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Insight

Dentons Financial Markets Disputes and Regulatory Update

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In this edition of *Dentons Financial Markets Disputes and Regulatory Disputes Update*, we have summarised the key financial markets cases, and UK conduct-related financial regulatory action, from the first half of 2017, and have drawn conclusions as to the likely direction of travel in these areas and implications for the clients. We hope this will provide readers with a digestible series of considerations to feed into ongoing work.

Contents

What can we learn from the first half of 2017

Court decisions

Whilst a number of cases in the first six months of 2017 dealt with issues of particular interest to litigators (e.g. *LBI EHF v. Raiffeisen* on default provisions and service by fax, *BPE Solicitors v. Hughes-Holland* on loss flowing from negligence), the recent case with perhaps the widest implications for lawyers and investigators is *SFO v. ENRC*. Like the *RBS Rights Issue* decision at the end of 2016, this takes a restrictive approach to privilege and is likely to encourage the SFO and FCA still further in following their approach of recent years of scrutinising and challenging privilege claims.

With regard to the obligations banks have to their customers, there is sometimes a tension between the approach of the courts – which tend to emphasise the contractual position – and that of regulators – which tend to have regard to broad principles of fairness. In *Thomas v. Triodos* the High Court interpreted the bank's statement that it would comply with a voluntary code as creating an additional duty to give the customer a balanced view of a product on request, over and above the bank's *Hedley Byrne* duty not to mislead. This may indicate that the courts are moving towards a more "regulatory" – and some would say paternalistic – position.

Two High Court decisions dealt with judicial reviews from the Financial Ombudsman Service (FOS). It is rare for such applications to be allowed, and in *Full Circle Asset Management* the application was duly rejected, the court robustly defending the wide FOS "fair and reasonable" jurisdiction. More unusually, in *Aviva Life & Pensions* the application succeeded, albeit on narrow grounds, and the judge made some concerned comments about the interaction between the FOS jurisdiction and the law. It remains to be seen whether this case will herald closer scrutiny of FOS decisions in future cases.

Regulatory developments

As ever, the regulators issued a plethora of policy communications. The most significant were perhaps the FCA Mission Statement and business plan – these repay a detailed read, but future developments for financial institutions include the retail banking business model review, follow up work on the investment and corporate banking market study, and discovery work into the non-workplace pensions market.

In contrast, there were fewer significant enforcement cases in the last six months than in past periods. The Tesco final notice, and those given to Niall O'Kelly and Lukhvir Thind (formerly of Worldspreads), demonstrate the importance of listed companies having robust controls over internal and external financial reporting, and making sure that accurate financial information flows up to those who have to sign off the accounts.

Whilst not widely commented on, the Express Gifts remediation agreement is of considerable interest as it shows the FCA considerably extending the "treating customers fairly" principle to, in effect, regulate the price of financial products merely because they were poor value for money, in the absence of mis-selling. Firms will need to take a step back and consider whether their products are reasonable and appropriately priced, irrespective of how clearly they are described to customers.

The outcome of the FCA/PRA Enforcement Review means that firms under investigation should expect – and feel entitled to push for – a more open approach from investigation teams. Firms will need to give careful consideration as to whether the new "focused resolution agreement" procedure is preferable to either reaching a full settlement and drawing a line under the matter, or having full freedom of argument in the Regulatory Decisions Committee (RDC).

What to watch out for

Litigation

The second half of 2017 is likely to see the Court of Appeal hand down judgment in relation to UBS's appeal of the 2014 judgment in its litigation with Kommunale Wasserwerke Leipzig GmbH and others. The judgment is likely to consider a number of interesting issues, including in connection with bribery, agency, dishonest assistance, deceit and the use of rescission as a remedy.

Other well-publicised cases in which judgment is likely to be handed down over the next few months include: *National Bank Trust v. Ilya Yurov* (in relation to the collapse of National Bank Trust); *Fortress v. BNP Paribas* (in relation to the execution of an Islamic finance transaction); and *Sharp and others v. Blank and others* (in relation to information provided to shareholders regarding Lloyds's takeover of HBOS).

Regulatory and other developments

Brexit looms, but in the meantime firms have many other upcoming regulatory changes to deal with. Firms not currently subject to the Senior Managers and Certification Regimes (SMCR) can expect a consultation paper shortly, and judging by the experience of banks will have a considerable amount of work to do before the go-live next year.

The regulators will be under political pressure to show that the SMCR has "worked" in banks. The FCA has ongoing enforcement investigations in relation to senior managers. Firms and senior managers should scrutinise any resulting final notices closely for applicable lessons.

The final report of the asset management market study was published shortly before going to press, accompanied by a consultation paper setting out the FCA's proposals in relation to fund governance, risk-free box profits and share class switching. The industry will be responding to the consultation, which closes on 28 September 2017, and awaiting further detail from the FCA on what the SMCR will look like for asset managers. The FCA will also flesh out its Mission Statement with regard to authorisation, supervision, enforcement, competition and market design.

Most firms should be far advanced in their MiFID II preparation by now, but will need to ensure that there are no surprises in the second FCA policy statement, due to be issued soon.

Judgments

No duty to obtain best price reasonable in a forced sale – upheld by Court of Appeal

(1) Rosserlane Consultants Ltd (2) Swinbrook Developments Ltd v. Credit Suisse International [2017] EWCA Civ 91

This was the appeal of an unsuccessful claim against Credit Suisse International (the Bank), in which the claimants alleged that the Bank had failed to secure the best price reasonably obtainable when it exercised its powers of sale under a participation agreement (the Agreement) entered into between the parties.

The claimants had entered into a short-term loan of US$127 million with the Bank in December 2006, to refinance existing debt, and for future expenditure for Caspian Energy Group (CEG), a partnership between the claimants, which owned a stake in a company operating an oilfield (Shirvan).

The loan was secured, to be repaid upon a sale of the claimants' interests in CEG. The parties entered into the Agreement, pursuant to which the Bank was granted the right to force a sale of CEG if a sale of it or its related assets (including the stake in Shirvan) had not been achieved by mid-August 2007, provided that the sale proceeds were not less than US$180 million. The Agreement included an express duty on the claimants to use reasonable endeavours to achieve the best possible price but no such corresponding duty on the Bank.

The claimants failed to achieve a sale and the Bank enforced its right to sell CEG achieving a sale price of US$245 million in February 2008. The claimants alleged that there was an implied duty of care in the Agreement (similar to a mortgagee's duty to obtain the best price when exercising a power of sale over its security), which the Bank breached by selling CEG for less than its true value. It was said that the claimants had lost the chance to sell CEG to Gazprom Neft for US$650 million.

At the hearing in February 2015, the court refused to find that such a duty was owed by the Bank in relation to its right of forced sale, because the Agreement had: (i) been negotiated between sophisticated parties; and (ii) included an express duty owed by the claimants in relation to the sale price, but was silent as to any duty owed by the Bank. The court also concluded that the Bank had not been appointed as agent of CEG, and therefore owed no fiduciary duties to it. As to the loss of chance, the claimants could not establish that they had lost the chance of securing a sale to Gazprom Neft, because Gazprom Neft would not have made an offer without a site visit, which the claimants/CEG would have refused.

The appeal was heard by Lord Justice Christopher Clarke in February 2017 and concerned two issues: whether the judge was wrong to find that: (i) there was no implied duty; and (ii) the claimants would have refused a site visit.

Clarke LJ decided to hear argument on the second issue first. He found that the judge was entitled to reach the conclusions that he did, and accordingly he dismissed the appeal without it being necessary to consider the first issue. His reasoning on the second issue was based on three factual issues as to whether: (i) CEG had a policy about site visits; (ii) Gazprom Neft would have been treated as an exception to any such policy; and (iii) the Bank would have overridden that policy. Having considered the evidence on these matters, Clarke LJ decided that the claimants would not have permitted a site visit.

The judgment did not, however, address the wider point in the first issue as to whether the judge at first instance was wrong to conclude there was no implied duty in the Agreement. The first instance decision therefore remains good law, and reinforces the position that claimants may find it difficult successfully to imply terms into complex agreements negotiated by sophisticated parties.

Skilled Persons Reports need not be treated as the regulatory standard by FOS

Full Circle Asset Management Ltd v. Financial Ombudsman Service and others [2017] EWHC 323 (Admin)

February 2017 saw the High Court dismiss an application for judicial review relating to a decision made by the Financial Ombudsman Service (FOS).

Full Circle recommended to a customer (Mrs King) that she should open an investment account which Full Circle would manage. On Mrs King completing an "attitude to risk and loss" questionnaire, Full Circle recorded her as a "medium risk investor". Mrs King lost £90,000 over 15 months and complained to FOS on the basis that investments were made into funds which were too risky for a standard retail client.

Section 228(2) of FSMA 2000 states that FOS must determine complaints by reference to what is fair and reasonable in the circumstances of the case. This must be read alongside the FCA's Dispute Resolution: Complaints sourcebook (DISP). DISP 3.6.4R (1)(b) states that the Ombudsman must take into account any relevant regulator's rules, guidance and standards when reaching a decision.

FOS upheld Mrs King's complaint on two grounds. The first was that Full Circle had personally recommended a portfolio that was unsuitable for Mrs King in her circumstances. In addition, the fact that Full Circle had obtained a Skilled Persons Report (SPR) (accepted by the FSA) stating Mrs King's portfolio was a "medium risk profile" did not detract from the finding that the portfolio was unsuitable for Mrs King.

Full Circle argued that FOS' decision should be quashed on numerous grounds. Notably, Full Circle argued that the SPR constituted a set of standards for the purposes of DISP 3.6.4R (1)(b). As the Ombudsman had departed from the SPR (and therefore the standards) without explaining why, Full Circle argued the decision should be quashed per *R (Heather Moor and Edgecomb) v. Financial Ombudsman Service* [2008] EWCA Civ 642. Furthermore, Full Circle argued that FOS had considered issues, such as whether Full Circle recommended the portfolio, which were not envisaged in Mrs King's complaint.

The court roundly dismissed all aspects of Full Circle's application. Addressing Full Circle's complaint regarding the SPR, Nicol J held that the report did not constitute a set of standards for the purpose of DISP 3.6.4R (1)(b) as it had not been created to investigate a complaint such as Mrs King's. Mrs King's complaint was not that the portfolio was not "medium risk"; it was that the portfolio was not suitable for her personally. FOS had upheld the complaint and the SPR did not provide a legal basis to challenge this.

In respect of the argument that FOS should have limited what it considered to Mrs King's initial complaint, Nicol J held that the Ombudsman's first task when adjudicating is to determine the scope of the complaint. The judge noted the comments of Irwin J *in R (Keith Williams) v. Financial Ombudsman Service* [2008] EWHC 2142 (Admin) that the Ombudsman's jurisdiction is "inquisitorial not adversarial". In addition, Nicol J held that the Ombudsman was not confined to the contents of the complaint form completed by Mrs King; it was the right of the Ombudsman to broaden the scope of his enquiries to the correspondence which Mrs King had provided. This exercise led the Ombudsman to conclude that Mrs King's personal circumstances (being over 60, not wanting sizeable cash holdings and seeking to obtain long-term income with the investments) meant that assigning any "medium risk" portfolio would not be sufficient.

The *Full Circle* case can be seen as useful guidance in the way the court deals with arguments regarding FOS determinations. Nicol J's judgment robustly defends the right of FOS to deal with a complaint in a manner it

deems fair and reasonable. This right extends to broadening the scope of the initial complaint and considering additional evidence.

Any party applying for judicial review will also need to be cautious before attempting to interpret a "regulator's standard" too broadly for the purpose of DISP 3.6.4R. As can be seen from *Full Circle*, the fact the FCA approved a report into the status of Full Circle's portfolio did not mean it was a relevant document in the context of Mrs King's complaint. If the court holds that a document is not relevant for the purposes of DISP, the Ombudsman will not be under an obligation to provide reasons for departing from the reasoning in that document.

It is notable that Nicol J's judgment appears to rest on the finding of the Ombudsman that Full Circle recommended the portfolio to Mrs King. Full Circle did not contend this finding was an error in law; this meant the application proceeded on the basis that the Ombudsman was entitled to make that finding. It is arguable that this amounted to a large concession which left much of Full Circle's application without merit.

High Court confirms FOS may depart from the general law when determining what is fair and reasonable

Aviva Life & Pensions (UK) Ltd v. Financial Ombudsman Service [2017] EWHC 352 (Admin)

The High Court has upheld an application for judicial review by Aviva, which had challenged a decision made by the Financial Ombudsman Service (FOS).

The decision made by FOS arose from Aviva's avoidance of a life insurance policy on the grounds that the policyholder, Mr McCulloch, failed to make relevant disclosures in his application. Mr McCulloch was suffering from a rare form of dementia; FOS determined that it was Mr McCulloch's illness that resulted in the non-disclosure rather than any carelessness or negligence on behalf of the policyholder. FOS also determined that Mr McCulloch's policy be reinstated. This ran contrary to the relevant law (s2 and s3 of the Consumer Insurance (Disclosure and Representations) Act 2012) which allows an insurer to void a policy in the event of a careless misrepresentation.

Aviva applied for judicial review on two grounds. The first was that, whilst FOS could depart from the law under s228(2) of the Financial Services and Markets Act 2000 (FSMA), the Ombudsman failed to follow the requirements set out in *R (Heather Moor and Edgecomb Ltd) v. FOS* [2008] EWCA Civ 642 by failing to provide detailed reasons for the decision to depart from the relevant law. It is worth noting that FOS had already conceded it failed to comply with the requirements in *Heather Moor*. The second ground was that the Ombudsman had shown Wednesbury unreasonableness (i.e. that no rational person who had applied their mind to the case could have reached that conclusion) in departing from the relevant law.

The court concluded that FOS had not followed the procedure set out in *Heather Moor* and quashed the finding that Aviva should reinstate Mr McCulloch's policy. Despite this finding, Jay J held that Mr McCulloch's complaint remained live and would need to be redetermined by FOS.

The more significant finding was that the court disagreed with Aviva that the Ombudsman had not demonstrated Wednesbury unreasonableness in departing from the law. Whilst the court accepted Aviva had followed the relevant law and guidance, it was not irrational under the "unusual circumstances" for the Ombudsman to uphold Mr McCulloch's complaint. There was no evidence of carelessness or negligence on behalf of Mr McCulloch; it was his illness that led to his failure to comply with the law. The law did not make a provision for innocent misrepresentations; accordingly it was not implausible for FOS to believe that reinstating the policy would be fair and reasonable.

The judge acknowledged that making such a finding may suggest that FOS was free to apply a general policy in contradiction with the law. To that end, Jay J indicated that FOS would likely have to explain its broader rationale for such a policy decision in the future.

Interestingly, the judge expressed his personal concerns with the jurisdiction of FOS and its ability to depart from the established law. Apart from the Ombudsman being required to give detailed reasons when it decides contrary to the law, Jay J stated that he was not entirely satisfied that the relationship between what is fair and reasonable, and what the law lays down, has been sufficiently defined by the Court of Appeal. Further, the breadth of FOS' discretion under s228(2) does not absolve it from consistency when it comes to making decisions.

The decision in *Aviva* is significant for insurers even if the case appears to simply apply the law set out in *Heather Moor*. That is, any complaints upheld by FOS which involve a contradiction of the law will need to contain detailed reasons explaining why such a contradiction was fair and reasonable in the circumstances, and a failure to provide those reasons should result in that decision being quashed. However, insurers will need to be aware that this will not defeat a complaint entirely; it will lead to a redetermination of the complaint by FOS and may result in the same decision being made.

More significantly, the requirement for FOS to provide detailed reasons may open the decision up to a claim of Wednesbury unreasonableness if the decision can be shown to be so irrational that no other Ombudsman would have reached the same conclusion. Whilst that claim was unsuccessful on this occasion, the facts in *Aviva* are unique; the case involved a party with unusual circumstances (a rare illness leading to a failure to disclose that illness) and it is likely be limited to its facts in future judgments. Further, whilst obiter, Jay J's concerns regarding FOS' powers under s228(2) FSMA 2000 may indicate that there is a gap in the law which requires further judicial clarity.

Bank's duty of care

Thomas & Anor v. Triodos Bank NV [2017] EWHC 314 (QB) (2 March 2017)

This case concerns the scope of the duty of care owed by a lending bank to a retail customer. The borrowers, Mr and Mrs Thomas, who were partners in an organic farming business, switched some of their indebtedness from a variable to a fixed rate basis, for a term of 10 years. They alleged that the bank had misrepresented, or at least not adequately explained, the financial consequences which would follow if they tried to get out of the fixed rate before the expiry of the 10-year term.

Judge Havelock-Allan QC found it significant in this case that the bank had advertised to the borrowers that it subscribed to the Business Banking Code (BBC). The BBC contained a fairness commitment, including a promise that, if the bank was asked about a product, it would give the customer a balanced view of the product in plain English, with an explanation of its financial implications. There were no disclaimers, "basis" clauses or exclusions in the terms and conditions which applied between the claimants and the bank that would lead to the conclusion that the bank was not willing to assume responsibility for honouring that promise. In the circumstances, the judge found that, when the claimants enquired about fixing the interest rate on their borrowing, the bank owed them *more* than a duty not to mislead or misstate.

Rather, the bank had a duty to explain the financial implications of fixing the rate, in response to the claimants' enquiries. It was not a duty to volunteer information if not asked. What was required was an explanation in plain English of what fixing the rate entailed, and the consequences of such a decision. The bank was obliged, in the opinion of the judge, to provide an accurate description of how the agreement would operate in the event of an early repayment. A worked example was not necessary, but the ingredients of the calculation under each clause should have been made clear in terms which gave a balanced picture. In particular, the claimants should have been told that the earlier they repaid the loan during the fixed term the higher the redemption penalty might be. The judge termed this "the information duty". The information duty obliged the bank to follow the best practice set out in the BBC.

On the facts, the judge found that the borrower had told the bank that it seemed prudent to fix for 10 years and that in response Mr Price, who was a senior manager in the bank's food, farming and trade team, agreed. While the judge had some sympathy for Mr Price in this situation, because Mr Thomas was inviting endorsement of his view, the judge came to the conclusion that Mr Price probably did say something which conveyed to Mr Thomas that he was sensible to think of fixing for 10 years rather than five years or two years, because the 10-year rate was lower. Although Mr Price's statement did not cross the line between information on the one hand and advice or a recommendation on the other, it would have been misleading, and would have amounted to a misrepresentation because it only told half the story. Even if it was not a misrepresentation, the judge was in no doubt that it amounted to a breach of the information duty which the bank owed to the claimants. The judge found that Mr Price had not explained the potential downside to fixing for a longer period, nor the implications for the calculation of redemption penalties of a longer fixed term. Further, Mr Price's failure to disabuse Mr Thomas when he asked whether the maximum likely redemption penalty was in the range of £10-20,000 gave rise to a misrepresentation which influenced the decision to enter into the first fixed loan.

This case supports the view that there may be a mezzanine duty to explain financial products which goes beyond the *Hedley Byrne* duty not to mislead. The decision seems to be at odds with the High Court decisions in *Green and Rowley v. RBS* and *Thornbridge v. Barclays Bank*, although it may be distinguished by the drafting of the contractual documents and the reference by the bank to the BBC. A further decision clarifying the position may be necessary.

Effective service by fax and valuation of securities in repo transactions

LBI EHF (in winding up) v. Raiffeisen Zentralbank Österreich AG and Raiffeisen Bank International AG [2017] EWHC 522 (Comm)

Following the decision in *LBIE v. Exxonmobil* referred to in our last update, Mr Justice Knowles CBE had to consider whether default notices sent by fax had been properly served, and how securities should be valued under the termination provisions in the Global Master Repurchase Agreement 2000 (GMRA) and Global Master Securities Lending Agreement 2000 (GMSLA), in particular as to the meaning of the words "fair market value".

The claimant bank, Landsbanki Islands hf (LBI), entered into trades with the defendants (RZB). When LBI failed in October 2008 there were several open positions between LBI and RZB: 11 repo trades on GMRA terms, and three securities lending trades on GMSLA terms. RZB had attempted to serve default notices in relation to these trades by fax on 8 October 2008.

Both the GMRA and GMSLA specified the fax number to be used (a number starting "0044207") and that service would be effective "at the time when the transmission is received by a responsible employee of the recipient". RZB's position was that it sent default notices by fax, and LBI's was that it could not trace receipt of any such notices.

RZB's transmission receipts were marked "OK", but contained the number for LBI starting "0207". Based on the fact that the number had been dialled previously for trade confirmations, the judge concluded it was more likely than not that the correct number was dialled and the receipt just showed the answerback of the machine reached.

LBI contended that "responsible employee" should be interpreted as meaning someone who would recognise what a default notice was. The judge felt this went too far, and would result in too much uncertainty, to have been the intention behind the contractual service provisions. An employee in the fax room is given responsibility for this task by their employer: accordingly, receipt by such an individual is sufficient. The fact that LBI had searched for the notices and been unable to find them did not mean they had not been delivered. The fact that LBI was not found to have a reliable system of recording or storing faxes evidently had a significant bearing on this conclusion.

In respect of the valuation point, LBI's position was that RZB's valuation of the transactions was incorrect. It argued that RZB did not serve a default valuation notice in time. In those circumstances, the GMRA provided for RZB to determine the default market value as an amount representing the "fair market value" of the securities, in the reasonable opinion of RZB.

LBI contended that the approach to fair market value should be informed by other valuation standards. In particular, it should be interpreted as excluding prices achieved in a distressed market. However, the judge considered this was inconsistent with other GMRA provisions.

LBI accepted that the court had to put itself into the shoes of RZB (as decision-maker) and ask what decision it would have reached, acting rationally and not arbitrarily or perversely. The judge found the approach of Blair J in the *LBIE v. Exxonmobil* case helpful and concluded from it that he needed carefully to examine what RZB contended it would have taken as "fair market value" and why.

On dispatch of the default notices, RZB requested bids from 10 institutional counterparties. It also used algorithm-based prices from

Bloomberg, but did not consider them commercially realisable in the volatile circumstances following Lehman's default. RZB used this combination of information, applying haircuts to the Bloomberg figures as it considered appropriate, to set the fair market value. The judge considered RZB's approach was rational and made in good faith. The availability of other valuation methods, or other information that RZB could have used but did not, did not render RZB's assessment irrational.

As with the *Exxon* case, the judgment is another reminder of the importance of following default provisions precisely. It is also a prime example of the difficulties in sending notices by fax. Firms would be well advised to consider whether it remains appropriate to include fax as a means of notification in their agreements and, if so, to review whether they have sufficiently reliable systems and procedures to receive, store and forward on faxes.

As to valuation, on the facts of this case, it appears that, provided non-defaulting parties act in good faith in determining valuations and their approach is not irrational, the court will be reluctant to intervene and impose any particular approach.

A question of identification – interpreting s393 of FSMA 2000

Financial Conduct Authority v. Macris [2017] UKSC 19

In March 2017, the Supreme Court overruled a much-publicised 2015 Court of Appeal decision, and determined the proper interpretation of s393 of the Financial Services and Markets Act 2000 (FSMA). It held that the Financial Conduct Authority (FCA) had not identified Mr Achilles Macris in notices served on his former employer, JP Morgan Chase Bank NA (JP Morgan), on 18 September 2013.

In 2012, JP Morgan reported trading losses within its Synthetic Credit Portfolio (SCP) of US$6.2 billion. The SCP was part of JP Morgan's Chief Investment Office (CIO) in London and New York, and the head of SCP reported to Mr Macris. As well as considering the causes of the losses, an investigation by the FCA also found that JP Morgan had not been as open with the FCA as it should have been when the FCA first started enquiring about the matter.

The FCA served notices on JP Morgan in September 2013, in which it criticised the actions of "CIO London management" and stated that it had been misled by the actions of CIO London management. Mr Macris argued that references to CIO London management referred specifically to him and therefore under s393 of FSMA he, as a third party, should have been served with a copy of the notices to enable him to make representations to the FCA.

In the Upper Tribunal, Mr Macris produced two witnesses who stated they could identify him from the reference to CIO London management. He also relied on a report published by the US Senate Committee on SCP's losses prior to the notices. The report, which was available on the internet, identified Mr Macris by name and quoted from emails also referred to in the FCA's notices, leading Mr Macris to argue that anyone reading the report and the notices could deduce that references to CIO London management were references to him. Judge Herrington upheld Mr Macris' complaint and held that he was entitled to be treated as third party for the purpose of s393.

The Court of Appeal, while departing from the reasoning of Judge Herrington, reached the same conclusion. Lady Justice Gloster formulated a two-stage test of whether an individual is identified for the purpose of s393. First, the allegedly prejudicial statements in the notice, when read alone, must refer to a person (other than the one to whom the notice is addressed). Second, and based on the law of defamation, the relevant words must be such as would reasonably lead a person acquainted with the individual, or who operates in his or her sector of the financial services industry, to believe that he or she is the person identified. In considering this second stage, recourse to material not contained in the notice was held to be permissible. Applying this test, it was held that Mr Macris was identified by the notice.

Before the Supreme Court, the FCA argued that a person is identified in a notice only if the terms of the notice would reasonably lead the ordinary reader to conclude that the notice unambiguously identifies the individual. Lord Sumption adopted an even narrower test. He concluded that a person is identified in a notice under s393 only if he or she is identified by name or a synonym, such as a job title or office such as "chief executive". If the identification is by synonym, it must be apparent from the notice alone that the synonym could only apply to one person and that the person could be identified by the contents of the notice or from publicly available information. Such publicly available information can be used only to interpret, not to supplement, the contents of the notice. Lord Sumption also stated that the relevant audience for a s393 notice is the public at large. Applying this test, Lord Sumption allowed the appeal, finding that reference to CIO London management was insufficient for the ordinary person to conclude that it was a synonym for Mr Macris.

The decision was not unanimous with Lord Wilson dissenting and stating that the decision of the Supreme Court did not strike a fair balance between the implications of identification for the FCA and an individual wrongly criticised in notices. His alternative formulation of the test was also a two-stage test: first, the notice alone must refer to an individual; and second, the words of the notice would cause a person in the same sector of the market, not personally acquainted with the individual, and by reference only to information in the public domain, to conclude the individual is the person referred to in the notice. Although Lord Mance agreed with Lord Wilson's legal analysis, he reached the same conclusion as the majority.

The judgment is a significant one for the FCA, which had faced a number of similar references of FCA notices to the Upper Tribunal following the Court of Appeal's decision. The practical effect of the decision is that, applying the extremely narrow interpretation of s393, it is unlikely the FCA will ever be found to identify an individual in a notice unless it expressly intends to do so.

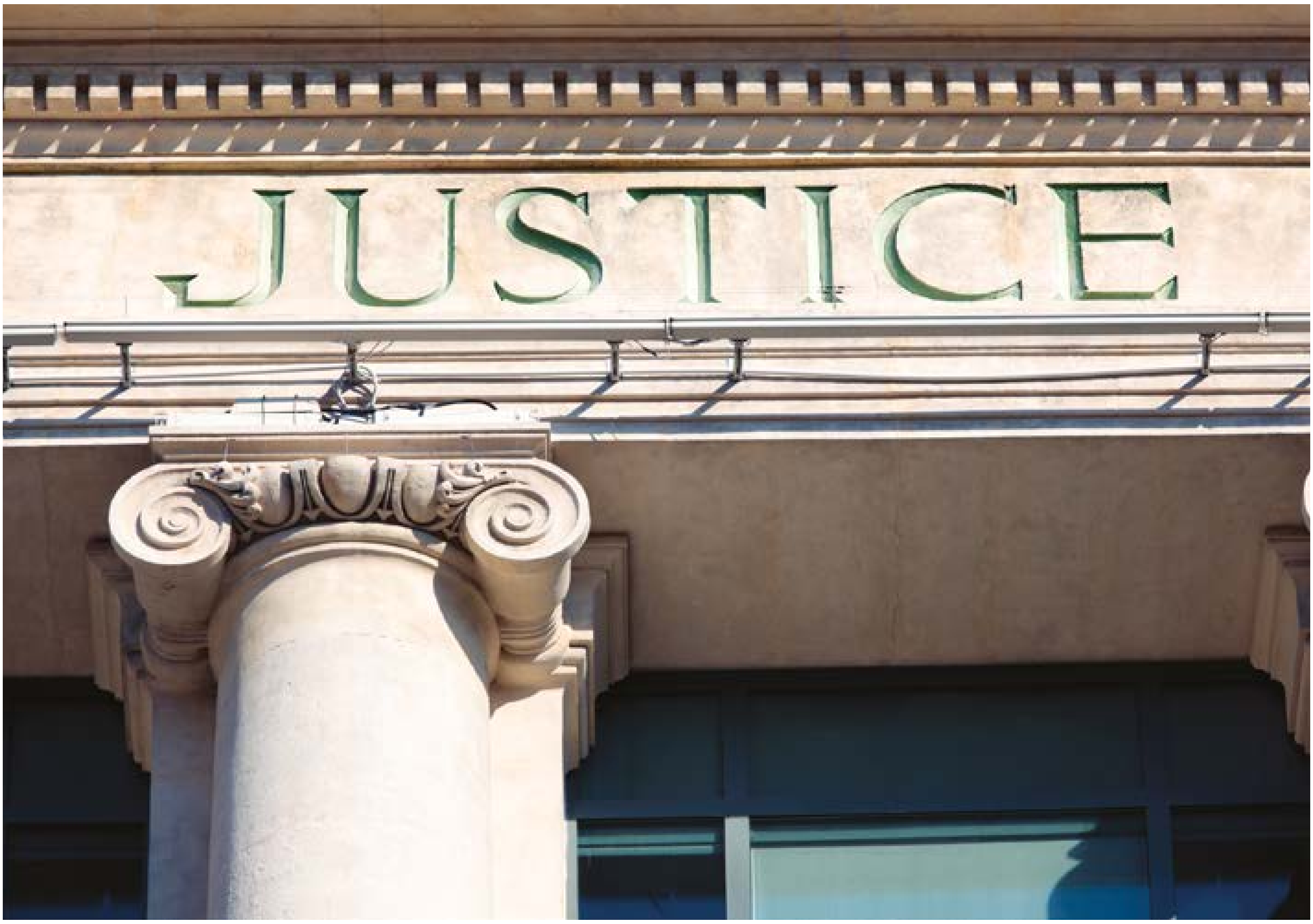
SAAMCo revisited: the Supreme Court judgment in *BPE Solicitors v. Hughes-Holland* [2017] UKSC 21

The Supreme Court has reinforced the principles set out in the landmark professional negligence case of *South Australia Asset Management Corporation v. York Montague Ltd* [1997] A.C. 191 (known as *SAAMCo*), a case often misunderstood and misapplied. The Supreme Court found that, although a firm of solicitors had been negligent in failing to identify the correct purpose of the loan, the loss suffered did not flow from the solicitors' negligence, but from a poor commercial decision to lend money for which the solicitors were not liable.

The facts of this matter were that Mr Gabriel had lent £200,000 to his friend, Mr Little, assuming that the purpose of the loan was to finance the redevelopment of a disused heating tower (the Tower). Mr Gabriel retained BPE Solicitors (BPE) to draft the loan documents for the transaction, but BPE was instructed by Mr Little, and did not seek confirmation or clarification from Mr Gabriel directly. Rather than using Mr Gabriel's money for the development of the Tower, Mr Little used it to discharge an existing charge over the Tower. The transaction was a failure and Mr Gabriel lost all his money.

In a unanimous decision, with Lord Sumption providing the sole judgment, the Supreme Court found that although BPE had negligently drawn up the loan facility agreement by stating an incorrect purpose, its instructions were only to draw up the loan documents and it was only liable for losses which flowed directly from its negligence in this regard. Therefore BPE was not liable for the losses which flowed from Mr Gabriel's own commercial decision to lend the money.

In coming to his decision, Lord Sumption clarified and reinforced the well-known *SAAMCo* principle, which arose from the House of Lords' decision in *SAAMCo*. *SAAMCo* concerned a negligent overvaluation of a property – damages were held to be limited to the difference between the negligent valuation and the true value at the time. The lender claimant was not entitled to recover more than the amount it would have lost had the valuation not been negligent.



As the *SAAMCo* principle has not always been correctly understood, Lord Sumption's clarification of it is welcomed. Lord Sumption drew a distinction between advisers who advise on the merits of taking a particular course of action and those who provide information on a limited aspect of that course of action:

- Adviser: in this situation, the adviser is responsible for taking into account all factors which will impact on the decision to take a particular course of action. If a factor is negligently ignored or misjudged, and proves to be paramount to the decision to take that course of action, the client will be entitled to recover all losses flowing from taking the course of action. The negligent Adviser of Action is liable for the overall riskiness of the transaction.

- Provider of information: here the adviser is contributing a limited part of the information enabling the client to make a decision. The process of considering other relevant factors and assessing the overall commercial merits of the transaction are matters for the client. The adviser's duty does not extend to the decision itself, and therefore the negligent adviser is only liable for the financial consequence of the particular information he or she is under a duty to provide being wrong.

Lord Sumption held that BPE had not assumed responsibility for Mr Gabriel's decision to make the loan – its instructions were limited to drawing up the loan documents. BPE had negligently confirmed in the loan facility agreement that the intended purpose of the loan was the redevelopment of the Tower. Even if the loan had been used for that purpose, the evidence showed that Mr Gabriel's loss would have been the same, as the value of the Tower would not have increased. Therefore, Mr Gabriel's loss was the result of a poor commercial decision to lend Mr Little's company £200,000. This was a decision taken by Mr Gabriel and fell outside the scope of BPE's duty of care.

Although there are often difficulties in the mathematical calculation of the damages, as acknowledged by Lord Sumption, the *SAAMCo* principle nevertheless remains crucial in determining the quantum of damages in negligence cases against all types of professionals in commercial transactions.

Disclosure of the identity of third party funders and existence of ATE insurance

RBS Rights Issue Litigation [2017] EWHC 463 (CH)

In the *RBS Rights Issue Litigation* (RBS later settled with the relevant action group at the start of the trial period), the High Court set out important principles with respect to the circumstances in which the court may order disclosure of the identity of third party funders, and the details of any ATE insurance.

The defendants sought disclosure of: (1) the names and addresses of any third party funding the claimants' litigation; and (2) a copy of any ATE insurance policy, or confirmation that neither the claimants nor any third party funder would seek to rely upon such a policy in opposition to an application for security for costs.

The defendants argued that they were unable to make an informed decision as to whether to apply for security for costs in the absence of information as to the claimants' ATE arrangements and funders, which the claimants had refused to provide. Such application would potentially be pointless if adequate ATE cover was in place.

The claimants argued that the court should not exercise its discretion to make the disclosure order because: (1) it was not certain that any application for security for costs would be made; and (2) any such application would have no real prospect of success, largely due to delay. The claimants also argued that the ATE policy was privileged.

Application in relation to third party funder

The judge granted disclosure, holding that an application for security limited to a third party funder was not "so unrealistic or hopeless" that the defendant sought not to be granted some latitude. The judge in this judgment was not encouraging as to the prospects of success of such application, particularly if it were to imperil the trial or its preparation, although an order for security for costs was in fact later made.

He commented that an application for security for costs should come as no surprise to a commercial third party funder, particularly in the context of a group litigation order, where the claimants' several liability for costs makes enforcement against multiple claimants difficult. Funders provide the "nearest and deepest pockets" and "stand in the front-line".

Application in relation to the ATE policy

With respect to disclosure of the ATE policy the judge rejected the argument that it was by its nature privileged, although he accepted that some parts of it may attract legal advice privilege and require redaction.

Despite conflicting case law on the point, the judge held that the court has power under CPR 3.1 to order disclosure of an ATE policy when that disclosure is necessary to enable the court proportionately and efficiently to exercise its case management function.

The judge said the key question was whether, on true analysis, the defendants were seeking to invoke a case management power in aid of the proportionate, expeditious and efficient management of the proceedings, or whether they were in reality seeking disclosure with a view to enforcement or some other objective. The judge concluded that it would be inappropriate to make the order for disclosure of the ATE policy in this case, finding that the defendants' primary objective was enforcement.

Supreme Court determines proper construction of an indemnity clause in a sale and purchase agreement

Wood v. Capita Insurance Services Ltd [2017] UKSC 24

In March 2017 the Supreme Court interpreted an indemnity clause in an agreement between Mr Wood (and two others) and Capita, for the sale and purchase of the entire share capital of an insurance brokerage company (the agreement).

Following the purchase, the company's employees raised concerns about the company's sales processes, leading the company to conduct a review, which identified that a number of customers had been missold insurance-related products in the period preceding the agreement. In compliance with its regulatory obligations, Capita reported the misselling to the (then) FSA. The FSA agreed with the company, and Capita, that a remediation scheme to provide redress to the customers affected would be implemented.

Capita alleged that the company's misselling had caused it losses of some £2.4 million, and sought to rely in its claim against Mr Wood (the former managing director of the company) on an indemnity clause in the agreement. Mr Wood disputed certain of the allegations in relation to the company's misselling, and argued that Capita's losses fell outside the scope of the indemnity, on the basis that they were caused by Capita's (and the company's) own reporting to the FSA, rather than by claims or complaints made by customers.

Lord Hodge delivered the Supreme Court's judgment, in which he stated that there had been no change in the court's approach to contractual interpretation between the judgments in *Rainy Sky SA v. Kookmin Bank* [2011] 1 WLR and *Arnold v. Britton* [2015] AC 1619. The judgment went on to state that both a textual and contextual analysis can be used to assist interpretation of a particular clause. In the opaque and poorly drafted clause before it, the Supreme Court first considered the text and then went on to consider the context of the clause as whole, examining whether the wider factual matrix could give guidance to its meaning.

The court considered that the text supported Mr Wood's position, and also found the context to be significant in this case. The court noted that the indemnity was in addition to detailed warranties that covered the misselling, and that these warranties were time limited (the time having lapsed by the time Capita made its claim).

Further, the parties were sophisticated and experienced in the relevant market, and, whilst Capita may not have been aware of the sales processes in place at the relevant time, that would not assist the court to determine the scope of the indemnity clause. The court found that it was not contrary to business common sense for parties to agree wide-ranging warranties, subject to a time limit, and also to agree a further indemnity not subject to a time limit, but triggered only in certain circumstances.

Based upon the above, the Supreme Court dismissed Capita's appeal. In doing so it stated that whilst this may lead to the agreement being a poor bargain from Capita's point of view, it was not the court's role to improve that bargain.

The decision highlights the need for clear and precise drafting to avoid any uncertainties but also demonstrates the different tools available to the court when interpreting contracts.

Clarity provided by the Court of Appeal on the operation of the consent regime in POCA

The National Crime Agency v. N and Royal Bank of Scotland Plc [2017] EWCA Civ 253

The Court of Appeal in this case provided further clarity for banks in relation to the money laundering suspicious activity regime contained in the Proceeds of Crime Act 2002 (POCA) and the ability of customers to challenge banks when bank accounts are temporarily frozen.

The background was, in summary, that the Royal Bank of Scotland (the Bank) suspected that the credit balance in certain accounts of its customer (N) constituted criminal property. Accordingly, it froze the accounts and made a suspicious activity report to the National

Crime Agency (NCA) seeking consent to return the funds to N. N issued proceedings for an interim mandatory injunction requiring the Bank to operate N's accounts and for declaratory relief. On hearing the application, Mr Justice Burton made a series of orders requiring the Bank to make a number of specified payments. In order to protect the Bank, the court made an interim declaration that, in making payments, the Bank would not be required to make "an authorised disclosure" seeking consent from the NCA under POCA and would not commit a criminal offence by failing to make a disclosure or by complying with the injunction. The NCA appealed.

The Court of Appeal decided that:

1. in Part 7 of POCA, Parliament had set out a procedure for the reporting of money laundering suspicions – where a bank suspects that money in its customer's account is criminal property, freezes the account and seeks consent to deal with the money, the court should not intervene during the course of the seven-working-day notice period and 31-day moratorium period;

2. the jurisdiction of the court to grant interim relief was not completely ousted, but the statutory procedure was highly relevant to the exercise of the court's discretion, and could not be "displaced merely on a consideration of the balance of convenience as between the interest of the private parties involved". The public interest in the prevention of money laundering is, in most cases, likely to be decisive;

3. earlier authority considering the regime predating POCA needed to be considered with caution and could not be regarded as providing general guidance;

4. Mr Justice Burton's finding that there was no evidence that the monies were suspected to be, or were, criminal property was not borne out in his reasons or by the evidence; and

5. no interim declaration or mandatory relief requiring the Bank to make payments should have been ordered. In considering the balance of convenience, Mr Justice Burton did not have regard to the important public interest in the prevention of money laundering as reflected in the statutory procedure.

This decision is important for banks and brings much-needed clarity. In the absence of very clear evidence that the bank has acted in bad faith, it is now clear that the customer will be unable to seek an order from the court to compel the bank to take any action, during the period when it has frozen an account and is waiting for a response to a consent request from the NCA. This should reduce the risk of an otherwise invidious position, whereby banks would be required to comply with their legal obligations to report money laundering (and where appropriate seek consent) on the one hand, whilst seeking to defend claims from customers on the other.

Court blocks ex-Keydata's cross-examination of witnesses
Ford v. The Financial Conduct Authority [2017] UKUT 147 (TCC)

In April 2017, the Upper Tribunal refused an application by the former chief executive of Keydata Investment Services Limited (KIS), Mr Ford, for witness summons or letters of request in respect of eight named individuals, including senior individuals from the FCA, FSCS and Luxembourg regulator the CSSF.

The application was made in connection with the references by Mr Ford and by Mr Owen, former sales director of KIS, to the Upper Tribunal of decision notices issued by the FCA. In the decision notice issued in respect of Mr Ford, the FCA seeks to impose a fine of £75 million, the largest ever financial penalty imposed by the regulator on an individual, for Mr Ford's role in the collapse of KIS.

The Tribunal noted that, whether by witness summons or letters of request, evidence should be compelled only if it is relevant and will materially assist in the determination of an issue, or issues, in the proceedings. As in *Jefferey v. FCA* (FS/2010/0039), the test is not whether the party making the application hopes that the evidence sought will assist its case; that would be in the nature of speculation, or a fishing expedition.

The Tribunal observed that, pursuant to s133(4) of the Financial Services and Markets Act 2000, the evidence which it can consider is any evidence relating to the subject matter of the reference which, in this case, is the conduct of Mr Ford. Conversely, the application in question sought evidence on the issue of consumer detriment. The Tribunal concluded that there is a link between the alleged misconduct and consumer detriment, but that it is not the consumer detriment (or its causes) that will determine whether Mr Ford's conduct amounted to misconduct. That was the principal question for the Tribunal and it would not assist Mr Ford to seek to characterise the FCA's case as something different, in order to assert that it was the cause of consumer detriment rather than him.

On that basis, the Tribunal refused seven of the eight requests, allowing only the request for a witness summons to Peter Johnson. Mr Johnson, former senior compliance officer and Chief Operating Officer of KIS, was himself the subject of a decision notice issued by the FCA and made a reference to the Tribunal, joining the present proceedings. However, that reference was subsequently withdrawn and a final notice issued in respect of Mr Johnson in May 2016. The Tribunal accepted that Mr Johnson would be able to

provide relevant evidence regarding certain operational and compliance matters as regards KIS, and that such matters, so far as material to the misconduct allegations against Mr Ford, would be relevant and likely of material assistance to the Tribunal. Accordingly, the Tribunal provisionally acceded to the application in respect of Mr Johnson although Mr Johnson himself will be given the opportunity to object.

Interestingly, the judge considered, but did not determine, whether the Tribunal had the power to issue a letter of request for the taking of evidence from individuals outside the jurisdiction, under Council Regulation (EC) No 1206/2001 (the Taking of Evidence Regulation). Ultimately the issue did not fall to be determined in this case given that the requests did not meet the initial test of relevance and material assistance, as set out above.

The judgment is a helpful reminder of the test that the Tribunal will impose when seeking to determine whether evidence should be compelled, and that it is necessary for applicants to demonstrate the relevance of the evidence sought; the Tribunal is unlikely to allow a request that it considers amounts to a fishing expedition.

Settlement payment of £815 million by Société Générale SA to the Libyan Investment Authority

In May 2017, Société Générale SA (SocGen) and three companies within its group settled their dispute with the Libyan Investment Authority (LIA) by agreeing to pay €963 million to the LIA.

The LIA brought proceedings against SocGen alleging that trades involving the payment of US$2.1 billion by the LIA to SocGen and its affiliates were part of a fraudulent and corrupt scheme. The LIA claimed that this scheme involved the payment of US$58.4 million by SocGen to Mr Giahmi, the fifth defendant, via a Panamanian company, Leinada Inc., owned and controlled by Mr Giahmi. The claim related to events that took place between 2007 and 2009 when Libya was controlled by Colonel Gaddafi, although Libya was opening up to western investments after years of sanctions.

It was alleged that certain employees and officers of the LIA were influenced by the payment of bribes and the making of threats, which caused the LIA to enter the disputed trades. It was said that Mr Giahmi was able to effect this scheme through his links with the Gaddafi regime.

Shortly before the case was due to start, SocGen and the LIA reached a settlement. The terms of the settlement were confidential and SocGen had previously denied the claims, but, in a joint statement, it apologised to the LIA for "the lack of caution of some of its employees".

SocGen is still the subject of regulatory investigations in relation to the transactions which were the subject matter of the proceedings, initiated by various US authorities including the Department of Justice. Such investigations have led to a request for assistance from the Serious Fraud Office (SFO).

Tight controls on the extent of privilege

The Director of the Serious Fraud Office v. Eurasian Natural Resources Corporation Ltd [2017] EWHC 1017

The High Court has given a strict interpretation on the issue of litigation privilege. The SFO started proceedings against Eurasian Natural Resources Corporation (ENRC) under Part 8 of the CPR, challenging ENRC's claim to privilege in respect of various documents. The documents were created in the context of an anticipated criminal investigation, and during the course of ENRC's engagement with the SFO in a self-reporting process in relation to allegations of fraud, bribery and corruption in Kazakhstan and Africa (which ENRC has denied).

Litigation privilege

In order for a document to attract litigation privilege, litigation must be in reasonable contemplation. The court ruled that a reasonable anticipation of a criminal investigation did not amount to reasonable anticipation of litigation. The policy that justifies litigation privilege did not extend to enabling a party to protect itself from having to disclose documents to an investigator. Documents that are generated at a time when there is no more than a general apprehension of future litigation cannot be protected by litigation privilege just because an investigation is, or is believed to be, imminent. Prosecution only becomes a real prospect once it is discovered that there is some truth in the accusations or, at the very least, that there is some material to support the allegations of corrupt practices.

The court found that one critical difference between civil proceedings and a criminal prosecution is that there is no inhibition on the commencement of civil proceedings where there is no foundation for them, other than the prospect of sanctions being imposed after the event. Criminal proceedings could only reasonably be in contemplation where the prospective defendant knew enough to appreciate that a prosecutor would realistically be satisfied following investigation that there was sufficient evidence for there to be a good chance of securing conviction. There was no evidence that the company was ever aware that it had any such problem, or of anything more tangible than a fear of criminal prosecution.

The court also considered whether the documents had come into existence for the sole or dominant purpose of conducting litigation. The court found that the dominant purpose of obtaining evidence from employees and ex-employees had not been to use the information for the purposes of constructing a defence, and the solicitors' role had not extended to giving advice in relation to the conduct of future criminal litigation.

Advice given in connection with the conduct of actual or contemplated litigation may include advice relating to settlement of that litigation once it is in train, and litigation tactics may include bringing them to an end by agreement. However, the judge rejected the notion that, by parity of reasoning, litigation privilege extends to documents created for the purpose of obtaining advice about how to avoid contemplated litigation.

Legal advice privilege

As regards the claim to legal advice privilege over interview notes, the court rejected this claim, on the

basis that the individuals with whom solicitors communicated were not authorised by ENRC to obtain legal advice on its behalf, and were therefore not the client for these purposes. The court also rejected ENRC's case that the interview notes comprised lawyers' working papers.

This is another example of the court taking a restrictive interpretation of the rules of privilege. The approach taken with respect to criminal investigations when asserting litigation privilege is especially strict. Further, the rationale of the judge's decision in relation to documents prepared for the purposes of avoiding litigation is arguably difficult to follow, and may be difficult to apply in the future. It is understood that ENRC is appealing this decision.

High Court declines jurisdiction over ISDA declarations

Deutsche Bank v. Comune Di Savona [2017] EWHC 1013 (Comm)

In May 2017, the Commercial Court upheld a jurisdictional challenge by the Italian local authority Comune di Savona (Savona) in the proceedings brought against it by Deutsche Bank.

The dispute concerns two interest rate swaps entered into by the defendant with Deutsche Bank pursuant to an ISDA Master Agreement which, in the standard form, was governed by English law and contained an exclusive jurisdiction clause in favour of the English court (the ISDA). However, prior to entering into the ISDA, the parties had entered into another agreement, pursuant to which Deutsche Bank agreed to provide advice in respect of Savona's existing derivative commitments, and in relation to restructuring its debts (the Convention). The Convention was governed by Italian law and contained an exclusive jurisdiction clause in favour of the Italian court.

Deutsche Bank commenced proceedings in England for various negative declarations in June 2016, and Italian proceedings were subsequently issued by Savona in February 2017. The focus of the Italian claim was the advice given by Deutsche Bank, and its role as adviser pursuant to the terms of the Convention. Accordingly, Savona sought to challenge the jurisdiction of the English court in respect of various declarations including, amongst others, that Savona had made its own independent decisions to enter into the swaps and that it did not rely on any communication from the bank as advice or a recommendation to enter into the swaps.

The court upheld Savona's challenge in respect of the five declarations in question. The first four of the declarations were founded upon various contractual estoppels in the ISDA, but the court did not consider that this necessarily meant that the dispute as to the declarations must be caught by the English clause. The court considered that an investigation into those issues could not be limited to narrow technical points but would inevitably stray into wider questions regarding the underlying advice given by Deutsche Bank, and whether it was acted upon. However, on the facts, this would have required incursion into the territory of the Italian clause. The final declaration, meanwhile, concerned any pre-swap obligation, howsoever it arose, and which caused Savona to enter into the swap. The court considered that this trespassed directly on the obligations which were the subject of the Italian claim and outside the scope of the English clause.

Deutsche Bank sought to contend that the English jurisdiction clause contained in the standard terms of the ISDA should be given universal and consistent application across different cases. However, the judge concluded that, whilst this approach might be appropriate if no other jurisdiction clause was involved, where there were different clauses, the relevant context should not be ignored. Here, it was necessary to construe the English clause in light of the Convention and the pre-existing Italian clause. If this meant giving the English jurisdiction a narrower scope than it might otherwise have, there was no rule of English law to prevent that approach.

The court also considered the wording of the English jurisdiction clause itself, which covered "any suit, action or proceeding relating to this Agreement". It was common ground this would cover any dispute as to the performance of the parties' obligations under the swap. However, the court concluded that, whilst it was possible that this wording could also cover a wider range of disputes (including, for example, misrepresentation), that approach would ignore the relevant context. The Convention was concerned with Deutsche Bank as adviser, and the swaps were merely concerned with Deutsche Bank as counterparty. Therefore, a dispute which was essentially concerned with Deutsche Bank's role as adviser was more naturally within the scope of the Italian jurisdiction clause.

Interestingly, the judge considered that the court should not strive to construe the two clauses as overlapping but mutually exclusive in scope – even if this caused jurisdictional fragmentation of a particular claim. The fact that some declarations might fall within the English clause and others within the Italian clause was not a consequence which must be avoided at all costs.

In addition, there was no presumption that the later clause was intended to cut down the earlier clause – again, even if that led to fragmentation. Whilst the ISDA was silent as to the earlier Convention, that did not mean the Italian clause was impliedly cut down as a matter of substance.

This is one of a number of similar cases currently going through the courts involving claims by municipal authorities against financial institutions in connection with interest rate swaps, and it will be interesting to see whether or not the jurisdictional points raised here will also be raised in the context of those claims. Further, judgment is an important reminder of the caution with which claimants should approach the issue of jurisdiction; clear wording in an ISDA will not be sufficient to ensure the jurisdiction of the English courts if there is a conflicting clause and the relevant context dictates otherwise.

Commercial Court decision regarding payment under letters of credit

Deutsche Bank v. CIMB [2017] EWHC 1264 (Comm)

In May 2017, the High Court ruled against Deutsche Bank in its dispute with CIMB following a detailed Request for Further Information (RFI) in which CIMB sought details of a payment made to a beneficiary under letters of credit.

The dispute concerns a series of 10 letters of credit between the claimant (Deutsche Bank), the confirming bank (CB, the London branch of Deutsche Bank), and the defendant, the issuing bank (IB, the Singapore branch of CIMB, a Malaysian bank). In summary, CB seeks repayment of the sums it paid under the letters of credit, in the amount of some US$ 9.9 million. IB claims that the transactions in question were sham transactions, entered into for the purposes of obtaining payment under the letters of credit. It argues that the documents presented under the letters of credit were discrepant, were presented late and did not comply with the terms and conditions of the letters of credit. Further, IB does not admit that payment was made by CB to the beneficiary, Global Tradinglinks Ltd.

The issue that fell to be considered by the court arose out of a lengthy RFI made by IB, in which it sought information from CB regarding its claim that it had indeed made payment to the beneficiary under the letters of credit. CB argued that it was a question of principle whether or not the issuing bank can enquire at all as to whether the confirming bank had made payment or whether it must simply take the confirming bank's word for it.

The starting point in considering the issuing bank's undertaking to the confirming bank in such circumstances is Article 7(c) of the Uniform Customs and Practice for Documentary Credits (UCP 600), which provides that an issuing bank undertakes to reimburse a nominated bank that "has honoured...a complying presentation". CB had sought to read into Article 7(c) the words "states that" before "it has honoured", but this was rejected by the court. The court concluded that it was not correct, as a matter of principle, to construe Article 7(c) by writing in words that materially changed its sense. The UCP 600 is revised periodically, and that is the occasion for introducing changes, if thought desirable.

The court held that, on a true construction of Article 7(c), read with the definition of "honour" set out in Article 2, an issuing bank's undertaking to reimburse a confirming bank arose where the confirming bank had honoured a complying presentation by making payment under credit.

As to whether IB was entitled to the information sought, the court noted that, in its defence, IB did not admit payment by CB. Therefore, CB was put to proof that it had honoured presentations by the beneficiary under the letters of credit. Indeed, in its reply, CB pleaded a detailed case as regards payment, and it is that pleading that was the subject of the RFI seeking details as to how CB says it made the payment to the beneficiary. The court concluded that, the claimant having made assertions as to payment, the defendant was entitled to ask for further information in the usual way.

The court also noted that there was a significant qualification on the issue, and that the length and breadth of the RFI served by IB had something of an air of a fishing expedition. The court would not entertain requests seeking unduly to investigate the CB's payment arrangements in the hope that something by way of a defence would turn up. The judge indicated that the legitimate scope of what should be produced in response to the RFI had been explored in oral argument and that the parties should be able to agree the terms of the appropriate order amongst themselves.

The judgment in this case provides helpful clarification as regards the interpretation of Article 7(c) of the UCP 600, and serves as a reminder of the fact that the court will not readily accept an interpretation which requires writing wording into the UCP 600 which does not already exist.

Further, and of perhaps broader application, this case is a reminder that, irrespective of the points of principle that underlie an RFI, the Commercial Court will give short shrift to any attempt at a fishing expedition. The wording of the Admiralty and Commercial Courts Guide, which provides that the court will only order further information to be provided if it is satisfied that the information was strictly necessary, must be adhered to.

Regulatory developments

For further information or analysis in relation to any of the issues raised below, please contact us directly.

Final Notices

Former Logica employee sentenced in prosecution brought by FCA

Manjeet Mohal, 13 January 2017

Manjeet Mohal, a former business analyst at Logica Plc, has been sentenced for insider dealing along with his neighbour, Reshim Birk. Mr Mohal was sentenced to 10 months' imprisonment and Mr Birk to 16 months, both sentences suspended for two years.

Mr Mohal was found to have come by inside information on CGI Holdings (Europe) Ltd's planned takeover of Logica and shared that information with Mr Birk, who then traded in Logica shares and options to make more than £100,000. The Executive Director of Enforcement and Market Oversight, Mark Steward, commenting on the case, stated that insider dealers are "more likely to be caught than ever before".

HSBC voluntarily sets up £4 million redress scheme

HSBC, 20 January 2017

HSBC is to voluntarily establish a redress scheme for customers who paid an unreasonable debt collection charge required by HFC Bank Ltd and John Lewis Financial Services Limited, both of which are now part of HSBC. The unreasonable debt collection charge relates to customers who fell into arrears between 2003 and 2009 and were subsequently charged a "debt collection charge" representing 16.4 per cent of the balance. The OFT previously deemed this charge to be unreasonable, as it did not reflect the actual cost of collecting the debt.

The FCA has established that approximately 6,700 customer accounts paid the debt collection charge. Those customers will be contacted by HSBC with offers of redress. In addition, during its review, the FCA identified certain customers where HFC Bank miscalculated the interest payable on their loan; HSBC has agreed to repay the overcharged interest to those customers. The FCA has estimated that, in total, HSBC will be required to pay approximately £4 million in redress to the affected customers.

Largest ever fine imposed on Deutsche Bank for AML controls failings

Deutsche Bank, 31 January 2017

In January 2017, the FCA fined Deutsche Bank AG (the bank) in London £163 million for failing to maintain an adequate AML control framework between January 2012 and December 2015. This is the largest fine that the FCA or FSA has ever imposed for AML controls failings.

The FCA considered that the bank failed to properly oversee the formation of new customer relationships and the booking of global business in the UK, thus exposing the UK to the risk of financial crime. Specifically, deficiencies in the control framework allowed thousands of highly suspicious trades to be made, covertly moving up to US$10 billion out of Russia in the relevant period.

The FCA concluded that the bank breached:

- Principle 3, which required it to take reasonable care to organise its affairs responsibly and effectively; and
- SYSC rules 6.1.1 R and 6.3.1 R, which required it to ensure its AML control framework was comprehensive and proportionate to the nature, scale and complexity of its activities and that it was able to identify, assess, monitor, and manage its money laundering risk.

The breaches were based on the FCA's findings that:

- The bank's customer due diligence (CDD) procedures failed to obtain sufficient customer information.
- The bank's culture failed to instil a sense of responsibility in the London front office. While the Deutsche Bank Moscow front office carried out onboarding in relation to the trades, the Deutsche Bank London front office was ultimately responsible for ensuring that adequate CDD was carried out. The London front office failed to appreciate this.
- The bank used flawed customer and country risk rating methodologies which omitted key factors in determining the applicable risk score, e.g. the lack of face-to-face contact between Deutsche Bank and customers.

- The bank's AML policies and procedures were deficient. For example, these policies did not require the gathering of information that would allow Deutsche Bank to check whether a customer's behaviour was consistent with its profile; nor did they require the London front office to supervise the onboarding of customers of the UK branch by offices in other jurisdictions. Moreover, Deutsche Bank's policies provided no guidance on how to evidence or establish the legitimacy of customers' sources of wealth and funds.
- The bank's AML IT infrastructure was inadequate in that, amongst other things, it failed to provide a single authoritative repository of know your client information.
- The bank lacked automated AML systems for detecting suspicious trades that could handle a high volume of transactions.
- The bank failed to provide adequate oversight of trades booked in the UK by traders in non-UK jurisdictions. The FCA found that the bank's AML functions were under-resourced and observed that Deutsche Bank had reduced the number of AML staff in both the UK and Moscow.

The FCA found that Deutsche Bank's failings were not deliberate or reckless, and there was no evidence that anyone at Deutsche Bank was aware of the existence of, or involved in, the suspicious trading. Deutsche Bank's fine was discounted by 30 per cent because it agreed to settle at an early stage. But for the discount, the fine would have been £229 million.

The ongoing nature of the problems and the large sums involved led the FCA to impose an extremely large fine, even in the absence of any deliberate or reckless wrongdoing. Those involved in setting up or scrutinising AML procedures should give careful consideration to the details in the Final Notice. A notable aspect of this case was the lack of adequate oversight of functions being carried across different regions. This is a perennial issue for global institutions, and a particular cause for concern for those subject to the Senior Managers Regime whose areas of responsibility may be impacted by overseas staff, often in different reporting lines.

Swiss regulator fines Coutts 6.5 million Swiss francs for AML failures

Coutts, 2 February 2017

In January 2017, the Swiss financial regulator, FINMA, fined Coutts & Co. Ltd CHF6.5 million (approx. £5.2 million) for failing to conduct proper due diligence in relation to business relationships and transactions totalling US$2.4 billion associated with the Malaysian sovereign wealth fund 1MDB.

In 2009, several business relationships connected with 1MDB were transferred from Coutts Singapore to Coutts Zurich. In particular, a Coutts Zurich account was opened for a young Malaysian businessman, ostensibly to deposit US$10 million. In fact, US$700 million of 1MDB assets were deposited. The documents supporting the transaction featured obvious mistakes as to the identities of the contracting parties, and the reasons given for this transaction were inconsistent and changed retrospectively. A number of the bank's employees raised their concerns about this transaction. For example, an employee in the Compliance unit noted in an internal email that "It would be the first time in my career that I would see a case where [in] an agreement over the amount of USD 600 Mio. or so the role of the parties had been confused". The bank ignored these concerns and failed to seek clarification.

There followed a series of further "obviously suspicious" transactions with a total value of US$1.7 billion. Again, various parts of the bank expressed concern, but still no further due diligence was undertaken.

FINMA's CHF6.5 million fine represents the profits unlawfully generated through these transactions. FINMA could have imposed wider-reaching measures in this case, but decided against doing so because Coutts Zurich has been winding up its licensed operations in Switzerland and has transferred many of its remaining customer assets to a private bank in Geneva. Nonetheless, FINMA is still considering initiating proceedings against responsible bank employees in relation to the same matter.

As well as being one of many recent cases illustrating the high regulatory priority given to proper anti-money laundering procedures, the case shows the importance of institutions being sensitive to employees' legitimate concerns. Here, suspicions were appropriately raised but this did not translate into appropriate action.

PRA fines Mitsubishi Bank and MUFG Securities

Bank of England press release, 9 February 2017

The Bank of Tokyo-Mitsubishi UFJ Limited (Mitsubishi) and MUFG Securities EMEA plc (MUFG) have been fined £17.85 million and £8.925 million respectively by the PRA for their failure to be open and cooperative with the PRA in relation to a 2014 enforcement action by the New York Department of Financial Services (DFS).

Mitsubishi and MUFG failed to inform the PRA of the DFS enforcement action before DFS's public announcement of it, falling considerably short of the PRA's expectation that firms engage in an open dialogue and take the initiative to ensure that the PRA has all relevant information at an early stage. Further, the PRA expects firms to have in place appropriate reporting systems such that information is provided quickly and accurately, including, for international firms which operate across multiple jurisdictions, when issues arise concerning operations in one jurisdiction that may impact other jurisdictions. This is necessary in order to ensure that the regulatory responsibilities of the firm as a whole are appropriately considered.

Mitsubishi and MUFG benefited from a 30 per cent discount on their fines for agreeing to settle at an early stage.

Express Gifts Ltd agrees £12.5 million redress scheme with FCA

Express Gifts Ltd, 17 February 2017

Express Gifts Ltd, a direct mail order and online retail company, has entered into an agreement with the FCA to pay £12.5 million to 330,000 customers to whom it sold insurance products with little or no value.

Express Gifts Ltd was FCA-authorised to sell general insurance products. Between 2005 and 2015, the firm sold bolt-on insurance to customers covering against accidental damage and theft. The premiums were calculated as a percentage of the customer account balance.

After an internal quality assurance review, Express Gifts Ltd reported itself to the FCA. The firm and the FCA agreed that the insurance "did not provide adequate value to customers because although it covered all items purchased, these were predominantly items of clothing, which customers would not generally consider insuring".

The agreement is of wider interest because it considerably extends the "treating customers fairly" principle. The FCA did not consider that the insurance products were "missold" in any conventional sense, merely that they were poor value for money. The agreement is further evidence that the FCA is prepared, in certain circumstances, to act as a price regulator.

FCA orders Tesco to pay compensation to investors for market abuse

Tesco plc, Tesco Store Limited, 28 March 2017

The FCA has published a Final Notice in respect of Tesco plc and Tesco Stores Limited (Tesco), in connection with market abuse in relation to a misleading trading update. The trading update in question, published on 29 August 2014, stated that Tesco's trading profits were expected to be in the region of £1.1 billion for the six months ending on 23 August 2014. This represented an overstatement of some £76 million. As a result of this overstatement of trading profits, the price of Tesco shares and bonds increased until Tesco corrected the false information in a statement on 22 September 2014.

The FCA considered that Tesco knew, or could reasonably have been expected to know, that the information in the 29 August 2014 announcement was false or misleading. Further, the FCA concluded that the misleading information contained within the 29 August 2014 announcement created a false market, resulting in purchasers of Tesco securities paying a higher price than they should have.

As a result, Tesco has opened a compensation scheme for all investors who acquired Tesco shares and bonds in the window of time between the 29 August 2014 statement being published and the subsequent corrective statement of 22 September 2014.

This marks the FCA's first use of its power, under s384 of FSMA 2000, to require a listed company to pay restitution in connection with market abuse. Under FCA estimates, the total amount of compensation that Tesco will ultimately pay is £85 million, plus interest.

Interestingly, the FCA decided not to impose any further sanction on Tesco, in addition to requiring it to set up the compensation scheme. This decision was taken as a result of the DPA entered into by Tesco Stores Limited with the SFO, for which Tesco must pay a fine of £128,992,500. This, coupled with Tesco's cooperativeness and its acceptance of responsibility for market abuse, means there will be no further sanctions placed on Tesco.

FCA fines investment banker for sharing client confidential information over instant messaging app

Christopher Niehaus, 29 March 2017

The FCA has published a Final Notice in respect of Christopher Niehaus, a former managing director at Jefferies International Limited, failing to act with due skill, care and diligence, in breach of Principle 2. On several occasions between 24 January 2016 and 16 May 2016, Mr Niehaus was found to have shared confidential client information over instant messaging application Whatsapp with two personal acquaintances, one of whom was also a client of Jefferies and a competitor of the client to whom the confidential information related. Mr Niehaus admitted that he had no explanation for his conduct, other than wanting to impress the people he had shared the information with.

Mr Niehaus had acquired the divulged information by way of his role as a managing director (CF30) at Jefferies, as a result of which he was obliged to maintain client confidentiality. In deciding the level of fine, the FCA took into consideration the fact that Mr Niehaus had not received any identifiable financial benefit from the breach, the lack of any substantial potential effect on confidence in markets, and Mr Niehaus's cooperation throughout the investigation. Mr Niehaus was fined £37,198; the potential fine of £53,140 was discounted in light of Mr Neihaus's early admission of his misconduct, and as he agreed to settle at the earliest possible stage of the investigation.

Acquittal of retried former Barclays traders in SFO prosecution

R v. Stylianos Contogoulas, Jonathan Mathew, Jay Merchant, Peter Johnson, Alex Pabon and Ryan Reich, 6 April 2017

In April 2017, a London jury acquitted two former junior Barclays traders, Stylianos Contogoulas and Ryan Reich, of conspiracy to defraud in connection with alleged LIBOR rigging.

The acquittals concluded a retrial of Contogoulas and Reich. At the first trial, in July 2016, a jury failed to reach a verdict on the pair, while finding four other former Barclays traders guilty of the same charge. The acquittals, which were unanimous, represent a significant defeat for the SFO not least because Contogoulas and Reich were the last of the SFO's prosecutions relating to LIBOR, which have resulted in five convictions but a total of eight acquittals.

The SFO is now preparing for a trial in September this year of six others in connection with alleged EURIBOR manipulation.

Final Notice to former Worldspreads employees for market abuse

Niall O'Kelly and Lukhvir Thind, 7 April 2017

The FCA has issued Final Notices to Niall O'Kelly and Lukhvir Thind, former Chief Financial Officer and Financial Controller (respectively) of collapsed spread betting business Worldspreads Limited (WSL).

The FCA found that various actions of Mr O'Kelly and Mr Thind constituted market abuse, contrary to s118(7) of FSMA 2000 (now replaced by Art 12(1)(c) of the Market Abuse Regulation). Mr O'Kelly was fined £11,900 (reduced from £328,100 because of serious financial hardship) and Mr Thind was fined £105,000. The FCA also found that both individuals lacked fitness and propriety, and permanently banned them from the UK financial services industry.

Mr O'Kelly had been closely involved in drafting, and had approved, the admission documents for the AIM flotation in 2007 of WSL's parent company, Worldspreads Group (WSG). As Mr O'Kelly was aware, these documents included substantially incorrect annual accounts and omissions of key information. The FCA found that investors would have needed this information in deciding whether to purchase WSG's shares.

The FCA also found that, when WSG ran into financial difficulty following its flotation, both Mr O'Kelly and Mr Thind knowingly falsified WSG's losses and client liabilities (and so its cash position), rendering WSG's annual accounts materially inaccurate, not least because they concealed client money shortfalls which by March 2011 amounted to £15.9 million.

The FCA found that Mr O'Kelly deliberately misled the market, by:

- providing information as part of WSG's request for trading on AIM (including in WSG's AIM admissions document) which he knew was materially false;
- approving WSG's annual accounts (among other documents) knowing that they contained material inaccuracies as to profit, trade payables and cash; and
- inaccurately describing WSG's financial position to financial analysts.

Mr Thind's behaviour consisted of falsifying and amending trading system reports, and participating in the provision of these reports to WSL's auditors, whilst knowing that this would have a material impact on the presentation of WSG's financial position in its own annual accounts.

Although WSL happened to be an FCA-authorised firm, the decisions are relevant to all UK listed companies. Whilst the behaviour in this case was particularly egregious, the cases show the importance of having robust controls over internal and external financial reporting, both at listing and on an ongoing basis thereafter.

FCA resumes investigation into HBOS impaired assets team

FCA press release, 7 April 2017

The FCA has announced the reopening of its investigation into misconduct at HBOS's Reading-based impaired assets team. The FCA suspended the investigation in early 2013 at the request of Thames Valley Police pending the completion of the latter's investigation. That investigation, named "Operation Hornet", led to six people receiving prison sentences for corruption, fraudulent trading and money laundering offences in connection with a scheme to lend aggressively to around 200 small businesses and charge them extortionate fees.

The FCA said its resumed investigation will focus on "the extent and nature of the knowledge of these matters within HBOS and its communications with the Financial Services Authority after the initial discovery of the misconduct".

In January this year, the FCA also announced that it will investigate certain former HBOS senior

managers to determine whether any prohibition proceedings should be commenced.

Lloyds Banking Group, which now owns HBOS, has set aside £100 million to compensate the victims for their economic loss, distress and inconvenience.

The case is one of a number of long-running matters, concerning different institutions, where criminal investigations have led to the postponement of regulatory investigations. The latter may then be restarted many years later. Inevitably memories will be less fresh at this point, demonstrating the importance of good document preservation procedures. Careful consideration should also be given to taking proofs of evidence, having due regard to the possibility that these may not be privileged.

Senior managers regime, certification regime and conduct rules

The Senior Managers and Certification Regime (SMCR) requires banks and major investment firms to:

- allocate prescribed responsibilities to pre-approved senior managers, each of whom must have a statement of responsibilities specifying those areas they are personally responsible for;
- produce a management responsibilities map showing how the statements of responsibilities all fit together; and
- certify the tier of staff below senior managers as fit and proper in order to perform their roles.

On 7 March 2017, all (bar ancillary) staff below the senior manager and certified tiers were made subject to overarching conduct rules.

On 3 May 2017, the FCA published a series of policy statements tidying up aspects of the SMCR for banks and insurers as well as finalising rules on remuneration and on whistleblowing in branches of overseas firms. With the roll-out of the SMCR to all regulated firms expected to commence this summer, for completion by 2018, the SMCR papers may be of interest to regulated firms more widely, especially as it is stated that the "duty of responsibility" will apply to senior managers in all types of firms.

This update covers a number of publications relating to the regime reflecting both the ongoing interest in the new regime and the fact that various aspects of the regime remained incomplete at the time it commenced. It is notable that the controversial issue of whether firms' general counsel should be senior managers or excluded remains unresolved with a policy statement surely due in the next six months. It is interesting to note that the FCA's approach is also attracting the attention of global regulators and the recent thematic review of the Financial Stability Board on Corporate Governance suggests similar regimes may be rolled out in other countries. Firms with an international presence will want to keep a close eye on this.

Response to Freedom of Information request for information on investigations under the SMR

Response, 27 February 2017

The FCA published its response to a request under the Freedom of Information Act 2000 on the number of investigations opened as a result of the introduction of the Senior Managers and Certification Regime (SMCR) since its introduction on 7 March 2016. The FCA's response stated that since the SMCR's introduction it has opened investigations into:

- two senior managers; and
- 11 approved persons likely to be certified persons.

Interestingly, in respect of enforcement investigations into any individual designated as a certified person, the FCA response noted that it does not keep a record of those individuals as under the SMCR it is the firm's responsibility to decide which members of its staff fall under that definition. The FCA's response therefore interprets the request as referring to approved persons since they are likely to have transitioned into certified persons under the SMCR.

It is interesting to note that the FCA reveals that it has not in all cases verified with the firms whether the individual in question is a certified person. Given that the definition of certified person is wider than that of approved person it suggests that the number may in fact be higher than that disclosed.

Final rules on applying conduct rules to all non-executive directors (NEDs) subject to the SMCR and SIMR

PS17/8, 3 May 2017

"Standard" NEDs are, broadly, those in banks and insurers that do not hold a senior management function or senior insurance management function, and that have no responsibility for implementing the decisions or policies of the board. Their regulatory treatment has proved to be one of the trickier aspects of the SMCR and SIMR, and the regulators' positions have changed several times since the first consultation paper in July 2014. The policy statement extends most of the conduct rules to standard NEDs, which will have to comply with the five conduct rules applicable to all employees, as well as the senior managers' obligation to disclose appropriately any information of which the FCA or PRA would reasonably expect notice. They will not, however, have to comply with the senior manager conduct rules on effective control, business area regulatory compliance and appropriate delegation. The FCA paper also refers to a related PRA policy statement, which has not yet been published.

Whilst firms and their NEDs will be reasonably comfortable with the end result, the FCA has introduced some uncertainty with the requirement to apply conduct rule breach reporting rules to standard NEDs where the firm has taken action "equivalent" to disciplinary action against an employee. Though it is not very clear what the FCA has in mind here, in practice such action is likely to be rare.

Firms will need to make sure that they have given appropriate, role-tailored training to their standard NEDs before the rules come into force on 3 July 2017. They will also need to consider whether and how to amend their conduct rule breach reporting procedures to ensure that any "equivalent to disciplinary" action against standard NEDs is considered for possible reporting.

Final guidance on the SMCR "duty of responsibility"

PS17/9, 3 May 2017

The duty of responsibility replaced the controversial presumption of responsibility before the latter was ever brought into force. It imposes a requirement on senior managers to take reasonable steps to avoid regulatory breaches in their business areas – and arguably adds little to the existing senior manager conduct rules, which include an obligation to take reasonable steps to ensure that the relevant business area complies with the requirements and standards of the regulatory system. Nevertheless, the FCA has finalised its guidance on the duty of responsibility, which is unsurprisingly similar, though not identical, to the guidance on the senior manager conduct rules. The guidance is helpful in that it gives a reasonably concise summary of how the FCA expects senior managers to run their businesses. So there are references to FCA favourites like dealing with possible breaches in a timely way, overseeing delegated responsibilities properly, and assessing and monitoring their area's governance, operational and risk management arrangements. Whilst little of this is novel, it amounts to a checklist that senior managers might find it helpful to run through.

Notably, the FCA will have regard to whether a senior manager took reasonable steps to ensure an orderly transition when they were replaced in the performance of their function by someone else. The FCA justifies this by referring to related conduct rule guidance – though this guidance actually applies to the manager of the senior manager who is being replaced. The FCA has previously only applied the obligation to the firm or line manager rather than the mover/leaver themselves, and senior managers may find it difficult to comply where their relationship with their employer has broken down (though this risk is limited by the fact that the obligation is to take "reasonable steps"). Many firms now require their senior managers to maintain a detailed governance and management framework. As well as being good regulatory practice, if kept up to date this can form the bulk of a handover document, avoiding the need to put one together from scratch in what may be difficult circumstances.

Senior Managers and Certification Regime: Review one year on

News story, 7 March 2017

Exactly one year after the SMCR came into force the FCA published a review of the regime. In it the FCA admits that changing the culture of the banking sector will take time, and that there is still further work to be done. The review indicates that the SMR has had some success in correctly identifying senior managers' roles and responsibilities; however, the review cites evidence of instances in which firms have allocated the same responsibilities to more than one senior manager, resulting in a lack of clarity over who is responsible for what, and in some cases "obscuring" who is genuinely responsible.

The overall impression left by the review is that there is still work to be done before a real culture change is imbedded in firms. The FCA promises to keep a "watchful eye" on firms in the coming year; time will tell if this proves effective.

Investment Managers

The conduct of investment managers is particularly topical in the context of the asset management market study. So far, interim findings and proposed remedies have been published and the FCA has indicated its intention to refer the investment consultancy sector to the Competition and Markets Authority. The final report was published shortly before going to press, alongside a consultation paper setting out the FCA's proposals in relation to a number of areas including fund governance. A number of other papers are also of interest.

Other Policy Developments

FCA Business Plan and Mission

18 April 2017

The FCA's Mission aims to give more clarity about prioritisation of interventions in financial markets.

It sets out its overarching Mission as being "to serve the public interest through the objectives given to it by Parliament". The paper then explains: how this will impact on the strategic decisions the FCA takes; the intervention framework behind those decisions; the rationale for its work; and how it chooses the right tools for the job. Much of what is said will be familiar but firms will be pleased to see that the FCA is also looking to enhance how it operates and improve transparency, particularly in potentially contentious situations. Further publications detailing the impact of the FCA's Mission on its main activities of authorising and supervising firms, taking enforcement action and encouraging competition and influencing market design can be expected over the next year.

The Business Plan 2017/18 gives details of specific areas the FCA

is prioritising for the next year in terms of both cross-sectoral issues and specific priorities for the seven sectors it regulates.

Key initiatives include:

- Supporting the UK government's preparations for the UK's withdrawal from the EU.
- Reviewing the implementation of the SMCR in banks and consulting on its extension to all regulated firms.
- A strategic review of retail banking business models.

The FCA identifies in its Business Plan six cross-sector priorities:

1. Financial crime and AML.
2. Culture and governance.
3. Promoting competition and innovation.
4. Technological change and resilience.
5. Treatment of existing customers.
6. Vulnerable consumers and access to financial services.

The FCA also sets out a number of planned activities in relation to each of the seven sectors into which it has split the regulated financial services market. These include:

1. Wholesale financial markets: implementing MiFID II; follow-up work on the investment and corporate banking market study; preparing for the Benchmark Regulation.
2. Investment management: final report on the asset management market study, scrutinising the internal controls of custody banks.
3. Pensions and retirement planning: interim report on the retirement outcomes review; outcomes of "wake-up" pack review; discovery work into non-workplace pensions market.
4. Retail banking: strategic review of business models; developing PSD2 technical standards and guidance.
5. Retail lending: interim report on the mortgage market study; assessing the treatment of mortgage customers at key points; examining the fairness of point of sale charges.
6. General insurance and protection: wholesale insurance market study; pricing practices discovery work; IDD implementation.
7. Retail investments: FAMR final guidance; investment platform market study; new rules on selling and distributing retail CFDs.

A detailed analysis of the FCA's Business Plan and Mission can be found in our article.

Banking Standards Board Statement of Good Practice 1 and Supporting Guidance, 28 February 2017

In February 2017, the Banking Standards Board (BSB) published its Statement of Good Practice and Supporting Guidance to set and provide a detailed explanation of the principles of good practice relating to the assessment of fitness and propriety (F&P). F&P is to be judged primarily based upon an individual's:

- honesty, integrity and reputation;
- competence and capability; and
- financial soundness.

The Statement of Good Practice identifies several situations in which an assessment of an individual's F&P is required:

- an individual joining a firm or following an internal role change;
- yearly for the reissuing of a certificate;
- in response to a "certification issue", which calls into question an individual's F&P; and
- in response to a "certification risk", which could call into question an individual's F&P.

Information should be gathered from several sources to determine an individual's F&P, including through due diligence checks before an individual starts a role, an annual appraisal, vetting and self-declarations.

The Statement emphasises aiming for high industry standards rather than simply meeting minimum requirements. Accordingly it suggests that assessments of F&P should also include evidence of positive affirmation of skills and behaviours, not just lack of negative information, and emphasises the importance of CPD.

Another key principle is the fostering of a culture of openness, challenge and support. This includes encouraging confidence in whistleblowing arrangements and ensuring individuals can properly disclose their own financial information to their employer without fear of judgement or repercussions.

The Supporting Guidance contains an F&P assessment record template which may prove helpful to firms reviewing their existing approach bearing in mind the requirements around regulatory references.

Illiquid assets and open-ended investment funds

DP17/1, February 2017

In February 2017, the FCA released its discussion paper (DP) on illiquid assets and open-ended investment funds. The DP looks at the post-Brexit market, considers existing liquidity management tools fund managers can employ and considers whether new measures are needed.

The FCA chose to examine this in light of the fact that some funds suspended dealing in the uncertain market conditions which followed the referendum in June 2016.

Illiquid assets are defined in the DP as assets that are difficult for a fund manager to buy, sell or value quickly. Examples include unlisted securities, property and infrastructure assets.

The benefits of holding illiquid assets in open-ended funds include that they can produce good medium- to long-term returns and certain illiquid assets such as national infrastructure can benefit the wider economy. However, they also give rise to difficulties – they are not revalued every day, so a fund manager cannot be certain that investors are getting a fair price when selling. There is also the risk of those exiting being favoured over those who hold illiquid assets for a longer term, as the fund manager may need to sell assets to raise the cash to pay these early leavers.

Liquidity management tools

A key aim of the regulation of open-ended funds is to ensure investors can exercise their redemption rights effectively. Liquidity management can help achieve this aim.

The paper highlights several factors to consider when determining a fund's liquidity. Low levels of cash inevitably make for potentially higher returns, but mean the fund is less well prepared for sudden market changes or an increase in redemption demands. High levels of cash come with reduced liquidity risk, but more modest investment performance.

The DP highlights ways to combat the liquidity risk, such as use of "redemption charges" to encourage medium- to long-term investment and asset valuation measures such as using a fair value pricing adjustment. It is clear that the FCA considers suspending dealing to be a last resort and to be used only after all other options have been discounted.

Improving liquidity

The DP offers a number of suggestions for improving liquidity management, including:

- preventing retail and professional investors participating in the same fund – it is noted this would require extensive restructuring and some retail-only funds may not be commercially viable;
- active management to avoid one investor acquiring more than a certain proportion of the fund;
- a cap on illiquid assets or minimum amount to be held in cash; and
- rules against high redemption frequency – however, this runs the risk of accumulating multiple orders being executed at a single point.

It is clear that there is no easy solution. The very aim of open-ended funds is for investors to be able to exit quickly if they need to; however, illiquid holdings offer potentially better returns in the longer term. How the balance between these two issues is struck may well be best left to individual fund managers to determine.

Implementation of the Enforcement Review and the Green Report

FCA PS17/1, PRA PS2/17, February 2017

The regulators published a joint Practice Statement on the *Implementation of the Enforcement Review and the Green Report* setting out changes they are making to their enforcement decision-making process as a result of recommendations in the Treasury's *Review of enforcement decision-making at the financial services regulators* (the Review) and Andrew Green QC's Report into the FSA's enforcement actions following the failure of HBOS (the Green Report) as referred to in a previous update.

These changes will have significant implications for all firms that may be subject to FCA and/or PRA investigation, in particular the introduction of a partly contested cases procedure. It is also part of a growing trend (also seen in the FCA's Business Plan and Mission Statement) towards the regulators being more open about how they will approach enforcement decisions.

Referral decision-making (FCA only)

The Review recommended that the regulators formally consider a full range of regulatory options for referral criteria. The FCA's response is that its Enforcement Referral Document (ERD) now includes a table setting out all potential subjects and the reasons why a firm or individual is or is not being referred for investigation. As promised, it has also since consulted on providing a set of guiding principles that determine the strategic choices it makes in its Mission Statement. Unsurprisingly both regulators emphasised the importance of keeping a significant amount of discretion in deciding whether a matter should be referred for investigation. A guide to the PRA's enforcement process is expected later in 2017.

Cooperation between the regulators in investigations (FCA and PRA)

Going forward meetings between both regulators will take place at least quarterly with representatives from supervision and enforcement. Subject representations before the scope of an investigation is changed will not be introduced.

The FCA will amend the Enforcement Guide (EG) to ensure that joint information requests make clear which parts of the request relate to which investigation, in order that subjects can be satisfied that the information sought is within scope. The PRA will formalise this approach in its guide to enforcement processes to be published this year along with proposals to establish an Enforcement Decision Making Committee.

Subjects' understanding and representations in investigations (FCA and PRA)

The Review and the Green Report recommended that the regulators provide more information to subjects regarding their referral to enforcement for investigation and increase the involvement of supervision to ensure all parties understand the relevant context. Both regulators will ensure that the subject of an investigation is given more information on the basis for its referral to enforcement; explanations for referral will cross-refer to the published referral criteria and more information about the context in which the alleged breaches occurred is promised. Investigators will also provide periodic updates about the progress of investigations and next steps. Internally, the FCA has amended EG to provide that in most cases it will be helpful for the referring area to inform the investigation team of such matters as the firm's business model and market practice issues.

Settlement (FCA and PRA)

The regulators are interested in considering how best to promote early, constructive engagement between investigators and subjects with a view to encouraging early admissions and settlement. The FCA intends to explore this issue further in its forthcoming penalty policy review and the PRA will do so in a planned review of its settlement policy. Striking a balance between the benefit of concluding matters quickly with the need to understand the full extent of the misconduct is a particular challenge.

Settlement (FCA only)

As to the FCA's own procedures, in order to improve the effectiveness of stage 1, it has concluded that it will aim to give 28 days' notice of the beginning of stage 1; and, "where appropriate", offer a preliminary without prejudice meeting to explain the FCA's view of the misconduct (including key factual and legal bases). It will not provide a list of all documents received during the investigation or provide those that it has not relied upon.

Partly contested cases

A particular concern the FCA has is that current stage 1 settlements do not benefit from the independent oversight of either the Regulatory Decisions Committee (RDC) or the Upper Tribunal. In the interests of narrowing the issues and encouraging more referrals to the RDC, amendments to DEPP and EG have been made to enable subjects to partially contest decisions via a "focused resolution agreement" (FRA) as follows:

- Penalty only: the FCA and the subject will enter an FRA wherein the subject accepts all facts and breaches arising therefrom but disputes the penalty imposed. The discount for contesting penalty only will be set at 30 per cent.
- Liability and penalty: the FRA will agree all the facts but enable the subject to contest whether they amount to the alleged breaches and the outcome. The subject can obtain up to a 30 per cent discount at the RDC's discretion.
- Facts, liability and penalty: the FRA will agree on some limited combination of facts, liability and penalty enabling the subject to dispute those areas not agreed (e.g. there is agreement on one allegation but not another). They will be eligible for a discount (of up to 30 per cent) as determined by the RDC and reflecting the extent of agreement.

Full settlement at stage 1 will continue to be possible but stage 2 and stage 3 discounts (of 20 and 10 per cent) will be abolished.

The FCA will also clarify the involvement of its senior management in settlement negotiations and increase the visibility of the project sponsor. It will also regularly review the process (but not the substance) of settled cases, including seeking comments from those who have settled, and the RDC will monitor the effectiveness of changes to the settlement process; this may lead to further consultation.

Contested decision-making (FCA only)

The FCA proposes to make it clearer to subjects under investigation that a person who has received a decision notice and has not previously made any representations to the FCA may nevertheless refer the FCA's decision to the Upper Tribunal.

An FCA review of the RDC's work including the settlement process review will be published annually. The FCA also clarifies that, except in particularly complex cases, the same RDC members who issue a decision notice may also decide to issue a warning notice on the basis this will enable hearings to be arranged more swiftly.

All of the above changes are now in force. The most significant of the above changes is the introduction of partly contested referrals to the RDC. The prospect of retaining up to a 30 per cent discount whilst still disputing key issues may well prove attractive to some parties. It will be interesting to see what impact it has on RDC referrals and, in particular, whether it makes any difference to the speed and efficiency in resolving cases.

PPI complaints handling: FCA releases Policy Statement on final rules and guidance

FCA PS17/3, 2 March 2017

Following extensive consultation (CP15/39 and CP16/20) PS 17/3 sets out the FCA's final rules and guidance on PPI complaints handling, adopting almost all of the proposals consulted upon.

The policy statement provides for a new rule which sets a deadline, 29 August 2019, by which consumers will need to make their PPI complaints or lose the right to have them assessed by firms or the FOS. This rule will come into effect on 29 August 2017 and be coupled with a consumer awareness campaign. The FCA believes that the deadline will give consumers sufficient time to complain. However, it will not apply to future complaints regarding a rejected claim on a PPI policy that is live on the deadline, and rejected for reasons relating to the sale, e.g. exclusions or limitations.

It will recover the £42.2 million cost of the awareness campaign with a new fee rule, whereby 18 firms will each pay a contribution in proportion to the number of reported PPI complaints against them between 1 August 2009 and 31 August 2015.

One of the most controversial issues throughout the consultations was the impact of *Plevin v. Paragon Personal Finance Limited* [2014] UKSC 61. In this case the Supreme Court ruled that Paragon's non-disclosure of the large commission payable as part of the premium was unfair within s140A of the Consumer Credit Act 1974. Prior to that, under ICOBs, there was no requirement to disclose commissions and non-disclosure was not considered likely "in and of itself to have been a breach of [the FCA's] principles". Nevertheless, the FCA requires firms to identify and write to previously rejected *Plevin*-type complainants to inform them that they may complain again. The FCA has also decided to include profit share, in addition to commission, in its approach to PPI claims.

To ensure consistency, the policy statement provides rules and guidance on handling complaints, which will be applied by firms and taken into account by the FOS. The FCA emphasises that these are not a rigid set of prescriptions, but a "common framework" to promote consistency, and to ensure the "appropriate assessment and, where appropriate, redress in the light of s140A-B, taking account of *Plevin*".

The FCA's approach is that firms should presume a relationship to be unfair where it was reasonably foreseeable at the point of sale that the profit share or commission would exceed 50 per cent. Premising 50 per cent as a reasonable profit share, the redress due should be the difference between 50 per cent and any amount actually received in excess.

Firms will need to be prepared to (a) identify and contact former complainants, and (b) deal with an increase in the volume of PPI claims. Whilst firms will no doubt be relieved that the end of PPI is finally in sight, they still need to ensure prompt and fair treatment of customers over the next couple of years; the FCA has been very clear that it will continue to proactively and robustly supervise this issue until all complaints have been dealt with.

Supervisory Statement on best execution oversight failings and use of dealing commission

Statement on best execution, Statement on use of dealing commission, 3 March 2017

In early March, the FCA issued two Supervisory Statements (the Statements) on oversight of best execution and use of dealing commission.

The best execution Statement reports inadequate oversight of best execution in the market and a failure by firms in general to take on board the findings of the FCA's 2014 Thematic Review of best execution and conduct a gap analysis. TR14/13 had found (among other things) that most firms had inadequate best execution "management focus, front office business practices or supporting controls", and that firms did not properly understand the full extent of their best execution monitoring and management obligations.

The Statement's main criticisms are that:

- While firms have data showing accurate information on execution costs, such data was inconsistent, and some firms could not evidence improvement to their execution process based on such data.

- Generally, more is needed to ensure compliance with MiFID II and, specifically, to meet the obligation to check the fairness of prices proposed to clients when executing orders or taking decisions to deal in OTC products.

- Monitoring was often little more than a tick-box exercise. There were instances where compliance staff were unable to challenge effectively the front office on execution quality, either because they lacked access to relevant data or because they did not use data already available.

The Statement reflects that the changes required in relation to best execution are considered significant and resource-intensive. However, firms would be advised to take action to review their position and address any deficiencies in light of the failings identified as the FCA has warned it will revisit this issue during the course of 2017.

Following visits to 17 firms, the dealing commission Statement also reported deficiencies in particular in relation to research valuation and budgeting. In particular these relate to how firms:

- attribute a price or cost to substantive research if they receive it in return for dealing commission;

- record their assessments to demonstrate they're meeting COBS 11.6.3R and not spending more of customers' money than necessary;

- set research budgets, including linking budgets to historical spending rather than properly assessing the amount of research needed.

The FCA also raised concerns that firms with overseas operations and outsourced investment management services had failed to implement controls and oversight structures to ensure those activities comply with the rules.

The FCA has indicated an intention to continue to focus on deal commission arrangements and that they will consider taking further action in relation to breaches of the rules, including referrals for formal investigation.

Final rules on whistleblowing in UK branches of foreign banks

PS17/7, 3 May 2017

In October 2015 both regulators introduced new rules for UK-incorporated banks and insurers requiring particular internal whistleblowing procedures, including setting up a whistleblowing channel open to all, informing employees about the regulators' whistleblowing services and making a senior individual into a "Whistleblower's Champion".

In relation to UK branches of overseas banks (Overseas Branches) these requirements do not have the force of rules but are considered "good practice guidance". In September 2016 (in CP16/25) the FCA consulted on how whistleblowing requirements might apply to Overseas Branches.

Overseas Branches should be relieved that the FCA's final rules take a very light-touch approach and only require Overseas Branches to tell their UK-based employees about the FCA and PRA whistleblowing services. The only change to the original proposals is a new piece of guidance (at SYSC 18.3.6A) clarifying that reporting something to the FCA or PRA does not override any obligations to report matters to their home state regulators.

In line with what was originally consulted upon, the final rules also require Overseas Branches to tell staff that they may make use of sister or parent company whistleblowing arrangements where the Branch has a sister or parent company which is subject to the full whistleblowing requirements. However, for many firms this may not be applicable.

Overseas Branches will need to ensure their internal documents comply with the new measures in time for the implementation deadline of 7 September 2017. For Overseas Branches considering whether to adopt a full whistleblowing policy may wish to consider and discuss with their advisers the points made in CP16/25, in particular the potential for conflict with home state laws and difficulties in providing genuine anonymity if the number of employees at the Branch is low.

Final rules and guidance on remuneration for CRD IV firms

PS17/10, 3 May 2017

These final rules and guidance (which took effect immediately) affect firms subject to SYSC 19A, 19C and 19D but also those within their group. The amendments to the Handbook and FCA guidance notes (FG 17/6, 17/7 and 17/8) are made to align the FCA position with the EBA Guidelines on proportionality published in December 2015 (which have been in force since 1 January 2017). In addition new guidance is issued in the form of remuneration FAQs (FG17/5).

Subsidiaries without their own remuneration committee should consider the new guidance at question 4 of the FAQs, which sets out the test for "significance" and clarifies that this must be assessed on a standalone basis.

In relation to long-term incentive plans (LTIPs) the guidance is amended to clarify that it is not sufficient just to assess individual performance at the point of grant with malus adjustment prior to vesting. Firms may need to review how their LTIPs work in practice and ensure that individual performance (as well as that of the firm and business unit) is considered both at the point of grant of an award and in the period prior to vesting, notwithstanding that malus adjustments may also be applied.

Limited licence and limited activity firms will welcome the amendments to paragraph 4.6 of the SYSC 19A and 19D guidance returning it to its former state such that they may disapply fixed/variable ratios under the proportionality rule in appropriate circumstances.

FCA consultation on implementation on PSD2

CP17/11, 13 April 2017

The FCA is consulting on proposals for implementing the Payment Services Regulations 2017 (PSRs). The PSRs will implement the EU Payment Services Directive (PSD2) and are required to be in effect by 13 January 2018.

The FCA proposes to adopt a new Approach Document on the FCA's approach to interpreting and applying the PSRs. It will replace both the existing Payment Services Approach Document and the E-money Approach Document.

The FCA is also consulting, as a result of the changes under PSD2, on (among other things):

- amendments to the Perimeter Guidance Manual to narrow the commercial agent exclusion such that, to be excluded, the commercial agent must only act for the payer or the payee;
- new requirements authorisation and passporting requirements;
- changes to the rules relating to complaints handling;
- new complaints reporting requirements for payment service providers and a new approach to collecting data on payment services fraud; and
- the regulation of account information providers.

The consultation closed on 8 June 2017 and a policy statement should be released in Q3 2017.

FCA's implementation of MiFID II

PS17/5, 31 March 2017; CP17/8, 12 May 2017

The FCA has been consulting since 2015 on the implementation of MiFID II. Recent progress on this is as follows:

- In March 2017, policy statement PS17/5 was published. This sets out the FCA's rules covering: (a) secondary trading of financial instruments; (b) commodity position limits; (c) management and reporting for derivative trading contracts; and (d) firm organisation and conduct.

In May 2017 the FCA issued consultation paper CP17/8. There were two main aspects to this consultation: chapter 2, which covers occupational pension scheme firms; and chapters 3 and 4, which cover changes to DEPP and EG and consequential Handbook amendments. The FCA expects to issue its policy statement on chapters 3 and 4 in June 2017.

PRA updates Supervisory Statement on Internal Governance to reflect MiFID II

SS21/15 UPDATE, 28 April 2017

The PRA's Supervisory Statement on Internal Governance has been updated to reflect the implementation of MiFID II. Specifically, the reference to MiFID in paragraph 2.26 on record keeping for non-MiFID business has been replaced by a reference to MiFID II. This update followed the publication of PS9/17, "Implementation of MiFID II: Part 2", and will take effect on 3 January 2018.

The Impact of Macris

Christian Bittar v. The Financial Conduct Authority [2015] UKUT 602 (TCC); *Julien Grout v. The Financial Conduct Authority* [2016] UKUT 0302 (TCC); *Philippe Moryoussef v. FCA* (FS/2015/0008 and FS/2015/0009); *Javier Martin-Artajo v. FCA* [2014] UKUT 0304 (TCC)

Recent developments in a number of cases against the FCA demonstrate that the significance of the Supreme Court's judgment in *FCA v. Macris*, summarised above is already being felt.

In Mr Bittar's reference to the Upper Tribunal, he argued that he had been prejudicially identified by the FCA in a Decision Notice and a Final Notice issued to Deutsche Bank for benchmark manipulation. The Upper Tribunal found in Mr Bittar's favour on the preliminary issue of whether or not he had been identified in the relevant manner in the FCA's notices, and the FCA's application for permission to appeal against that decision was stayed pending the decision in *Macris*. However, in light of the decision in that case, and the Supreme Court's narrow interpretation of s393 of FSMA, Mr Bittar has now withdrawn his reference.

Similarly, references made to the Upper Tribunal by Mr Moryoussef, former employee of Barclays Bank PLC, and Mr Martin-Artajo, former JP Morgan Chase employee, were stayed pending the decision in *Macris* and have now been withdrawn.

Mr Grout, meanwhile, has not dropped his challenge. In its decision of 7 July 2016, the Upper Tribunal determined that Mr Grout had been identified in a Final Notice issued to JP Morgan Chase in connection with the London Whale case. In particular, the Upper Tribunal found that reference to the "traders on the SCP [Synthetic Credit Portfolio]" was sufficiently specific to identify Mr Grout. The FCA sought to appeal that decision, and the appeal was stayed pending the Supreme Court's decision in *Macris*. That appeal hearing is now listed for 7 July 2017, and it will be interesting to see whether Mr Grout is able to successfully argue that, even applying the restrictive test developed by the Supreme Court, he was nevertheless identified in the relevant manner by the FCA in its Final Notice.

In any event, the number of such references that have recently been withdrawn demonstrates the significant impact that *Macris* will have on third parties to whom reference is made in a notice issued by the FCA, and the difficulty that individuals will now face in seeking to challenge the FCA's approach.

FCA consults on compulsion powers in relation to LIBOR

CP17/15, 12 June 2017

In June 2017, the FCA published a consultation paper setting out its proposed approach with regard to its compulsion powers for contributions to the London Interbank Offered Rate (LIBOR).

Under the Financial Services and Markets Act 2000 (FSMA), the FCA has the power to require banks to make LIBOR contributions, either by using its own initiative powers under s.55L of FSMA, or by making a rule under s.137A or s.137F of FSMA.

However, the FCA anticipates that LIBOR will be designated as a critical benchmark under the Benchmarks Regulation (BMR) in due course. As a consequence, the FCA's powers under FSMA would be replaced by the compulsion powers set out in Article 23 BMR. Accordingly, CP17/5 sets out the FCA's proposed approach to its compulsion powers under the BMR.

Under the BMR, compulsion of contributors to a critical benchmark must be based on their actual and potential participation in the market that the relevant benchmark intends to measure. Therefore, in order to establish the population of banks to compel, the FCA will start by measuring the relevant market. The FCA proposes that the relevant market for these purposes should be defined as "the interbank and corporate unsecured wholesale funding market for GBP, USD, EUR, CHF and JPY involving large banks that have good credit quality and a presence in the United Kingdom". Therefore, the FCA will, in effect, select banks of a similar size and credit quality to the existing panel banks, to avoid changing the nature of LIBOR.

In order to apply that participation test, the FCA proposes pre-selecting banks which fit the three limbs of the description (size, credit quality and presence in the UK). From that pre-selected population, the FCA will request further data measuring actual and potential participation to produce a ranking of the most appropriate banks to be on the panel. Actual participation will be measured by the number and value of transactions in the market. Potential participation will be measured on the basis of factors including the size of the banking group, participation in related markets and the bank's lending and borrowing activity.

The consultation paper makes clear that the FCA will intervene by using its compulsion powers to protect the representativeness of LIBOR only if this is necessary for market integrity or consumer protection, and in accordance with the BMR where applicable. It does not envisage supporting LIBOR by using its compulsion powers indefinitely.

However, the consultation paper does not address the wider issue of banks' potential reluctance in helping to set LIBOR - particularly in the wake of the LIBOR scandals of recent years. That reluctance may, in part, be an unintended consequence of the FCA's increased focus on accountability, and increased regulation in this area, which may have made certain kinds of activity less attractive for firms.

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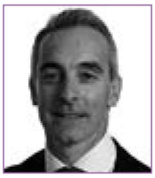

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