De-banking: the banks' response to navigating a regulatory minefield

Jago Russell and Ross Ludlow explain the reasons behind the trend for de-banking

© Getty images/iStockphoto

IN BRIEF

- Covers growing trend of banks to 'de-bank' customers in order to mitigate risk, which the Nigel Farage debacle highlighted.
- Banks are expected to police these risks and face severe penalties if they do not, therefore may de-bank clients to protect themselves.

On 2 October 2023, HM Treasury announced 'tougher rules to stamp out debanking', promising a public consultation and legislative change in 2024. The announcement followed public concerns about the closure of Nigel Farage's bank account at Coutts, on the basis of his personal and political views. Farage's case is, however, just one example of a growing trend. Banks are becoming increasingly risk-averse, utilising their ability to 'de-bank' customers as a tool to mitigate a range of risks and to manage their regulatory burdens.

Losing access to banking facilities can have profound implications. Without access to a bank account, individuals and business may be unable to receive or pay salaries, to make essential payments for things like utilities or rent, and may face difficulties when purchasing essential items like food. In an increasingly cashless society, having a bank account is almost essential for personal and financial freedom and security. The Treasury's recent news story states '[t]he Chancellor was quick to act', but how effective is this action likely to be?

A growing trend?

Farage's case grabbed the public and political attention but individuals and organisations being de-banked is surprisingly common. A freedom of information request submitted to the Financial Conduct Authority (FCA) revealed that just over 343,000 bank accounts were closed during 2021-22. In September 2023, the FCA reported that between June 2022 and June 2023 firms terminated between 0.2% and 3.4% of personal accounts and between 1% and 6.9% of business accounts. The FCA has been aware of this issue since at least 2015, when it commissioned a report into the drivers and impacts of de-banking ('Drivers and impacts of derisking', published in February 2016).

At that time, the FCA found that banks were becoming increasingly concerned about the risks posed by certain customers and types of customers, the substantial fines for failing to comply with their anti-money laundering (AML) and terrorist financing obligations, and the cost of complying.

What is causing this trend?

De-banking is being used by banks to mitigate different (sometimes overlapping) areas of risk.

Reputational risk

The focus on Farage's case might give the impression that 'reputational risk' is the major driver of de-banking. Banks will, of course, assess any reputational risk posed by a customer, but it is far less common for banks to admit that they have de-banked customers for this reason as they have no obligation to do so. The FCA has itself pointed out that firms' responses to its recent survey on closure due to reputational risk were inconsistent and that it needs to look into this issue further.

Farage had to issue a subject access request under the Data Protection Act 2018 (DPA) to discover this was the reason Coutts closed his account. Further cases have come to light including a gender-critical parent group and certain companies in the sex and adult entertainment industries. In the US, Deutsche Bank also received a $150m fine from the New York State financial regulator for failing to sever its relationship with Jeffrey Epstein.

With the risk of unquantifiable reputational damage, it is unsurprising that banks have de-banked some of their customers. Recent adverse press coverage and political comment in the context of Farage's case may, however, see a reduction in the number of customers being refused services for this reason.

Anti-Money Laundering (AML)

AML rules impose extensive and growing requirements on banks to detect, prevent and deter money-laundering, terrorist financing and other forms of economic crime. The systems and controls banks are required to put in place to mitigate the risk that they might be used to commit financial crime also explains the increase in account closures.

The sanctions for failing to comply with AML requirements are severe. Under the Proceeds of Crime Act 2002 (POCA), for example, it is an offence to fail to make a report to the National Crime Agency if a bank knows or suspects, or has reasonable grounds for knowing or suspecting, that a person is engaged in money laundering (Suspicious Activity Reports). Banks must constantly monitor their clients and investigate promptly if this threshold is met.

Under POCA, financial institutions are permitted to share information about mutual clients for the purpose of preventing a money laundering offence. For the customer who is de-banked on the basis of a reasonable suspicion, there is a risk that that information will be shared with other banks, setting off a cascade of account closures and potentially leaving them unable to open new accounts.

The FCA's report cites 'concerns about financial crime' as one of the most common reasons that firms gave for declining, suspending or terminating an account. Customers, however, may find it hard to identify anti-money laundering or terrorist

financing suspicions as the reason for their account closure. Under the DPA, banks are permitted to refuse to disclose information to a data subject to 'avoid obstructing an official or legal inquiry, investigation or procedure', or 'avoid prejudicing the prevention, detection, investigation or prosecution of criminal offences'. Indeed, a bank may be committing a criminal offence under POCA if, for example, it discloses that it has made a Suspicious Activity Report or that an investigation into a money laundering offence is underway.

Politically exposed persons (PEPs)

Much of the recent press-coverage on de-banking has focused on PEPs. The FCA defines PEPs as 'individuals whose prominent position in public life may make them vulnerable to corruption', and includes family members and known close associates. It is estimated that almost 90,000 individuals have been categorised as PEPs.

Anti-money laundering rules require banks to identify PEPs and to apply enhanced due diligence, risk assessments and ongoing monitoring on the basis that they pose a heightened risk of money laundering or bribery. It is not surprising that banks consider these customers to pose additional risks and regulatory burdens. This increased burden may discourage banks from taking on or maintaining PEPs as customers altogether.

Sanctions

Since Russia's invasion of Ukraine in February 2022, the number of people designated under the UK's sanctions regime has exploded. As of August 2023, there were 1,627 individuals designated under the UK's Russian sanctions regime alone. And the UK is not alone, with many countries imposing similar regimes which reach beyond their own borders and affect UK banks.

The most common form of sanctions are asset freezes, the effect of which is, among other things, to make it a criminal offence to deal with funds belonging to a sanctioned person or to make funds available to a sanctioned person. Sanctions legislation imposes extensive obligations on financial institutions, including to immediately freeze funds that are subject to an asset freeze and to submit reports to the Office of Financial Sanctions Implementation (OFSI) about funds held for sanctioned customers. OFSI can issue licences that permit banks to make transactions involving sanctioned customers, however the terms of these licences are usually very restrictive and compliance with these licences creates enormous regulatory burdens in itself.

Underpinning these requirements are tough enforcement powers. This includes criminal offences for dealing with a sanctioned person's money without a licence, failing to comply with reporting obligations, and failing to comply with a condition of a licence. In addition to criminal liability, OFSI has the power to impose significant monetary penalties for breaches and to publish details where it identifies a breach.

Banks are seen as key to policing sanctions, in much the same way as they are for the AML regime. Where banks fall short, regulators are keen to make examples of them; which in the current public and political climate can cause grave reputational damage. In August 2023, for example, OFSI published a report about Wise Payments Limited which had breached the Russian sanctions regime by allowing a sanctioned person to withdraw £250 from their account.

Given what banks do, and the number of people that are now subject to sanctions, it's easy to see how this has created a regulatory minefield for banks. It is not surprising that banks are wary of providing services to sanctioned people, those associated with them, or those they suspect might be sanctioned in the near future. The FCA has itself stated 'reputational risk may be legitimately considered [by firms], for example in decisions about relationships with sanctioned individuals or their close associates'.

Is there a right to a bank account?

The ease with which banks can refuse financial services seems at odds with how important it is for individuals to have access to banking services. While the FCA recognises that the decision to accept or maintain a business relationship is ultimately a commercial one for the bank, it is reassuring to know that there does exist a right in law to a 'payment account with basic features' courtesy of the Payment Accounts Regulations 2015.

Under the Regulations, there is a list of designated banks required to provide these basic accounts. The accounts must allow consumers to operate and close the account, to place funds in and withdraw funds from it, execute direct debits/standing orders and make card payments, including online. It does not include an overdraft. 'Consumers' are specifically defined as natural persons acting outside their trade, business, craft or profession so companies, for example, do not have a right to a basic account under the Regulations. One suggestion by the FCA is for the government to consider mandating a 'universal service obligation' on account providers, for retail or business customers (as in France and Belgium).

To be eligible for a basic account, a person must be legally resident in the UK, over the age of 16, and not already have an account with at least the same features. A bank can refuse to open or choose to close one of these accounts where the account will or is likely to be used in connection with various forms of illegality. The provision of these accounts is, however, specifically protected from discrimination on the basis of a number of protected characteristics including 'political or any other opinions'. Notwithstanding these protections, the FCA has noted the high numbers of people being declined a basic account.

The vast majority of individuals with a bank account in the UK will have one which has more than these basic features, and thus does not enjoy the same protection against de-banking. The only requirement for these accounts is that the account holder is given two months' notice of the intention to close their account. There is no obligation on the bank to substitute the account for a basic account; the 'de-bankee' must apply separately.

Looking forward

Coutts' closure of Farage's account has triggered a flurry of activity. Already the Treasury has explained that new rules will force banks to delay account closures by giving 90 days' notice (increased from two months), and require banks to give customers 'clear and tailored' explanations for why they are terminating an account. However, there are concerns this is irreconcilable with the 'tipping off' rules in POCA: if every other 'de-bankee' is told the reasons behind their account closure, those suspected of money laundering will be able to work out by default that they are under investigation. In September, the FCA launched a review of the treatment of PEPs by banks, including how firms are 'deciding to reject or close accounts for PEPs, their family members and known close associates'.

It is, however, doubtful the reforms currently being discussed will reverse the growing trend towards de-banking, particularly given the recent explosion in the number of people affected by sanctions. That is because de-banking is the result of two factors which the current proposals will not fundamentally change. On one side, we have a legal system that relies on banks to police AML and sanctions rules and that imposes severe penalties on banks where they fail to do so. On the other side, banks have an almost unhindered power to pick and choose their customers. Why wouldn't banks continue to choose de-banking as a way of mitigating their risks and reducing their regulatory burdens? NLJ

Jago Russell, partner, Boutique Law LLP (*www.boutique.law*) and **Ross Ludlow,** pupil barrister, Drystone Chambers (*www.drystone.com*).