Introduction

This chapter reviews some of the more important recent developments in U.K. banking law. The term “U.K. banking law” needs some explanation. It covers a wide range of legal territory that affects banks and their businesses. There is a U.K. Banking Act, but it is primarily concerned with the regulation of deposit taking by the central bank, that is, the Bank of England. There are, of course, many other statutes that impinge on banking business, although there is no “commercial banking law” of the type found in some countries, which circumscribes the business that commercial banks may carry on. In the tradition of the common law, much of the English law of banking is judge made. Finally, although many statutes apply to the whole country, the Scottish system in particular differs from that of England, both in ethos and in derivation.

In the past decade or so, undoubtedly the most pronounced development in U.K. banking law has been the growth in the formal body of regulatory law. It is curious to reflect that this growth has taken place at a time when “deregulation” has been the avowed political objective, but such is the fact. Deregulation has, of course, had its part to play, particularly in breaking down the barriers between different parts of the financial sector. Two separate though interlocked regimes regulate banking and investment business. In the case of the latter, a major and as yet unresolved challenge is to achieve a satisfactory balance between a regulatory system that gives due investor protection without placing an unnecessary burden on business.

The second major development—and undoubtedly this will be the most significant in the long term—has been the slow integration of the European financial sector. A single currency may still be a long way off, but the legal framework in which banking business is regulated is converging in many other respects. The most spectacular example of this is the “single passport” provision that came into effect throughout the European Union on January 1, 1993. In the field of private law, also, Europeanization has been proceeding apace. The common law is proving
well able to adapt, and lawyers in England and mainland Europe are fruitfully learning each other's strengths.

The third development is perhaps more difficult to quantify precisely, but, in a number of respects, there is a growing recognition of what might be termed the "social dimension" of banking. Banks play such an important role in society that inevitably higher standards come to be expected of them than of some other commercial businesses. Some examples are mentioned in this chapter. New rules on money laundering are placing active responsibilities on banks throughout Europe to prevent the abuse of the banking system. On the level of their day-to-day business, U.K. banks have responded to consumer pressure by introducing the Code of Banking Practice, by which they voluntarily undertake to follow principles of best practice in their dealings with customers.

These are the major themes on which this chapter will concentrate. There are, of course, many other developments of note across such a wide field. A recurring problem is one of achieving a balance between the new (and sometimes onerous) demands on banks and the commercial imperatives of a healthy and profitable industry.

Changes in the Structure of Regulation

Banking Business

As already indicated, English law does not have an overall definition of banking business. Historically, clear distinctions have been made between the types of business that various parts of the banking sector carry on, particularly between the "clearing" banks carrying on deposit taking and lending, and the "merchant" banks carrying on investment banking and securities business. At the retail level, "building societies" (roughly equivalent to U.S. thrifts) play a central role in absorbing savings and re-lending them as home loans. Also, international banking has enjoyed a solid revival in London in the past few years; as of 1993, 527 foreign institutions were represented in the United Kingdom.2

The Bank of England has long played a pivotal role in the regulation and orderly development of the U.K. banking sector. It has often been remarked that, until recently, it did so with very few formal statutory powers. When the Bank was nationalized in 1946, the Bank of England Act gave it power3 to issue directions to bankers, but this power was never exercised. The first formal legislation of real substance was the Banking Act, 1979,4 which required institutions carrying on deposit-taking business within the United Kingdom to obtain authorization from
the Bank of England. The current statute is the Banking Act, 1987, which gave the Bank significant new powers, although both the Bank and the Government expressed the view that the changes were not designed to make a fundamental break with the past. This sense of continuity and informality remains an important and valuable feature of the conduct of banking supervision by the Bank of England.

Banking Act, 1987, contains a variety of provisions and powers. The acceptance of deposits within the United Kingdom without authorization is prohibited, and the minimum criteria for authorization are specified. There are powers to regulate the ownership of U.K.-incorporated banks by objecting to new or increased control over them. Specific provisions regulate advertisements for deposits, large exposures, accounts and auditors, investigations, banking names, and descriptions; also, ancillary powers are specified, such as the right to apply to the courts for winding-up orders and injunctions.

Part 2 of the Banking Act is concerned with the Deposit Protection Scheme. The scheme remains (by U.S. standards) relatively conservative: in the event of an authorized institution’s insolvency, the Deposit Protection Board pays each depositor up to 75 percent of the first £20,000 of a sterling deposit with a U.K. office of the institution.

The system of prudential supervision depends heavily on the provision of regular returns to the Bank of England. Traditionally, this information has been supplied voluntarily. It was said at the time that the statutory provisions in the Banking Act, 1987, empowering the Bank to compel the provision of information, were enacted to cover the possibility that institutions not used to the customary style of supervision might be backward in supplying what was needed. Section 39 gives the Bank wide powers to require the provision of information from, and the production of documents by, an authorized institution and its parents or subsidiaries.

The principal prudential reporting tool is the Capital Adequacy Return (Form BSD1), which has to be completed quarterly by U.K.-incorporated institutions authorized under the Banking Act. The Bank issues detailed guidance notes dealing with the completion of this form. Separate returns deal with such matters as the analysis of large exposures.

The other main components of regulatory law are as follows. A number of statutory instruments (for example, those dealing with deposit advertisements) have been issued under the Banking Act. In practice, “notices” issued by the Bank are equally important and cover a much wider scope. These notices deal with issues relating to supervision, monetary control, and other matters, and they have been used to implement European Community (EC) directives. They do not have force of law as
such, but are in practice treated as binding by the institutions subject to the Bank of England's supervisory control.

**Investment Business**

The boundary between banking business and investment business is often blurred, particularly in the United Kingdom, where there has never been an equivalent of the U.S. Glass-Steagall Act of 1933, which enforced the separation of banking and securities businesses. The realignment of the financial sector was accelerated by London's so-called Big Bang of the mid-1980s, the effect of which was the acquisition of a large number of market-making and stockbroking firms by British and non-British banks to form financial conglomerates.

The general continuity of approach that has marked the supervision of banking business through the agency of the Bank of England has not applied to the supervision of investment business. "Investment business" is statutorily defined to include such activities as shares dealing, debt securities, government and public securities, warrants, certificates representing securities, options, futures and long-term insurance contracts, and the giving of investment advice.

Until 1986, the formal statutory regulation of investment business was comparatively light. The Financial Services Act, 1986, was an attempt to provide a cohesive system of regulation. Two often competing factors were at work in the conception of this system. First, political pressure was generated by the general recognition of insufficiently high standards of investor protection (particularly at the retail level), and of the need for a greater degree of public protection than was currently available. Second, the industry had a strong desire to avoid what was perceived to be the overly formal U.S. regulatory rules and the overly powerful Securities and Exchange Commission. The system that these factors produced was described as one of "self-regulation." It is debatable how far it has been a success.

In terms of structure, the Securities and Investments Board is the umbrella body. It presides over a number of self-regulating trade organizations. The theory is that authorization to conduct investment business within the United Kingdom is primarily obtained by joining such an organization. The Securities and Investments Board requires the self-regulating trade organizations to have in force rules to maintain proper standards of business conduct and capital adequacy levels among their members.

The system is undergoing a continuing process of adaptation. Two points in particular may be noted. There has been a welcome move away from too-detailed rule books to more general statements of principle and
core business conduct rules. It has been belatedly recognized that the emphasis on self-regulation by the industry has tended to neglect the interests of the small investor—the very person who needs protection most. To meet this concern, a new self-regulated trade organization, the Personal Investment Authority, is being set up as a unified organization with particular responsibility for the retail sector.

In summary, the body of U.K. law regulating investment business is primarily to be found in the Financial Services Act, 1986, statutory instruments made under that act, various EC directives, and the rules and regulations issued by the Securities and Investments Board and the self-regulating trade organizations pursuant to their statutory powers.

Bank of England’s Role in Regulating Investment Business

As has been mentioned, the regulation of banking and investment business is separate, but it does interlock. This is well illustrated by the role of the Bank of England, which, in practice, figures importantly in the regulation of both investment and banking business. Thus the wholesale London money markets are exempted from the scope of the Financial Services Act altogether and remain subject to nonstatutory supervision by the Bank of England. These markets primarily comprise the short-term markets in sterling, foreign currency, and bullion. The Bank of England issues the London Code of Conduct, which sets out the principles that should govern the conduct of those transacting business in the markets to ensure that the highest standards of integrity and fair dealing are observed.

Where a bank carries on investment business, prudential supervision remains a matter for the Bank of England under the "lead regulation principle." This principle is designed to avoid wasteful duplication in the financial supervision of institutions. In the case of financial conglomerates comprising banking and other businesses, prudential supervision is coordinated by an informal, nonstatutory body called the College of Supervisors, which is chaired by the Bank of England.

In the aftermath of the regulatory upheavals of the past decade, the Bank of England remains pre-eminent in the regulation of the City of London and the U.K. financial system as a whole; if anything, moreover, the trend is toward the consolidation of its position.

The Integration of the European Financial Sector and the Single Passport Provisions

The emergence of the European Union has been a remarkable achievement. Although the United Kingdom has often adopted a con-
servative approach to federal tendencies, it should perhaps be stressed that it has an excellent record for implementing EC directives, once agreed. In the field of banking regulation, European developments have been increasingly important and have proceeded along two distinct lines. First, Council directives have sought to standardize regulatory rules on a number of key aspects, such as own funds, solvency ratios (mirroring the 1988 Basle Capital Accord), consolidated supervision, large exposures, and deposit guarantee schemes. The EC Directive on Deposit Guarantee Schemes requires all EC member states to operate a deposit protection scheme covering all depositors in European banks for which they have home state supervisory responsibility and sets minimum standards as to the protection provided.

Second, since January 1, 1993, a credit institution authorized in one member state may under the provisions of the Second Banking Directive carry on the banking activities that it is authorized to carry on within that state throughout the EC without the need for further authorization. The activities covered are those set out in the annex to the Second Banking Directive.

The Second Banking Directive has been implemented in the United Kingdom by the Banking Coordination (Second Council Directive) Regulations, 1992. The result of this landmark reform is that the Bank of England no longer authorizes banks incorporated in other member states with branches in the United Kingdom. These branches may now accept deposits in the United Kingdom without the Bank’s authorization: the authorization of their home state supervisor is sufficient, provided that certain notification requirements are met. U.K.-incorporated subsidiaries of banks incorporated in other member states wishing to accept deposits in the United Kingdom do, however, continue to require authorization by the Bank, as previously.

The activities listed in the annex to the Second Banking Directive include activities that constitute investment business under the provisions of the Financial Services Act, 1986. As a result of the directive, however, if a bank is authorized to carry on such activities in its home state, it will no longer require separate authorization in the United Kingdom under the Financial Services Act.

The Bank of England has limited responsibilities and powers in respect of European institutions. Its principal responsibilities lie in liquidating the institutions’ branches in the United Kingdom and in assisting the home state supervisory authorities in supervising the institutions’ exposures to market risks in the United Kingdom.
The Bank of England does retain certain powers to impose prohibitions on, or restrict the listed activities of, European institutions in the United Kingdom. The Bank has stated that consistent with the allocation of supervisory responsibility in the Directive, the Bank will usually only exercise its powers after consulting the home State authority and, indeed, in certain circumstances the Regulations explicitly require the Bank to do this. In most cases, the home State authority will be best placed to take action to ensure that the institution rectifies a situation which might otherwise provide grounds for the Bank to exercise its powers.\textsuperscript{27}

To assist the home state authority, and to be better able to determine whether its powers are exercisable and should be exercised, the Bank of England has signed memorandums of understanding with a number of EC authorities (and is currently in the process of agreeing memorandums with the remaining authorities). The memorandums deal with such matters as the exchange of information in crisis situations and when the authorities become aware of contraventions of the law.\textsuperscript{28}

Such a prohibition or restriction may be imposed when, for example, the branch of a European institution has not maintained adequate liquidity, has failed to comply with the applicable law, or has provided misleading information, and when the Bank of England has been notified of various similar failures by a supervisory authority in the institution's home state.

The practical result of these provisions is that, where a bank is operating throughout Europe on the basis of a single authorization, regulatory action against it will have to be taken on a coordinated basis, with the home state regulatory authority taking primary responsibility for the action.

The principles contained in the eighth recital to the Second Banking Directive\textsuperscript{29} seek to address the possibility of abuse of the single passport provisions. First, member states should take steps to prevent supervisory forum-shopping. Second, an institution's place of incorporation (and thus its registered office) should be treated as its home. Third, an institution's head office should be in the same member state as its registered office. Thus an institution should not be permitted to incorporate and subject itself to supervision in a member state where it judges supervisory standards to be most lax while effectively running its business from another member state where supervisory standards are thought to be more rigorous.

An equivalent Investment Services Directive\textsuperscript{30} was adopted on May 10, 1993, to be implemented by December 31, 1995.\textsuperscript{31} The business activi-
ties covered by the single passport provisions of the directive are contained in an annex to it.\textsuperscript{32}

**Developments Affecting Regulatory Law**

The matters discussed above concern the structure of regulatory law. Also, a number of noteworthy developments of a more specific nature will affect the regulation of banks to a greater or lesser degree. Five of these are now considered.

**Duties of Auditors**

The affair involving the Bank of Credit and Commerce International (BCCI) threw into sharp focus the role of auditors in the regulatory process. Auditors are, of course, engaged by the company that they are auditing, which is responsible for paying their fees. The relationship between auditor and company can be a sensitive one, in part because bank auditors are often better placed than the supervising authority to detect regulatory breaches at an early stage.

Under English law, auditors were until very recently permitted to communicate with the Bank of England as regulatory authority without breaching their duty of confidentiality to their clients; however, they were not obliged to do so. Under the auditing guidelines of the Institute of Chartered Accountants, auditors and reporting accountants were, however, subject to a clear professional duty to report directly to the Bank in the circumstances specified in the guidelines. In his Inquiry into the Supervision of the Bank of Credit and Commerce International,\textsuperscript{33} Lord Justice Bingham recommended that a legal duty to report should be imposed, principally on the ground that this would strengthen the position of the auditors and clarify the content of their duties in law.\textsuperscript{34}

That recommendation has been adopted. As from May 1, 1994, the Accountants (Banking Act 1987) Regulations, 1994,\textsuperscript{35} specify that auditors or reporting accountants are to communicate to the Bank of England material matters that give them reasonable cause to believe that the bank in question no longer fulfills the minimum criteria for authorization. In summary, these criteria are that

- directors, controllers, and managers are fit and proper to hold their particular positions;
- at least two individuals effectively direct the business;
- there is an appropriate number of non-executive directors for home-incorporated institutions;
• the business is conducted in a prudent manner and maintains net assets or own funds of appropriate amounts;

• the business maintains adequate liquidity and has adequate accounting and other records;

• the business is carried on with integrity and professional skill; and

• the business holds minimum net assets of the specified amount.

Similar provisions apply to building society auditors and auditors of investment businesses authorized under the Financial Services Act.36

Derivatives and Legal Risk

The term “derivatives” covers a wide range of instruments of varying degrees of complexity. There has been considerable recent controversy over the regulatory aspects of these instruments, in particular their potential effect on a bank’s financial soundness. It may safely be predicted that the controversy is far from over. In this section, a different aspect of derivatives is considered, namely, the legal risk factor.

Financial markets depend on the confidence that obligations will be honored, and derivatives markets have a good record in this respect. However, all such instruments are, in essence, a contract or series of contracts that depend for their ultimate efficacy on the effectiveness of the contractual relationships in law.

The legal risks that derivatives are capable of creating were exemplified by the famous (or infamous) 1991 swaps litigation, which was finally resolved by the House of Lords, the supreme court for the United Kingdom. The instruments in question were interest rate swaps, and the counterparties were U.K. local authorities. In its simplest form, an interest rate swap is an agreement by which one party agrees to pay a fixed rate of interest by reference to a notional capital sum, and by which the other party agrees to pay a floating rate, such as the London interbank offered rate. In practice, the contracts are settled periodically on a net basis.

In the mid-1980s, many such contracts were entered into by a number of U.K. local authorities for purely speculative purposes. Their legal power to do so was challenged by the Audit Commission, a public body charged with auditing local authority spending. The House of Lords held37 that the authorities had no express power under the Local Government Act, 1972,38 to enter into swaps transactions, and that it could not be said that such transactions were incidental to their borrowing powers. The transactions were, therefore, ultra vires and void.
The decision prompted a good deal of concern on the London markets and led indirectly to the setting up of the Financial Law Panel under the aegis of the Bank of England. The panel is a small body of City practitioners who undertake to keep financial law under review, alerting fellow practitioners as to emerging risks and recommending best practice. It is important to note that the House of Lords’ decision itself was of limited effect. The swaps transactions were invalidated because of the particular nature of the counterparties, which were local authorities set up by statute and with powers beyond those given by statute. In other words, the issue was one of the legal capacity of the parties, not the enforceability of the underlying contractual obligations.

The House of Lords’ ruling left a large number of transactions to be unwound. The English courts have subsequently held that payments made under void swaps contracts are recoverable; the local authorities have thus been obliged to return payments made to them (with compound interest), and vice versa. The Scottish courts have followed the English courts in holding that swaps contracts are ultra vires local authorities under the relevant Scottish legislation and therefore void. The Scottish courts, however, have also held that payments made under such agreements are not recoverable, applying the doctrine that payments made under a mistake of law generally cannot be recovered. It remains to be seen whether the different results achieved under English and Scottish law will be resolved by the House of Lords.

Setoff

Setoff is the legal principle by which claims owing between the same parties are set off against each other, so that only a net amount is payable. It is particularly important in the banking field, where obligations are invariably monetary in character. The law of setoff will determine, for example, the amount owing on the insolvency of a customer or on the insolvency of the bank itself. As a leading lawyer puts it: “Set-off plays a crucial role in international financial and commercial affairs. This is because of its security function. Claims are a major form of property and the reciprocity of claims produces a field of law comparable to that of security proper.”

The basic English law rules of setoff are well settled. The banker’s right of setoff—a bank’s right in the absence of contrary agreement to set its customer’s accounts off against each other—is long established. The fundamental principle is that, to qualify for setoff, debts must be between the same parties in the same right and must all have matured. With insol-
vency, setoff is mandatory, so that only the balance can be claimed by the liquidator or proved for in the liquidation.\textsuperscript{44}

The operation of netting procedures on the financial markets has recently been buttressed by statute. It has been enacted that the proceedings of a recognized investment exchange or clearinghouse (for example, its default and settlement rules) are to take precedence over insolvency law.\textsuperscript{45} Also, the courts have held that in case law the guarantors of obligations of former customers of BCCI are entitled to set off the amount of deposits held as security,\textsuperscript{46} but the result has varied according to the nature of the security documentation.\textsuperscript{47}

Cash collateral arrangements also involve setoff considerations. There are a number of situations in which a bank may stipulate for a specific deposit against a specific liability, for example, when issuing a performance guarantee at a customer's request. In these circumstances, security over the deposit is required. Security documentation is taken in the form of a contractual setoff right, an agreement by the customer that the deposit is not to be repayable until the relevant obligations are repaid to the bank, or a charge over the deposit (or a combination of all three). A good deal of controversy has been generated by the question of whether a bank can, strictly speaking, take a charge over a deposit held with itself (as opposed to a deposit held with another bank). It has been argued that there are conceptual difficulties in a debtor (that is, the bank holding the deposit) taking a charge over its own indebtedness to the depositor.\textsuperscript{48} Recent authority, however, has tended to indicate that such a charge is possible,\textsuperscript{49} and it is to be hoped that this view prevails. In any event, the debate is to a considerable extent academic; a bank's setoff rights are usually sufficient to protect its position.

In the regulatory field, the law of setoff has an important impact on on-balance-sheet netting and cash collateral arrangements for capital adequacy purposes. As from 1994, the Bank of England has tightened the reporting requirements in this respect. In the case of on-balance-sheet netting, accounts with the reporting bank may be offset against credit balances on other accounts only if a legal opinion has been obtained to the effect that a legal right of setoff exists, and if the bank's right to apply setoff is legally well-founded in all relevant jurisdictions and would be enforceable in the default or insolvency of the customer or the bank itself. For a group facility, the arrangement must be supported by a full cross-guarantee structure. The debit and credit balances must relate to the same customer or to customers in the same group, and the netted accounts must be managed and controlled on a net basis.

If exposures that do not meet the rules for setoff are collateralized by cash, they are reported under the relevant item in the zero percent band.
An exposure is collateralized by cash for these purposes only if the cash is held on the terms that it may not be withdrawn for the duration of the exposure, and that the reporting institution may apply the cash to discharge the exposure on default. Again, the Bank has specified that the reporting institution must obtain a legal opinion to the effect that the collateral arrangements are legally well-founded.50

Money Laundering

International cooperation implemented by national legislation against money laundering is perceived as one of the principal weapons in the fight against illegal drug trafficking. The United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 198851 requires Parties to legislate as necessary to establish a modern code of criminal offenses relating to illicit trafficking in all its different aspects. Pursuant to Article 3(1)(b), parties are required to treat money laundering as a criminal offense. Many countries have done so, although few have gone as far as the United States, which requires cash transactions of over $10,000 to be reported under the provisions of the Bank Secrecy Act.52 As far as the United Kingdom is concerned, the most recent development has been the implementation of the EC's Money-Laundering Directive.53 Rather than impose a blanket reporting obligation, the directive is intended to place the onus on financial institutions to identify customers who deal with them and to report transactions that are suspicious.

The Money-Laundering Directive is not limited to drug-trafficking offenses; it extends to other forms of criminal activity. The effect of these changes will take some time to work through, but they appear to involve a fundamental reappraisal of the banker’s traditional role. Not only are rules of banking secrecy overridden, but banks are expected to take an active part in preventing abuse of the financial system. In applying the new rules, it is hoped that the courts will seek to achieve a balance between requiring banks to take reasonable steps to thwart obviously tainted transactions and requiring banks to act as detectives, a role for which they are not suited.

Central banks have played an important part in promoting anti-money-laundering measures. As the Basle Committee on Banking Regulations and Supervisory Practices put it in 1988, although the primary function of banking supervision “is to maintain the overall financial stability and soundness of banks rather than to ensure that individual transactions conducted by bank customers are legitimate . . . all members of the Committee firmly believe that supervisors cannot be indifferent to the use made of banks by criminals.”54
The Bank of England wrote to banks on November 10, 1989, reminding them of the provisions of the Basle Statement of Principles. The statement remains an important summary of the basic steps expected of banks, namely, to

- know their customers;
- comply with all relevant laws;
- cooperate with law enforcement agencies; and
- adhere to the following statement:

All banks should formally adopt policies consistent with the principles set out in this Statement and should ensure that all members of their staff concerned, wherever located, are informed of the bank's policy in this regard. Attention should be given to staff training in matters covered by the Statement. To promote adherence to these principles banks should implement specific procedures for customer identification and for retaining internal records of transactions. Arrangements for internal audit may need to be extended in order to establish an effective means of testing for general compliance with the Statement.55

The already substantial body of U.K. law relating to money laundering56 was extended substantially to cover the proceeds of all serious crime, in addition to drug- and terrorist-related activities, by the Criminal Justice Act, 1993,57 and the Money-Laundering Regulations, 1993,58 which contain the provisions necessary to implement the EC Money-Laundering Directive. Under the Act, it is a criminal offense for a person who knows or suspects that another person is engaged in the laundering of drug money to fail to disclose the fact to the police.59 “Tipping off” the subject of an investigation into the laundering of drug money also becomes a criminal offense.

The Money-Laundering Regulations came into force on April 1, 1994. They apply (among others) to banks, building societies, and investment businesses. The regulations require the establishment of (i) identification procedures (to identify the person with whom business is being transacted), (ii) record-keeping procedures, (iii) internal reporting procedures, and (iv) “such other procedures of internal control and communication as may be appropriate for the purposes of forestalling and preventing money-laundering.”60 Failure to comply with the regulations is a criminal offense. There are exemptions for transactions of small monetary value.61

Independent duties are also placed upon certain supervisory authorities, including the Bank of England. Supervisors are placed under an obli-
gation to disclose information indicative of money laundering to the police.\(^6\)

In addition to these often complicated (and sometimes obscure) statutory provisions, "guidance notes" have been issued to provide a practical interpretation of the regulations and give examples of good practice. The guidance notes are produced by the Joint Money-Laundering Steering Group, which includes representatives of the Bank of England, the British Bankers' Association, building societies, banks, investment businesses, and the National Criminal Intelligence Services. There are three sets of guidance notes. The first covers all mainstream banking, lending, and deposit-taking activities of banks and building societies within the jurisdiction of the United Kingdom, including the taking of sterling and foreign currency wholesale deposits. The second covers insurance and retail investment products, and the third covers wholesale institutional and private client investment business.

The guidance notes for all three sets are couched in similar terms. They offer practical guidance in relation to such matters as identification procedures and record keeping. Although they are not mandatory and have no legal effect, it is noteworthy that the Bank of England indicates in its statement of the minimum criteria of authorization applicable under the Banking Act that the requirement for carrying on the business of a bank with integrity and skill is unlikely to be satisfied if an institution fails to comply with the guidance notes on money laundering.\(^6\)

These provisions represent, of course, a major inroad into the traditional rule that a bank must respect the confidentiality of its customers' affairs. In English law, this rule is judge made,\(^6\) but it has always been subject to qualifications. It does not follow, however, that the confidentiality rule is in any sense redundant. In the normal course, customers are entitled to expect that banks will keep their affairs secret. The money-laundering provisions are justified as an exception made in the wider public interest.

**Environmental Liability\(^6\)**

No discussion of recent developments in banking law is complete without a mention of the intense debate as to the circumstances, if any, in which a bank as lender may incur liability under new or proposed environmental production legislation for the polluting activity of its borrowers. In Europe, comparisons have been drawn with the position in the United States, where the Comprehensive Environmental Response Compensation and Liability Act of 1980,\(^6\) as amended in 1986 by the Superfund Amendments and Reauthorization Act of 1986,\(^6\) permits the
Federal Government to clean up sites at which hazardous substances have been released or deposited. Liability for the cost of the cleanup operation rests upon the "owner or operator" of the site concerned. The definition of "owner or operator" excludes a person who, "without participating in the management of the facility, holds indicia of ownership primarily to protect his security interest in the . . . facility" (the secured lender exemption). Despite its apparently plain purpose, some court decisions have given a restricted interpretation to the secured lender exemption; both Congress and the Environmental Protection Agency have made recent moves to strengthen the exemption. (A new rule was introduced by the agency in April 1992.)

The EC has been considering its own rules, the most recent being the Amended Proposal for a Council Directive on Civil Liability for Damage Caused by Waste. The European Commission has issued a "green paper" on the remedying of environmental damage—not merely damage caused by waste—within a single legal framework. Consultations on these proposals are taking place. The indications from the U.K. Government are that banks cannot expect special treatment.

In U.K. domestic law, the Environmental Protection Act, 1990, introduced a new system of integrated pollution control for industry "for the purpose of minimizing pollution of the environment due to the release of substances into any environmental medium." Section 61 imposes certain duties on local authorities to clean up polluted land, and gives such authorities the right to recover the cost incurred in doing so from the person who is for the time being the owner of the land. It seems clear that a bank could not be an owner for these purposes merely by virtue of holding a mortgage over the land, except (perhaps) if it has taken possession of the land following the borrower's default, or possibly in other circumstances in which it exercises a degree of control. There are other potentially relevant provisions under this and other statutes (such as the Water Resources Act, 1991, in respect of water pollution), but in general it is believed that the circumstances under the present law in which a bank will incur liability for its borrower's pollution will be rare.

**Consumer Protection**

A healthy banking system requires the prompt and efficient enforcement of debts through the courts. The English system has, on the whole, a good record in this respect and is generally unreceptive to unmeritorious defenses and speculative claims. The virtual absence of the jury in the trial of civil claims is an important contributing factor. Nevertheless, the recognition of basic consumer rights is increasingly emphasized, and
three topical developments will be discussed in this section of the chapter. Issues of balance come into play here, also; it is not in the interests of consumers to place unreasonable burdens on the banking industry. What has come to be firmly recognized, however, is that good consumer relations in the context of fair customer contracts contribute importantly to the successful conduct of banking business.

Protection of Guarantors

A series of conflicting Court of Appeal decisions on the protection of guarantors has culminated in an important judgment of the House of Lords. The case concerned the position of a wife securing the guarantor of her husband’s business debts on the family home, but the reasoning is applicable to other cohabiters, as well. Although ordinarily a creditor owes no duty of care to a surety, it was held that, because a guarantor of a husband’s business debts is not to a wife’s advantage and because of the risk of wrongdoing by her husband, the creditor had a responsibility to enquire into such possible wrongdoing. In those circumstances, if the guarantee was obtained by the husband by undue influence or misrepresentation, the bank would be unable to enforce the guarantee unless it took reasonable steps to see that the wife’s consent was properly obtained.

What amounts to “reasonable steps” for these purposes? For past transactions (that is, those entered into before the case was decided), it will depend on whether the creditor took steps to bring home to the wife the risk that she was running by standing as guarantor and advised her to take independent legal advice.

As to future transactions, a bank will be considered to have taken reasonable steps if it warns the wife (at a meeting not attended by the husband) of the amount of her potential liability and of the risks involved, and if it advises her to take independent legal advice. The court made it clear in a companion case that these principles do not apply when a wife obtains a joint loan with her husband. What distinguishes this companion case from the surety case is that in the latter there was not only the possibility but also the increased risk of undue influence having been exercised because, at least on its face, the guarantee by the wife of her husband’s debt was not in her financial benefit.

Despite some broad early decisions, it is believed that the courts will construe these principles relatively narrowly. For example, it has recently been stressed that a fair balance must be struck between the need to protect wives (and others in a like position) and the need to avoid unnecessary impediments to using the family home as security. It will generally be
sufficient for a bank to urge a proposed guarantor to take independent advice from a lawyer. How far the lawyer should go in probing the matter and in giving advice is a matter for the lawyer’s professional judgment and a matter between lawyer and client, in which the bank is not generally involved.81

Legislation Against Unfair Contract Terms

On the wider level of consumer protection, English law has for many years invalidated unfair contractual terms in consumer contracts82 and thus been capable of affecting banking contracts. For example, it has been said that a clause in a guarantee holding the guarantor liable for more than the principal debtor may be invalid.83 However, the EC Directive on Unfair Contract Terms in Consumer Contracts84 goes considerably farther than anything seen to date. It will apply to contracts for the sale of goods and the supply of services to a consumer. The precise scope of the directive on banking business is unclear, but all consumer banking services may be covered. The provisions of this directive came into effect on December 31, 1994.

Article 3 of the directive apparently introduces into English law for the first time the civil law concept of “good faith” in the performance of contractual obligations. Hitherto, the law has looked exclusively to the terms of the agreement on the basis of the doctrine of freedom of contract. However, Article 3(1) provides that “[a] contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer.” The width and uncertainty of this provision has concerned the banking industry.

A broad welcome should, however, be given to Article 5, which provides that, in the case of contracts where all or certain terms offered to the consumer are in writing, “these terms must always be drafted in plain, intelligible language”: a challenge for lawyers, indeed! The article goes on to provide that “[w]here there is doubt about the meaning of a term, the interpretation most favorable to the consumer shall prevail.”

Code of Practice

A concrete and constructive response to consumer pressure has come from the banking industry itself. The Code of Banking Practice85 is a voluntary code drawn up by the British Bankers Association, the Building Societies Association, and the Association for Payment Clearing Services, which is to be observed by banks, building societies, and card issuers in
their relations with personal customers. The second edition of this code came into effect on March 28, 1994. The code does not have the force of law, although the courts are likely to have regard to its provisions when considering the extent of banks' legal liability.86

The Code of Banking Practice seeks to set out standards of good banking practice. It stipulates that banks will (i) act fairly and reasonably in all their dealings with their customers, (ii) help customers to understand how their accounts and other banking services operate, and (iii) strive to maintain confidence in the security and integrity of banking and card payment systems. These very general principles are given effect to in the body of the code. Written terms and conditions of a banking service are to be expressed in plain language and provide a fair and balanced description of the relationship between customer and bank. Reasonable notice of variations is to be given to the customer. Much-improved details of bank charges and interest rates were already given under the first edition of the code. Banks are to have in place internal procedures for handling customers' complaints, and if the complaint remains unresolved, the customer may refer the matter to the independent Banking Ombudsman Scheme.87

The code reaffirms the principle that, in the absence of express written consent, details of customers' accounts must be kept confidential save where the law permits or requires, including in respect of companies in the same group (for example, insurance sales organizations).

The Code of Banking Practice provides for liability for loss in the event of misuse of credit or debit cards. It seeks to balance the interests of card issuers and customers by limiting customers' liability for unauthorized transactions to a maximum of £50, save where the customer has acted fraudulently or with gross negligence. In the case of disputed transactions, the burden of proving fraud or gross negligence will lie with the card issuer.

Jurisdiction, Governing Law, and Sanctions

This final section of the chapter deals with three allied private law topics that are important for banks and have been the subject of significant recent developments.

Civil and Commercial Jurisdiction

Within Europe, jurisdiction in civil and commercial matters is now governed by the Brussels Convention (in respect of EC members)88 and the substantially identical Lugano Convention (in respect of EFTA members).89 The principal rule of these conventions is that defendants are to
be sued at the place of their domicile, although the English courts will have jurisdiction in matters relating to a contract if England was the place of performance\textsuperscript{90} and in matters relating to tort if England was the place where the damage or the event that gave rise to the damage occurred.\textsuperscript{91} Where the conventions do not apply, the English jurisdictional rules (which in most respects are similar) continue to apply. In international transactions, there will, of course, almost invariably be jurisdiction clauses, which are given effect to under the convention rules.\textsuperscript{92}

**Governing Law and the Rome Convention**

There will also almost invariably be choice-of-law clauses; again, such clauses remain fully effective. In respect of contracts entered into after April 1, 1991, the law governing contractual obligations is determined under the provisions of the EC Convention on the Law Applicable to Contractual Obligations (the Rome Convention).\textsuperscript{93} Many of the principles in the Rome Convention are not significantly different from the common law rules;\textsuperscript{94} the basic rule is that, to the extent that the applicable law has not been chosen by the parties, a contract is governed by the law of the country with which it is most closely connected.\textsuperscript{95}

Bank accounts, including foreign currency accounts, are frequently operated without any express choice of law. In pre-Rome Convention cases, the English courts generally ruled that the law governing a bank account is the law of the place where the account is kept (in the absence of agreement to the contrary).\textsuperscript{96} The position under the Rome Convention is somewhat more complicated, because the basic rule—that a contract is governed by the law of the country with which it is most closely connected—is qualified by a number of (rebuttable) presumptions. It is presumed that the contract is most closely connected with the country where the party that is to effect “characteristic performance” has its central administration. In respect of a bank account, the bank should probably be regarded as such a party. However, if the contract is entered into in the course of that party’s trade (which will be the case as regards a bank opening an account), the governing law will be that of the country in which the party’s principal place of business is situated; where performance is to be effected through a place of business other than the principal place of business, the governing law will be that of the country in which that other place of business is situated.

These presumptions do not readily lend themselves to the obligations created by bank accounts. However, it is believed that characteristic performance in respect of a bank account should be regarded as “to be effected through” the branch where the account is kept. If so, it is the law of the country where that place is situated that should govern the con-
tract, as under existing English law. This view appears to be consistent with the *travaux préparatoires* to the Rome Convention, which state that “in a banking contract the law of the country of the banking establishment with which the contract is made will normally govern the contract.”

A number of recent English cases have considered the law governing bank guarantees in the absence of a choice-of-law clause. Frequently, a bank guarantee is issued to the beneficiary (for example, the employer under a construction contract) against a counterguarantee issued by a bank in the advising party’s home state. Therefore, two separate instruments must be considered. It has been held that the bank guarantee is ordinarily governed by the law of the place where payment is to be made under it. However, as the place of payment may depend simply on the currency of the instrument concerned, more recent cases have held that the law governing counterguarantees should not depend on the place of payment, but should follow the law governing the guarantees because the natural expectation of the parties is that the two instruments would be governed by the same law. In post Rome-Convention cases, the result may not be the same, given the examples in the *travaux préparatoires* to the effect that, in a contract of guarantee, the characteristic performance is that of the guarantor.

**Effect of Sanctions on Banking Contracts**

The final topic is an appropriate one for an international gathering. In a number of recent cases, the English courts have had to consider the effect of sanctions on banking contracts. Different results have been reached, depending on whether the sanctions were considered to be the unilateral acts of another state or to have been incorporated into English law.

Where unilateral sanctions are imposed by state A on state B, bank accounts held by citizens of state B in the United Kingdom will be unaffected, even if held in the currency of state A, because the accounts are governed by English law and performance in the United Kingdom is lawful under English law. An opposite result may be reached in a case involving international sanctions that have been incorporated into U.K. law.

The first of these principles is exemplified by cases concerning the sanctions imposed on the Socialist People’s Libyan Arab Jamahiriya by the United States in January 1986. The Libyan plaintiffs maintained current accounts in New York and deposit accounts in London that were denominated in U.S. dollars. By agreement, amounts in excess of a “peg” were transferred from New York to London on a daily basis. The account hold-
ers not only recovered judgment for the sums on deposit in London, but also won damages for such amounts, as the banks concerned had failed to transfer to London in breach of the agreement made prior to the imposition of sanctions.\textsuperscript{102} Illegality under U.S. law was no defense for the defendant banks (which were both U.S. banks).

Opposite results have followed in cases of UN sanctions that have been incorporated into U.K. law. For example, the English courts have recently refused performance of a counterguarantee in favor of a Libyan bank, applying the provisions of the Libya (United Nations) Sanctions Order, 1992.\textsuperscript{103} The English courts have also refused to interfere with the operation by the Bank of England of UN sanctions against Serbia and Montenegro.\textsuperscript{104}

Where sanctions do apply to prohibit payment of deposits, the effect is suspensory; the contracts are not frustrated.\textsuperscript{105} In practice, it seems that most recent sanctions orders permit the crediting of interest to frozen accounts at commercial rates.