamental to the financial stability. The second is the Financial Conduct Authority, (FCA) to which the objectives is to maintain confidence within the UK's financial system. In terms of operation, the FCA, the focus here is on consumer protection and promoting competition in the financial markets.

Now that we have laid that foundation, let us turn to the importance of regulation. Given the significance of a bank, which we covered earlier in the chapter, the failure of a bank can have a substantial impact on the larger economy. Banks are quite closely connected with each other, as are the activities that they undertake. Because of the nature of banking business, many if not all of these banks are interdependent on each other. If one bank were to fail, it would have a detrimental impact on the other banks, similar to a domino effect. Additionally,

the failure of one bank could send fear to the other banks, thus, sending panic to the entire system.

The failure of any bank within the system may have consequences for both the bank and the consumer. From the consumer perspective, there is the fear of losing savings or investments with the banks thus, decreasing confidence in the banking system. From the perspective of the bank, there is the fear of instability within the system and the lack of consumer confidence. This is similar to Northern Rock which was nationalised during the global financial crisis of 2007-2009. This nationalisation was a move by the government to avoid a collapse in the UK banking system and to negate further fear.

This brings us to the question of why we regulate and supervise banks. Before we go into the reasons behind this, it is helpful to understand the meaning of both terms. Banking regulation refers to rules and guidelines which banks are required to comply with. Banking supervision refers to the process and method of banks by regulators.

Regulation is necessary for two reasons. The first, is that from the customer perspective, it is important that customers feel that the banks they are trusting with their money are properly regulated and supervised by appropriate bodies. If you have an account with Halifax Bank for example, you want to know that Halifax is being regulated properly and that your money is safe. The Consumer Rights Act 2015 is an important Act to note also as it provides comprehensive protection of consumer interests. The main area of focus includes the fairness of contractual terms for consumers. In addition to this, it is important to remember the important role that common law has played in terms of defining what a bank is, who a customer is and the duty of care which is owed by the bank to customers and indeed from customers to banks. These duties will be addressed in further detail, in the subsequent chapter.

Secondly, the aftermath of the global financial crisis 2007-2009 exposed the severe regulatory weaknesses which existed in the financial system. The global crisis was a critical moment for regulators globally to rethink regulation, however, in the UK particularly, it caused regulators to rethink their approach adopted towards regulation and supervision of banks. The global crisis started with a bursting of the US housing bubble and the bankruptcy of the Lehman brothers, an investment bank, in 2008. Banks in America had engaged in a particularly in sub-prime mortgages. These types of mortgages are usually offered to high-risk customers, who usually have poor credit. These borrowers then started to default on payments, which had a knock on effect within the system and affected other interconnected banks.

In the case of the UK, Northern Rock was one of the banks which experienced a bank failure. This bank was nationalised by the UK government due to the financial difficulties it experienced and its connection with the sub-prime mortgages. The events in the UK and the US affected other economies, particularly within the European Union region. To safeguard the financial system, the UK introduced measures to mitigate the possibility of another financial crisis. Such measures include the introduction of the Financial Services Authority, the Prudential Regulatory Authority, and the Financial Conduct Authority as a tripartite regulatory structure.

**Now you understand why regulation is important in the banking sector.**

**You also know the different regulatory bodies in the UK.**

## 7. The impact of the global financial crisis

Now that we have considered the importance of why we regulate banks and considering there has been some mention of the global financial crisis in the earlier sections, it follows that we should briefly consider the impact of the global crisis on the banking system before concluding this chapter. Although the crisis originated from the US, it is important to note that did impact several other countries including those in Africa. Much of the literature however does focus on the developed countries such as the US, the UK etc.

Many US based banks had engaged in securitisation and transforming loans into different securities products. These products were also made with sub prime mortgages. Sup prime mortgages may be described as mortgages offered to borrowers who have a risker lending profiles. Eventually, the growth of this securitisation market led to weak regulation and affected banks globally interconnected.

The global financial crisis revealed several regulatory weaknesses within the financial system. In the absence of sound regulation within the banking system, the crisis also demonstrated that there were poor corporate governance standards. To address these issues, the Turner Review was issued in 2009 with a view of clearly identifying the factors which contributed to the crisis. This report was instrumental in the supervisory approach previously as being 'light touch'. The report underscored the issues that went wrong leading to the crash and identifying the actual causes of the crash. One such identification was the idea that the markets were self-regulatory and that banking institutions could be trusted to rely on their internal controls to address issues. Another finding was that the interconnectedness of banks globally, coupled with the notion of 'too big to fail' meant that no one country would be insulated from feeling the impact. The fact that these countries were interconnected also made responding to the crisis difficult in some instances

## 8. Summary

This chapter has considered how a bank is defined under the common law and the statute. In addition, we have explored several important cases which have helped shape this definition. This chapter has also considered the reason why we regulate banks and the type of banks that exist in the system. Finally, we have considered the impact of the global financial crisis and how this has changed the regulatory approach.