dentons.com

大成 DENTONS

Insight

Dentons Financial Markets Disputes and Regulatory Update

Issue 6 | January 2018

In this edition of *Dentons Financial Markets Disputes and Regulatory Update*, we have considered the key financial markets cases, and UK conduct-related regulatory action, from the second half of 2017, and have drawn conclusions as to the likely direction of travel in these areas and the implications for 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 second half of 2017?

Court decisions/impacts 3
Regulatory developments 3
What to watch out for 4

Judgments

Court of Appeal upholds consistent interpretation of ISDA Master Agreement 5
When can a note trustee lawfully adopt expenses incurred by noteholders? 6
Who can sue for breach of the non-payment terms of a bearer note? 7
Commercial Court highlights the importance of how default interest clauses are drafted 8
No duty of care owed by banks to customers in relation to IRHP review 8
Acceptance of settlement offer as part of IRHP review precluded subsequent claim for consequential loss 10
Agency, effect of a bribe on the enforceability of a contract by a third party, and the effect of a conflict of interest 11
Situs of the debt owed under letters of credit 12
When and how dishonesty needs to be shown 13
Application and rejection of the "Braganza Duty" in case of "classic abusive trading" 15
Fetters on contractual discretion 16
Unwinding a loan participation where the deadline for meeting a condition has expired 18
Claim for breach of mandate and failure to operate stop loss protection upheld against discretionary fund manager 18
Successful claim for damages for breach of FCA rules in relation to advice and whether a decision said to amount to "financial suicide" should affect causation 20
Meaning of financial institution and right of a party already in default under an ISDA Master Agreement to terminate for the default of the other party 22
Substantially negotiated LMA facility agreements not caught by section 3 of UCTA 22
Unfair relationships under the Consumer Credit Act 1974 23
Preliminary ruling on the requirement for "plain intelligible language" in consumer contracts 24
Effecting service of proceedings on uncommunicative defendants 25
Duty of care owed by Arranger in relation to the execution of sukuk documents 25
Choice of English governing law upheld over arguments of non-Shariah compliance 26
Quantum of damages where loan advanced on the basis of a negligent valuation 27
Application for summary judgment granted after nine-day hearing 28
Privy Council decision on pre-contract representations in a commercial borrower-lender relationship 29

Regulatory developments

Senior managers regime, certification regime and conduct rules (SMCR) 30
Final notices 32
Complaints in relation to the FCA 34
Benchmarks 36
Advice and customer understanding 37
Asset management 40
AML 41
Other developments 42

About Dentons' Financial Markets Disputes and Regulatory Practice

What can we learn from the second half of 2017?

Court decisions/impacts

Cases which consider the construction and use of standard form financial agreements almost always deserve reading. Most notable in this category is the judgment of the Court of Appeal in *Dexia v. Comune di Prato*, allowing an appeal by Dexia against a first instance decision that would have caused considerable uncertainty for parties using standard form agreements governed by English law (in this case, the 1992 ISDA Master Agreement) in other jurisdictions.

The Supreme Court has intervened to correct longstanding errors in relation to two areas of law: first, in overhauling the *Ghosh* test applied to criminal cases involving dishonesty, and second, in dealing with the question of where debts due pursuant to Letters of Credit are situated.

The court has also been called upon in two cases we consider below to decide claims based on the way in which the banks involved exercised their discretion. There have recently been a number of cases involving similar claims, suggesting that this is an area where boundaries are still being tested. The judgments we summarise below contribute to defining those boundaries.

Finally, it is also well worth considering the Court of Appeal's judgment in *UBS v. Kommunale Wasserwerke Leipzig*. The judgment considers a number of complex areas of the law, including agency, bribery (and its effects) and conflict of interest. Banks will wish to reflect on the implications of the case for, amongst other things, their procedures for communicating with a counterparty's agent.

Regulatory developments

Many of the key regulatory developments of the past six months fit within broad patterns of interest on the part of the FCA, and we can expect these patterns to repeat into next year.

In terms of enforcement, the second half of the year, like the first, has not seen a large number of fines compared to previous years, but the FCA's Enforcement annual performance account for 2016/2017 indicates that it has a large and increasing number of open investigations, the areas of financial crime, insider dealing and market manipulation seeing a particular upsurge in activity. There has also been a small but significant increase in the number of capital market disclosure investigations (and fines issued), reflecting the FCA's stated concerns in this area. Listed companies and their advisers will want to ensure they have the right internal procedures for escalating and considering information that could affect the share price.

The FCA has started a large piece of work in relation to asset management which nicely illustrates some of its general areas of interest both within and outside this specific sector. First, the FCA is showing considerable interest in the functioning of competition in the asset management industry – it has initiated its first use of its own competition enforcement powers, and has also pressed ahead with a reference to the Competition and Markets Authority in relation to investment consultancy services.

Second, the FCA has targeted part of its remedies package at issues surrounding fund governance, and at the composition and considerations required of fund manager boards.

Part of this relates to a third, continuing preoccupation within the FCA in relation to pricing. One of the key planks in the FCA's response to its view of weak competition in the asset management industry is to require the boards of fund managers to report annually on the extent to which a fund has achieved value for money for its investors, and the FCA has supplied some mandatory considerations that must feed into this assessment. It seems quite likely that, should the FCA consider that this approach has worked, it might be adapted to other areas. Continuing the theme, the FCA produced a Strategic Review of Retail Banking Business Models in October 2017, which has as one of its key focuses the "free-if-in-credit" model for retail banking.

In turn linked to this is a dual interest in behavioural economics, and the use of technology. The Strategic Review referred to above is also concerned with the development of business models in light of the increasing demand for, and use of, financial technology. Much of the FCA's recent work in relation to advice models (following the Financial Advice Market Review) has focused on automated or semi-automated systems and on the importance of analysing the behaviour of customers using them. Finally, it is also clear that the FCA has its eye on technology more widely – in a recent speech, Stefan Hunt, the Head of Behavioural Economics at the FCA, outlined the future of technology as a regulatory tool, including in predicting potential issues.

These are wider trends that we can see illustrated by developments in the second half of 2017, but which we can also expect to see rolling forwards into next year.

What to watch out for

Litigation

The trial in *Sharp v. Blank* (in relation to the acquisition by Lloyds of HBOS at the height of the financial crisis) has attracted some press coverage, and it seems likely that judgment in that case will be handed down in the first half of 2018.

The trial of claims by Dutch housing co-operative Stichting Vestia against Deutsche Bank, in relation to the sale of interest rate derivatives allegedly procured by bribery, is expected to start in spring 2018, and is likely to be interesting.

In addition, appeals in a number of significant cases are due to be heard early next year. Of these, one relates to the first decision in LBI v. RZB (in relation to close out under the GMRA), and is due to be heard in March. Another is the appeal in *Property Alliance Group v. RBS*, in which the Court of Appeal will consider the only first instance decision on whether a LIBOR setting bank, when selling products referenced to a LIBOR rate, made implied representations as to the veracity of that rate. Judgment in both is likely to follow in the first half of 2018.

Regulatory and other developments

The big event of early 2018 is the implementation of MiFID II, at the very start of the year. Other developments in the first half of next year are likely to include the publication of final rules in relation to the extension of the Senior Managers and Certification Regimes to all authorised firms. The FCA may also take the opportunity to clarify the position of General Counsel under these regimes, which has been an outstanding issue for some time.

The FCA has a long-outstanding promise to review its financial penalty policy; though no specific date has been set, it is likely to consult on this issue in 2018.

Early 2018 is also likely to see final rules introduced following some of the consultations to which we refer in this update. This includes final rules relating to pension transfers, and incentives, remuneration and performance management in consumer credit firms.

There are also likely to be further developments in relation to two of the FCA's larger projects: in relation to asset management (where the FCA has several items of unfinished business); retail banking, where an update is promised in Q2; and benchmarks, chiefly the introduction of the Benchmarks Regulation and the planned transition from LIBOR to SONIA.

Judgments

Court of Appeal upholds consistent interpretation of ISDA Master Agreement

Dexia Crediop S.P.A. v. Comune di Prato [2017] EWCA Civ 428

Dexia was appointed as Prato's adviser in relation to debt restructuring and interest rate swaps in 2002. In November 2002, Dexia and Prato entered into an ISDA Master Agreement (1992 version), containing English choice of law and jurisdiction clauses, pursuant to which they entered into six interest rate swap transactions. From late 2010, Prato stopped making payments due under the sixth (and only outstanding) swap and began a process of administrative self-redress in Italy. Dexia started proceedings in England, claiming the sums due to it. Prato defended the proceedings in the English court on bases including: (a) that the swaps were void as a matter of English law because of Prato's lack of capacity; and (b) Prato was entitled to treat the swaps as null and void, because of breaches by Dexia of mandatory rules of Italian law.

The aspect of this case which had considerable practical relevance was the superficially abstract question of the role of article 3(3) of the Rome Convention[1]. Prato relied on article 3(3), which states that: "The fact that the parties have chosen a foreign law, whether or not accompanied by the choice of a foreign tribunal, shall not, where all the other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of rules of the law of that country which cannot be derogated from by contract, hereinafter called 'mandatory rules'." Prato argued that article 3(3) was engaged, because the swap was only connected with Italy. It alleged that Dexia had breached a number of requirements of Italian law that were properly characterised as mandatory rules, with the consequence that the swap was voidable by Prato. The judge at first instance agreed, holding (in summary) that neither the use of a globally-accepted, standard form ISDA Master Agreement, or Dexia's use of banks outside Italy in order to hedge its own exposure, amounted to a connection with a country other than Italy. Dexia had therefore been obliged to comply with any mandatory rules of Italian law (which it had not). Please click here for our summary of the first instance decision.

In essence, therefore, the judge determined that "standard form" was not as standard as Dexia thought. In concluding an agreement with Prato, it had been obliged to take into account a number of Italian law requirements that the ISDA framework did not contemplate. If this judgment were correct, there would be both legal and commercial implications.

Only a short time after the first instance judgment in Prato, the Commercial Court came to a different view in *Banco Santander Totta SA v. Companhia de Carris de Ferro de Lisboa SA* [2016] EWHC 465 (Comm) (please click here for our summary of that judgment). In that case, the court held that it was enough to consider elements pointing away from the purely domestic, and there was no need to establish a connection with another specific jurisdiction (as the judge in Prato had appeared to consider necessary. This decision, while arguably preferable to that in Prato, appeared to conflict with it.

That conflict has now been resolved by the Court of Appeal in two judgments of 2017. The first upheld the decision at first instance in the *Banco Santander* case. The more recent, in the Prato litigation, applied the same principle to similar effect. The Court of Appeal in Prato was bound to follow the decision on appeal in *Banco Santander* as to the meaning of article 3(3). Consequently, it held that there was no need to establish a link to a specific jurisdiction other than Italy, provided that there were elements that lent an international flavour and pointed away from Italy.

In this regard, the judgment notes two elements, each of which would be sufficient to break the exclusive connection of the transaction with Italy:

1. use of the ISDA Master Agreement, in particular its international nature, the fact that the use of the Multicurrency – Cross-Border form contemplates the involvement of more than one country or currency, and the fact that the agreement was signed in English (not the first language of either party); and
2. back-to-back hedging of the swap by Dexia outside Italy, which was

1 The relevant contracts were all made between 1 April 1991 and 16 December 2009. The Rome Convention was replaced by Regulation (EC) No 593/2008 (Rome I), applicable to more recent commercial contracts, but Rome I largely replicates the provisions of article 3(3) (see recital (15) and article 3(3) of Rome I).

described as "highly significant".

Both judgments by the Court of Appeal should come as a relief to banks routinely using standard form documentation such as that provided by ISDA. They provide some comfort that English courts are likely to take a consistent approach to parties' obligations, irrespective of the jurisdiction in which the transactions actually happen and that, in most cases, parties will not have to build tailored local requirements into the standard forms they use.

When can a note trustee lawfully adopt expenses incurred by noteholders?

UBS AG, London Branch v. GLAS Trust Corporation Ltd. and another [2017] EWHC 1788 (Comm)

A securitisation transaction took place in 2006, the subject of which was cashflows generated by a portfolio of sheltered housing. Such cashflows were to be used by the issuer of the notes in this case (the Notes) to repay its debts to the holders of the Notes (the Noteholders). The cashflows were also to be used in order to meet any payments due to UBS and another entity (together, the Issuer Swap Counterparties). Such payments arose as a result of swaps entered into by UBS and the issuer as part of the overall transaction. Cashflows generated by the portfolio became insufficient to pay both the Issuer Swap Counterparties and the Noteholders, who effectively became competing creditors. UBS terminated the swaps in October 2015, the termination amount being almost £312 million.

At around the same time:

- an ad hoc group of the Noteholders (referred to throughout the judgment as the AHG) replaced the original note trustee with GLAS Trust Corporation Ltd. (the Note Trustee), apparently on the basis that it would be more "proactive";
- the issuer failed to pay the interest due on the Notes; and
- the Note Trustee directed the cash manager not to make payments under the swaps.

In August 2016, the issuer purported to rescind the UBS swaps on the basis of alleged fraudulent misrepresentations (which UBS denies), but no proceedings were started in that regard. The parties have also been considering a restructuring of the transaction since 2015.

The AHG, in the meantime, had instructed Freshfields and N.M. Rothschild & Sons Ltd (together the AHG Advisers). Their combined fees for the year March 2015 to March 2016 were approximately £2.5 million (the AHG expenses). In March 2016, the Noteholders passed an Extraordinary Resolution to "authorise and direct the Note Trustee to execute a Fee Letter" with the AHG Advisers so as to pay the AHG expenses "as an expense of the Note Trustee which will be provided for and reimbursed by the Issuer to the Note Trustee..." As well as paying the fees already incurred, the Note Trustee proposed to pay the AHG Advisers for their work after March 2016 (which, in the case of Rothschild, included a £75,000 per month retainer and a £3.75 million transaction success fee). The AHG Advisers were not advising on the swaps dispute.

UBS argued that the Note Trustee had no power to incur and claim reimbursement of these costs. The practical significance for UBS was that, as would be expected, the transaction documents provided for a pre-enforcement payments

waterfall. In that waterfall, UBS ranked above the Noteholders, but below the Note Trustee's right to recover its expenses. UBS took the view that the AHG was effectively trying to jump the queue, by getting the Note Trustee to pay for its advice.

The issue was one of construction – under the relevant clauses of the Issuer Deed of Charge (IDC) and the Note Trust Deed (NTD), the issuer was obliged to pay for certain costs properly incurred by the Note Trustee. The obligation arose in relation to all "legal fees" and "other costs, charges, liabilities, damages and expenses" which had properly been incurred by the Note Trustee in relation to four broadly described categories of activity by the Note Trustee. UBS disputed whether the fees of the AHG Advisers came within the scope of such clauses.

The judge described clauses dealing with trustees' expenses as typically widely drafted and to be given a "commercial and not artificially restricted meaning... This reflects the fact that the exercise of the trustee's powers may contain a substantial measure of judgement, may be controversial, and may have to be carried out speedily to enable resolution of the transaction. Of course, the position depends on the construction of the particular clause, but subject to that, the trustee should be able to fulfil its duties with confidence that if it acts in a commercially reasonable manner, it will be entitled to indemnification".

Having said that, the judge decided that the Note Trustee was not entitled to adopt the past and future AHG expenses "en bloc", on the basis that this would effectively surrender the trustee's duty to form an independent view as to whether the costs were properly incurred. He also noted a continuing lack of transparency as to what the costs related to, and a doubt as to the extent to which the Note Trustee could pay for advice on which it expressly could not rely. He added that "it is evident that the adoption of the expenses in such circumstances required a degree of careful scrutiny by the Note Trustee in order to form the opinion that the expenses were properly incurred".

The judge's conclusion on this point is not surprising, and the Note Trustee itself had conceded the point at trial. However, the judge was clearly not keen for unnecessary expense to be incurred in the Note Trustee and the AHG duplicating advice.

The practical difficulties facing the Note Trustee following this judgment (largely in assessing a significant amount of costs in order to determine whether they were properly incurred for these purposes) argue in favour of finding a different way of dealing with similar situations, which avoids the trustee becoming too enmeshed in the partisan interests of noteholders. There seems no reason why trustees and noteholders should not liaise on what advice needs to be obtained and from whom, and this case illustrates the risks of not doing so.

Who can sue for breach of the non-payment terms of a bearer note?

Secure Capital SA v. Credit Suisse AG [2017] EWCA Civ 1486

Secure Capital SA (SC) was the owner of the entire beneficial interest in a series of notes issued by Credit Suisse (the Notes). The Notes were governed by English law and issued in bearer form. SC held its interest in the Notes through Clearstream. It argued that a provision of Luxembourg law (under which Clearstream operates) gave it the right to assert a claim directly against Credit Suisse for breach of a term of the Notes, to the effect that Credit Suisse had taken all reasonable care to ensure that information it provided in relation to the Notes was correct, and that there were no omissions that would make the information misleading. Please click here for a link to our summary of the first instance decision.

The Notes were issued in bearer form, each one represented by a single Permanent Global Security which was held by Bank of New York Mellon (BNYM) as common depositary. Interests in the Notes were traded through Clearstream, between accounts held by its members (Account Holders), including, in this case, RBS Global Banking Luxembourg SA (RBSL). Payments due under the Notes would be made by Credit Suisse to Clearstream, and from Clearstream to the Account Holders, who would distribute any sums as appropriate to those of their clients who had an interest in the Notes (the Account Owners). Ultimately, and prior to the issue of these proceedings, RBSL held the whole interest in the Notes for the account of SC as Account Owner.

The Court of Appeal noted the "no look through" principle, under which this system operates. In other words, each link in the chain only has recourse against its immediate counterparty. On this basis, English law gives SC no right to sue Credit Suisse for a breach of the terms of the Notes. SC, however, relied on a provision of Luxembourg law, as the law applying to settlements under the Clearstream system. In particular, it relied on Article 8(1) of Luxembourg law dated August 2001 on the circulation of securities. That provision stated that "the investor may exercise or arrange to exercise corporate rights attached to the securities and the rights attaching to the holding of securities linked to the possession of the securities by producing a certificate drawn up by the relevant account holder attesting to the number of securities registered in its custody account".

SC did not argue that it was entitled to assert the rights of the bearer of the Notes (accepting that BNYM retained those rights), but said that it was entitled to assert a "parallel

but independent right of action" that did not fit existing categorisations (such as contractual or proprietary) and should be treated *sui generis*. SC argued, in summary, that English law governed the question of whether there had been a breach of the Notes, but that the question of who was entitled to sue was for Luxembourg law as the law of the settlement system. Further, it argued that the relevant aspect of Luxembourg law was incorporated by reference into the terms of the Notes (an argument that the Court of Appeal rejected on the facts).

Lord Justice David Richards, giving the Court of Appeal's judgment, dismissed SC's appeal. He said: "Under English conflicts of law principles, the identification of the parties entitled to sue on a contract is governed by the proper law of the contract." In this case, that was English law and, on that basis, the only person entitled to sue Credit Suisse on the terms of the Notes was their holder, BNYM. He also rejected the argument that the "no look through" principle applied only to payment obligations. The Court of Appeal also stated that SC's approach could lead to a potentially "incoherent, if not chaotic" result. Clearstream is governed by the laws of Luxembourg, but there are other settlement systems governed by other laws, e.g. Euroclear (subject to Belgian law) and the DTC (subject to US law). On that basis, the issue of whether or not an issuer would be subject to direct claims from those having an interest in securities would depend on the system through which those interests were held.

One of the interesting aspects of the judgment is the pragmatic (and quite robust) approach of the Court of Appeal. It found that parties like SC knew that they were, in fact, trading in interests in securities, not the securities themselves. The limitations on direct action were part of an overall package of rights that a party in the position of SC chose to trade.

This decision is unsurprising, in that SC's arguments were somewhat ambitious set against the language of the Notes. However, the judgment is also welcome, in that any decision to the contrary would have opened the way for the chaotic result the Court of Appeal identified.

Commercial Court highlights the importance of how default interest clauses are drafted

The Law Debenture Trust Corporation plc v. Ukraine [2017] EWHC 1902 (Comm)

On 29 March 2017, Mr Justice Blair (the Judge) in the Commercial Court gave summary judgment for US$3 billion in proceedings relating to a Eurobond issue. The issuer was Ukraine, and the sole noteholder was the Russian Federation. The decision dealt with complex issues regarding conflicts of laws and non-justiciability. The Court dismissed Ukraine's arguments on capacity and alleged duress. That judgment attracted considerable attention.

Judgment was handed down in July 2017 in relation to a number of consequential matters. This judgment is significant in relation to its consideration of the appropriate rate of interest on the amounts Ukraine was ordered to pay to Law Debenture (the Note Trustee), and it highlights the importance of how the default interest provision is drafted. In case of late payment, the trust deed governing the relevant notes (the Trust Deed) specified interest, both before and after judgment, at 5 per cent or (if higher) the rate of interest on judgment debts for the time being provided by English law (presently 8 per cent). Ukraine argued that the judgment obtained by the Note Trustee was denominated in US dollars, and that there is no judgment rate in relation to foreign currency judgments, the question of the appropriate rate of interest being at the court's discretion. On that basis, Ukraine argued that it should only be ordered to pay five per cent. The Judge found that, by the clause as drafted, the parties had agreed to apply the judgment rate for sterling judgments to a non-sterling sum, and the court should enforce that bargain. On that basis, the Judge ordered that the higher rate of 8 per cent was applicable both pre and post judgment. In his reasoning, the judge acknowledged that Ukraine's point would have been valid, and the court's discretion would have come into play, had the clause not been drafted as it was.

The Judge took a contrasting approach to an unpaid coupon which fell outside the drafting of the default interest clause in the Trust Deed. Here, the court used its discretion to determine the appropriate rate of interest (held to be US dollar three-month LIBOR plus 2 per cent).

The decision, and the marked contrast between the rate of interest arrived at by using the contractual drafting as compared with the rate determined by the Judge at his discretion, illustrates the practical importance of drafting default interest clauses carefully. The court granted permission to both sides to appeal and the appeal is due to be heard in January.

No duty of care owed by banks to customers in relation to IRHP review

(1) CGL Group Limited; (2) Jacqueline Bartels and Adrian Bartels; (3) WW Property Investments Limited v. (1) The Royal Bank of Scotland plc and National Westminster Bank plc; (2) Barclays Bank plc; (3) National Westminster Bank plc [2017] EWCA Civ 1073

The Court of Appeal decided that banks do not owe a duty of care to customers in relation to their conduct of the review agreed between the banks and the Financial Conduct Authority (FCA) in relation to past sales of interest rate hedging products (the IRHP Review).

Each bank participating in the IRHP

Review agreed with the FCA that it would assess its past sales to each eligible customer (within the terms of the IRHP Review) against regulatory requirements, and would make an offer of redress to customers where appropriate. The entire exercise, together with all determinations of redress, would be overseen by an independent reviewer that the FCA required each bank to appoint as a skilled person. All customers were to be contacted by letter (the Letter) in order to explain the IRHP Review, the role of the FCA and the role of the independent reviewer.

In each case before the Court of Appeal, the claimants believed that they had a claim against the relevant bank arising out of alleged misselling of an IRHP. In two cases, the bank had a limitation defence to certain of the claims made. The claimants in each case had participated in the IRHP Review carried out by the relevant bank, but had been dissatisfied with the outcome.

The claimants said that they had relied on the banks to undertake the IRHP Review competently, that the banks had failed to do this, and that it was fair, just and reasonable for a duty of care to be found to exist in a relationship that was akin to contract. They argued that the banks had assumed responsibility voluntarily, chiefly by means of the Letter[2].

Part of the judgment of Lord Justice Beatson considers the different tests applied by previous cases in determining whether a duty of care exists in relation to economic loss: the voluntary assumption of responsibility; the tripartite test in *Caparo v. Dickman* (foreseeability, proximity and "fair, just and reasonable"); and the so-called incremental approach. Having considered these tests, Beatson LJ concluded that the assumption of responsibility test was not the most

2 In the case of Mr and Mrs Bartels, it was also argued that the bank had voluntarily assumed responsibility by entering into the agreement with the FCA.

appropriate, but that, considering all factors relied on in earlier authorities, such factors pointed away from the existence of a duty of care. He found that this conclusion was confirmed by applying the other tests, in particular the one in *Caparo*. The reasons for this conclusion included:

- the regulatory context clearly weighed against the imposition of a duty of care, the Court of Appeal noting that it would be unusual for a common law duty to be imposed on a statutory one, particularly where the common law duty was more extensive;
- it was artificial to characterise the IRHP Review as a purely voluntary exercise, and in addition, the Letters (on which the claimants relied to a significant extent) were required to be sent in the form they were by the FCA;
- the role of the independent reviewer militated against the imposition of a duty of care and, in circumstances where the independent reviewer could not owe a duty of care (please click here for a summary of a related judgment), it was hard to see how the banks could;
- applying the *Caparo* test, it was not fair, just and reasonable to impose a duty of care;
- allowing the appeals would have the effect of allowing the claimants to litigate their time-barred causes of action "by the back door"; and
- the Court of Appeal did not accept that the claimants had relied on the Letters or the IRHP Review, in that it was unclear what they would have done differently – their participation in the IRHP Review did not preclude them from pursuing their original claims.

The Court of Appeal's decision is not surprising. It would be strange indeed if so carefully designed a process as the IRHP Review, containing as it did a substantial dose of regulatory intervention, should be held to create a duty of care. There seems no reason why the court's conclusions in this case should not also apply in any future review agreed by firms as an alternative to enforcement action.

Acceptance of settlement offer as part of IRHP review precluded subsequent claim for consequential loss

Cameron Developments (UK) Limited v. National Westminster Bank Plc [2017] EWHC 1884 (QB)

In July, HHJ Moulder struck out a claim by a property developer (Cameron), for consequential losses allegedly incurred as a result of entering into an interest rate swap. The sale of the swap was reviewed as part of the Interest Rate Hedging Product (IRHP) review process conducted by the defendant bank (the Bank) (amongst other UK banks), pursuant to an agreement with the FCA. Having reviewed the sale of the swap, the Bank offered Cameron redress by way of an alternative product and a cash sum. Cameron was also invited to submit details of any claim it wished to make in relation to consequential losses not included in the initial offer of basic redress.

Cameron accepted the offer of basic redress. In doing so it acknowledged that acceptance represented "full and final settlement of any claims, liabilities, costs or demands that [it] may have against [the Bank] arising under or in any way connected with the sale of this IRHP as identified above. For the avoidance of doubt this applies to any past, present or future claims, actions, liabilities, costs or demands, regardless of whether or not you are aware of them at the date of this letter." Cameron subsequently submitted a claim to the Bank for consequential loss. The claim for consequential loss was rejected by the Bank.

Cameron subsequently made a claim for consequential loss in the courts. The claims brought by Cameron in the court proceedings alleged mis-selling; however, in view of the acceptance of the offer of basic redress, it was common ground between the parties that there could be no recovery of direct losses resulting from the sale of the swap. In order to pursue its claim for consequential loss, Cameron made allegations regarding the way in which the Bank conducted the review of the sale of the swap. The Bank applied to strike out the claim.

At the time the strike out application was heard (10 July 2017), a judgment of the Court of Appeal was anticipated in the case of *CGL Group Limited v. The Royal Bank of Scotland plc* considered above, considering whether the Bank owed a duty of care to customers when conducting the IRHP review. Whilst the CGL decision was awaited, it was agreed by all parties that it would be assumed for the purposes of the application that the Bank did owe a duty of care in relation to the IRHP review[3].

The main issues left to be determined by the court included, first, whether there had been a contractual agreement in relation to the Bank considering consequential loss in the review. If there was such an agreement, there was then the question of whether a claim on such a contractual agreement (along with the hypothetically agreed duty of care claim) was precluded by the terms of the settlement. The third issue was whether the contractual claim should be struck out or summary judgment granted.

The judge found that there was no evidence of any dealing between the parties to support the assertion

3 Following the hearing on 10 July 2017, on 24 July 2017 the Court of Appeal handed down judgment in CGL, confirming that the Bank did **not** owe a duty of care to customers when conducting the IRHP review agreed with the FCA

that the Bank entered such a contract. There was no link between the acceptance of the basic redress offer and the review of a claim for consequential loss given consideration of consequential loss was not contingent on acceptance of a basic redress offer. The judge noted that the FCA's website stated that all customers who "receive" (as opposed to "accept") a basic redress offer have the opportunity to make a claim for consequential loss. The FCA's website was said by the judge to contain several features which negated any suggestion of a contractual relationship with regards to the review, including: the fact that the FCA did not require banks to give details of how redress calculations were made, as these were reviewed by the independent reviewers; the fact that customers were informed that the review process was overseen by independent reviewers; and the fact that customers were cautioned in relation to using lawyers as costs are unlikely to be recoverable.

The court found that, even if a contractual agreement was found to exist, a claim based on breach of it would have been precluded by the settlement agreed by acceptance of the basic redress offer. The court found that the use of the words "in any way connected with" the sale of the swap, on a literal reading, brought Cameron's challenge within the settlement. As the judge put it, "No review would be necessary unless the claimant fell within those category of customers who had been sold a swap." The judge was also persuaded by submissions that the settlement between the parties caught not only claims in existence but also those arising in the future.

In addition to a literal interpretation of the meaning of the language used in the settlement agreement, the court also found that the commercial context and practical consequences of the IRHP review was consistent with an interpretation that the settlement agreement was intended to preclude future challenges to the review process (outside of the mechanisms prescribed by the review process). The view of the court was that any distinction between the initial review and the consequential loss review was illusory rather than real, as the final determination took into account both the basic redress and any consequential losses, to reach a single final outcome. As the review was in essence a single process, it was not irrational to have a single settlement agreement dealing with it in its entirety.

The court therefore held that both the alleged contractual claim and the hypothetically agreed duty of care claim were precluded by the language of the settlement agreement and should be struck out.

This is one of a number of recent court cases where customers who participated in IRHP reviews conducted by various banks sought to re-open, re-review or reverse the outcome of those reviews by asserting a right to bring the review process itself before a court. The court's decision provides some clarity and assistance to banks, particularly in circumstances where a customer has accepted an offer of redress.

Agency, effect of a bribe on the enforceability of a contract by a third party, and the effect of a conflict of interest

UBS AG (London Branch) and another v. Kommunale Wasserwerke Leipzig GmbH [2017] EWCA Civ 1567

Kommunale Wasserwerke Leipzig GmbH (KWL) is the municipal water company of Leipzig. It was run at all relevant times by two individuals, Mr Heininger and Dr Schirmer. They became involved with two corrupt financial advisers acting through a Swiss company called Value Partners. As part of a restructuring of cross-border leasing arrangements, Value Partners induced KWL to enter into four single tranche collateralised debt obligations (STCDOs), all of which, in commercial terms, ultimately had UBS as their counterparty. Three of the STCDOs, however, were concluded with an intermediary procured by UBS (either Depfa Bank plc (Depfa) or Landesbank Baden-Württemberg (LBBW)), such that there was a "front swap" between KWL and Depfa/LBBW, and a "back swap" between Depfa/LBBW and UBS. Pursuant to the STCDOs, KWL sold credit protection in relation to a basket of reference entities either directly to UBS, or to Depfa/KWL who in turn sold it on to UBS for a relatively small intermediation fee. In exchange, UBS sold KWL credit protection in relation to the four institutions referred to as part of the cross-border leasing arrangements above.

The commercial outcome of the STCDOs was to release substantial sums to KWL in the form of premium payments (a net total of USD28.1 million plus €6.4 million), but expose KWL to a potentially massive liability if the reference entities underlying the STCDOs defaulted, as a number duly did during the financial crisis.

Underlying these complex transactions was a fraud on KWL, orchestrated by Value Partners. Value Partners succeeded in extracting almost the whole premium paid to KWL under the STCDOs, and bought Mr Heininger's complicity through bribes paid to him. At first instance, Mr Justice Males found that, while UBS did not know that Value Partners had bribed Mr Heininger, or how much of the proceeds of the STCDOs Value Partners extracted, UBS had been aware that Value Partners stood to make a large and disproportionate profit. He also found that UBS knew that Value Partners was dishonest, and UBS was content to use the services of Value Partners to bring "captive" clients such as KWL to it in order to conclude lucrative transactions, regardless of whether

this was in the client's interests.

There were 10 issues on appeal. The key points of general interest are whether:

1. Value Partners acted as UBS's agent in bribing Mr Heininger (as Males J held that it did);
2. if not, the bribe meant that the STCDO with UBS was unenforceable in any event; and
3. UBS's knowledge of conflict of interest on the part of Value Partners meant that KWL was entitled to avoid the STCDO with UBS and, specifically, whether Mr Heininger's knowledge that Value Partners was not acting as KWL's disinterested adviser was to be attributed to KWL in this context.

In relation to the first issue, the Court of Appeal considered the traditional elements of an agency relationship: the existence of a fiduciary duty owed by the agent to the principal; authority on the part of the agent to affect the principal's relationships with third parties; and control by the principal over the agent. The Court of Appeal accepted that the absence of any of these characteristics in this case was a "significant pointer" away from the existence of an agency relationship, but would not go so far as to accept that no agency could be found to exist where those three characteristics were not present. The Court of Appeal also noted earlier authority to the effect that the court should be wary of "forcing into an agency analysis a relationship better explained in some other way, in particular where the supposed agent is already an agent of another party to the contemplated transaction". In this case, of course, Value Partners was acting as KWL's agent, however poorly. In the circumstances, the Court of Appeal found that Value Partners was not UBS's agent.

The underlying question on the second issue was whether a party should be entitled to rescind a contract upon discovering that a fraud had been committed on him/her, on the basis that it would be inequitable for the other party to hold him/her to a contract procured in that way. It was common ground that the conscience of the party seeking to enforce the contract would need to be affected in some way in order for rescission to be possible. The issue was how to determine whether a party's conscience was affected, applying dicta of Millett J in *Logicrose Limited v. Southend United Football Club Limited*[4]. The general position was held in Logicrose to be that a party's (A's) conscience is not affected by a bribe or other breach of fiduciary duty by its counterparty's (B's) agent, unless A actually knows or is wilfully blind to the fact of the breach. However, Millett J added, in what he described as a "reservation", that A's conscience would be affected, where A dealt secretly with B's agent, knowing that B was unaware of the fact, and that the agent might be looking to his own advantage.

In the view of the majority (Gloster LJ dissenting) in the Court of Appeal, UBS had demonstrably dealt with KWL's agent, Value Partners, behind KWL's back, and dishonestly assisted it in breaching its fiduciary duties to KWL so as to bring about the STCDO transactions. On that basis, having assisted in one aspect of Value Partners' breach of duty, UBS's conscience was sufficiently affected in relation to any other abuse (in this case the bribing of Mr Heininger) that Value Partners chose to employ. UBS could not say that its conscience was clear, and KWL was therefore entitled to avoid the contract.

In relation to the third issue, Males J found that UBS's arrangement with Value Partners, whereby Value Partners was to deliver captive clients to UBS for STCDO transactions, meant that Value Partners was subject to a conflict of interest and therefore in breach of its fiduciary duty to KWL. As UBS knew of and assisted in such breach, and KWL did not know of it, KWL had a right to rescind its STCDO with UBS. UBS challenged this conclusion, in part because Mr Heininger knew that Value Partners was not providing disinterested advice to KWL. UBS argued that, in the context of the STCDO between UBS and KWL, Mr Heininger's knowledge should be attributed to KWL, and KWL should therefore be taken to have consented to the conflict of interest on the part of Value Partners.

Lord Briggs and Hamblen LJ referred to *Bilta (UK) Limited v. Nazir*[5] and said that: "It can now be taken as settled law that, where a company claims against a third party in respect of that person's involvement as an accessory to a breach of fiduciary duty by one of its directors, the state of mind of the director who was in breach of his fiduciary duty will not, as a matter of policy, be attributed to the company". The majority in the Court of Appeal (Gloster LJ again dissenting) accepted that this case did not fall squarely within the categories of case described in *Bilta*, but found that the same policy considerations applied, such that Mr Heininger's knowledge of breaches of fiduciary duty by Value Partners ought not to be attributed to KWL.

In addition, there was extensive discussion in the judgment (which we do not cover here) of the way in which the court is entitled to exercise its discretion in relation to claims for rescission. While this case is unusual on its facts, the legal principles it raised are of more general application, and the case broke new ground in relation to each.

Situs of the debt owed under letters of credit

Taurus Petroleum Limited v. State Oil

4 [1988] 1 WLR 1256
5 [2016] AC 1

Marketing Company of the Ministry of Oil, Republic of Iraq [2017] UKSC 64

In February 2013, Taurus Petroleum Limited (Taurus) obtained a final award in arbitration proceedings against State Oil Marketing Company of Iraq (SOMO). SOMO did not pay the sum that it was ordered to pay pursuant to the award. Taurus then learned that a company in the Shell group was to purchase two parcels of crude oil from SOMO, the purchase price for which was to be paid under Letters of Credit (LoCs) issued by Crédit Agricole. The relevant sums were to be paid into an account of the Central Bank of Iraq (CBI) at the Federal Reserve Bank in New York, designated the Oil Proceeds Receipts account.

The LoCs were subject to the Uniform Customs and Practice for Documentary Credits (2007 Revision) International Chamber of Commerce Publication No. 600 (UCP). They were addressed to CBI, but stated that they were "in favour of" SOMO. They also contained two unusual special provisions relating to payment that were crucial to this case.

Taurus applied for, *inter alia*, an interim third party debt order (TPDO) over the proceeds of sale to be paid pursuant to the LoCs, and the appointment of a receiver in relation to those funds. Crédit Agricole duly paid the sums into court. The interim TPDO and receivership order obtained by Taurus were set aside following a hearing, and the matter proceeded to the Court of Appeal and then the Supreme Court.

There were four broad issues before the Supreme Court:

- what was the situs of the debts due pursuant to the LoCs?
- what was the proper construction of the LoCs?
- did the position of CBI mean that no TPDO should be granted in any event?
- how much connection with the jurisdiction was needed in order for the court to make a receivership order?

The English court therefore generally lacks jurisdiction to make a TPDO in respect of debts situated outside the jurisdiction. In terms of determining where the debt was situated, there were two competing propositions. One was the general position, which is that a debt is situated where the debtor is resident, because that is the jurisdiction where the debt is recoverable. As the LoCs were issued by the London branch of Crédit Agricole, the provisions of the UCP meant that the London branch should be treated as a separate bank to the French arm of the bank, and the situs of the debt would be England. The other was based on settled law in a Court of Appeal decision, *Power Curber International Ltd v. National Bank of Kuwait SAK*[6], in which there was held to be an exception in the case of LoCs to the general position summarised above, on the basis that LoCs were "different from ordinary debts".

The Supreme Court agreed unanimously that *Power Curber* was wrong in principle, and that the ordinary means of identifying the situs of a debt should apply to LoCs too, Lord Neuberger adding that "such unreasoned distinctions do the common law, and in particular, commercial law, no favours". On that basis, the debt due in this case was situated in England.

Having found that it would be possible in principle to make a TPDO in relation to the sums payable pursuant to the LoCs, the Supreme Court had to decide whether to do so in practice. In this regard, there was a specific issue of construction of the special provisions contained in the LoC, on which the Supreme Court was split. We do not consider that issue in detail here, save to note that the majority held that, while the debt under the LoCs was due to SOMO, there was a collateral obligation to SOMO and CBI jointly, to pay the relevant amounts into CBI's account. SOMO argued that, because it had no interest in or rights over the account of CBI into which the LOCs provided that the debt should be paid, no TPDO was available to it. This argument was based on In re *General Horticultural Co, Ex p Whitehouse*[7], in which the court held that an order of that kind could only charge "what the judgment debtor can himself honestly deal with".

Lord Clarke (with whom the majority agreed) held that this did not create an independent principle in relation to honest dealing – looking at the circumstances of the case, it only reaffirmed that a TPDO could not be made in relation to property not belonging to the judgment debtor.

On the point of most general relevance in this case, the situs of debts due pursuant to LoCs, the Supreme Court was unanimous – it is the debtor's place of residence, not the place where the sums due under the LoC are payable. Lord Neuberger noted that 35 years of mistaken practice in this regard provided some argument for continuing with it, but not enough.

When and how dishonesty needs to be shown

Ivey v. Genting Casinos (UK) Ltd t/a Crockfords [2017] UKSC 67

In a much-publicised recent case, the Supreme Court has considered two issues: first, whether it is necessary to prove dishonesty in order to make out an offence of cheating under the Gambling Act 2005; and second, what the test for dishonesty should be.

6 [1981] 1 WLR 1233
7 (1886) 32 Ch D 512

Mr Ivey is a professional gambler. He played a number of games of Punto Banco at Crockfords over two days in August 2012, with the help of another professional gambler, Ms Sun. Punto Banco is played with six or eight packs of cards. It requires the dealer to deal two or three cards, face down, onto two positions on the table ("punto" and "banco"). The gambler places a bet on one of those positions, and if the total of the cards dealt is closer to nine than the other position (subject to the rules of the game), he or she wins.

There is an advantage to the gambler in knowing which cards are "high value" which, in this context, means cards with a face value of seven, eight or nine. That would not, of course, normally be possible. However, Mr Ivey sought to take advantage of a technique called "edge-sorting". This can be done where the manufacturing process means that the pattern on the back of the card is marginally closer to one long edge of the card than the other. The Supreme Court described the difference as "sub-millimetric". The difficulty lay in ensuring that the cards were sorted such that one type of long edge appeared for the high value cards, and not for the others. This was Ms Sun's role. As the cards were turned face up at the end of each coup, she indicated to the croupier which cards were "good" (asking her to turn them one way) and which were "not good", asking her to turn them the other (the croupier believing that Ms Sun was simply superstitious). The use of a shuffling machine (at the request of Mr Ivey) meant that the cards were not rotated when they were shuffled and Mr Ivey also asked to keep using the same cards. By the time the sorting process was finished, Mr Ivey's bets per coup increased. By the time he stopped playing, his success rate had risen markedly. His bets for the last three coups averaged £150,000 each time, and he ultimately won in excess of £7.7 million. Alarmed by the size of its loss, Crockfords reviewed its footage of the game, and the cards, and worked out how Mr Ivey had been so successful. It therefore refused to pay his winnings.

The parties agreed that there was an implied term in the contract between Mr Ivey and Crockfords that he would not cheat. There is also, as indicated above, a statutory offence of cheating. The Supreme Court held that cheating meant the same thing in either case.

Mr Ivey admitted edge sorting, but was adamant that this did not amount to cheating. It was said on his behalf that cheating necessarily involves dishonesty. In order for him to be held to be dishonest, the relevant legal test (in relation to the criminal offence) required Mr Ivey to have known that his conduct (viewed objectively) was dishonest. He did not see it as dishonest. He had therefore not cheated, and should recover his winnings.

The Supreme Court therefore considered two issues: (i) whether there was any requirement to show dishonesty; and (ii) if so, whether Mr Ivey was dishonest applying the proper test.

In relation to the first issue, the Supreme Court held that it is not necessary to show dishonesty, in

order to prove that someone has cheated. Lord Hughes accepted that the concept of honest cheating is an improbable one. It is not, however, impossible. Lord Hughes provided several examples, such as tripping an opponent in a race, giving a horse too much water before it is due to run, or deliberate time-wasting in a number of sports. The Supreme Court emphasised the role of dishonesty in some cases as supplying the necessary element of "illegitimacy and wrongfulness", but that, in the case of cheating for example, the cheating itself carried its own inherent stamp of wrongfulness.

The Supreme Court went on to consider what the proper test for dishonesty was. In relevant criminal cases, judges have been required for the last 35 years to direct the jury to consider the so-called *Ghosh* test[8]. The jury has been directed to consider dishonesty in two stages: (i) was the conduct complained of dishonest by the lay objective standards of ordinary, reasonable and honest people; and (ii) if so, whether the defendant must have realised that ordinary honest people would so regard his or her behaviour. The *Ghosh* test is therefore usually described as involving both an objective and a subjective test.

Lord Hughes, giving the judgment of the Supreme Court, identified six problems with the second, subjective limb of the test. These included the unintended effect that the more warped the defendant's standards of honesty are, the more likely he or she is to be acquitted, and the "unprincipled divergence between the test for dishonesty in criminal proceedings and the test of the same concept when it arises in the context of a civil action". He further held that the subjective limb of the test had been introduced on the basis of a misunderstanding of earlier authorities.

The Supreme Court therefore came to the conclusion that the subjective limb of the Ghosh test does not correctly represent the law. Going forward, in both civil and criminal cases, the test will be that currently used in civil cases – the judge or jury (depending on the type of case) will first have to ascertain the actual state of the individual's knowledge or belief as to the facts. Once that is established, the question of whether his or her conduct was honest or dishonest is to be determined by applying the standards of ordinary decent people. The test therefore retains a role for the state of mind of the individual defendant, but it removes the requirement for him or her to appreciate the dishonesty of his or her actions.

Application and rejection of the "Braganza Duty" in case of "classic abusive trading"

Shurbanova v Forex Capital Markets Ltd [2017] EWHC 2133 (QB)

In this case, the court considered whether the defendant's decision to revoke trades placed by the claimant was an exercise of a contractual discretion and therefore not to be exercised arbitrarily, capriciously or irrationally, or simply a contractual right and not subject to those conditions. It provides a further example of the careful analysis required in deciding whether a contract contains a right or a discretion, following the decision of the Supreme Court in Braganza v BP Shipping [2015] 1 WLR 1661, a recent case in the "*Socimer*" line of authorities (*Socimer International Bank Ltd v Standard London Ltd* [2008] EWCA Civ 116).

The defendant, Forex Capital Markets Ltd (FX), was an online broker. The claimant, Mrs Shurbanova, claimed FX had breached an implied duty of good faith in its terms of business when it revoked very profitable trades that she placed through a dealing platform FX operated for retail clients.

Mrs Shurbanova is a retired teacher from Bulgaria. On 8 November 2013 at precisely 8.30am New York time, data for the US Non-Farm Payroll (NFPD) was released. A positive NFPD result normally leads to a rise in the dollar and a decline in the value of gold. At 8:30.01am New York time, Mrs Shurbanova placed 25 orders to sell gold and 18 orders to buy US dollars (on a basket basis). Within 30 seconds, Mrs Shurbanova had closed out the same trades by giving instructions to buy back the gold and sell the dollars. The total amount committed by Mrs Shurbanova on these trades was US$130 million and her profit on the trades was US$463,410. Not too bad for less than a minute's work.

The FX platform used by Mrs Shurbanova is designed for non-professional traders and is structured such that the quoted prices react more slowly (in relative terms) to particular events, with the intention of allowing individual traders more time to think about the trades that they wish to make. With such "throttling" of quoted prices comes the potential for abuse.

FX revoked the trades later that day. Underlying FX's decision to cancel the trades was a concern that, by using a combination of software able to (i) process results of news events very fast and (ii) place appropriate buy and sell orders automatically according to predetermined settings, Mrs Shurbanova had been able to place trades that were not based on intelligent predictions of a particular news result, but in knowledge of what that result was. The trades abused the "price latency" which was built into the platform. Further, FX was concerned that Mrs Shurbanova was in fact acting as a front for her husband, Mr Shurbanov, whose activities had been restricted by FX previously, including for placing trades similar to the trades placed by Mrs Shurbanova, and/or for their son, whose trading activities had

8 Derived from R v. Ghosh [1982] QB 1053

also previously been restricted by the broker. Mrs Shurbanova denied the allegations and brought a claim against FX for breach of contract.

In its defence, FX relied on two provisions within its terms which permitted it to amend or cancel trades. The first line of defence concerned a clause which allowed FX to amend a transaction where there was "Manifest Error". The judge held that the provision did not apply to the circumstances as there had been no pricing error or misquote in relation to the trades. As regards the pricing, the platform operated as intended.

The second line of defence concerned a provision in FX's terms allowing it to revoke transactions if there had been abusive trading. The question of whether FX was acting within its contractual right in revoking Mrs Shurbanova's trades required the judge to consider whether the act of revoking was the simple exercise of a contractual right, or the exercise of a discretion, such that FX was under a duty to conduct its determination in a way that was not arbitrary, capricious or irrational in the public law sense. The judge referred to these limitations on the exercise of a contractual discretion as the "Braganza Duty", alluding to the *Braganza* case decided in 2015.

In support of her argument that the contractual provision amounted to a discretion, Mrs Shurbanova identified that FX had a range of options open to it in the event of abusive trading (including revoking, amending or doing nothing). The judge did not find that characterisation to be correct; the clause conferred a simple and absolute right to revoke, and a separate right to make adjustments to the account. On the face of the clear words in the clause, it was for the court (and not for FX) to determine finally whether, as a matter of fact, there was abusive trading. Under its terms, if FX exercises its contractual power to revoke a trade, it runs the risk of "calling" the transaction wrongly by revoking based on abusive trading where the court later determines that there was none. The Judge drew the distinction between this situation and, on the other hand, a contractual power of the type considered in *Braganza*, that arises from the evaluation of some state of affairs which one party makes as decision-maker, but which affects both parties, thereby giving rise to a potential conflict of interest. As Asplin J put it in *Property Alliance Group v. RBS*, if a power depends on a decision requiring the contracting party to make some kind of assessment or to choose from a range of options, then it is the exercise of that power which renders necessary the implication of a term that it should not be exercised arbitrarily, capriciously or in an irrational manner.

Mrs Shurbanova further identified that the clause provided for FX to intervene at its "sole discretion" in relation to the operation of accounts tainted by abusive trading or "gaming". The judge found this to be a separate matter to any action that FX took in response to a particular trade, and that it did not affect the analysis of whether FX had a contractual right or a discretion to revoke abusive trades. The judge did note that the final part of the relevant clause provided that FX had sole discretion to resolve disputes arising from quoting or execution errors. The judge decided that this discretion could only relate to those isolated factors, and that it would run counter to the clear words of the clause for the discretion to apply to its entirety.

On consideration of all the evidence, including expert evidence from both sides, the judge was also clear that Mrs Shurbanova's trades were a case of "classic abusive trading". Mrs Shurbanova's case was not assisted by the presentation of the evidence to support her claim: her own testimony was described as implausible and inconsistent and therefore unreliable, as was (to a lesser extent) that of her son; and the absence of evidence from Mr Shurbanov, when he could easily have supported his wife's claim, was considered telling. The judge was satisfied that Mrs Shurbanova was a "front" for her husband and/or her son.

Whilst it was not necessary in the light of the above findings, the judge also found that Mrs Shurbanova had made a series of misrepresentations when opening her trading account with FX, with the result that FX could have claimed damages and, in so doing, cancelled out any liability on its part for damages due to Mrs Shurbanova had the judge found in her favour. The claim was dismissed in its entirety.

Fetters on contractual discretion

BHL v. Leumi ABL Limited [2017] EWHC 1871 (QB)

BHL was successful in its claim against Leumi ABL Limited (Leumi) on the basis that Leumi had not been entitled to charge a collection fee of 15 per cent under a receivables finance agreement (RFA). The issue was not whether Leumi was entitled to charge a collection fee, but rather what percentage Leumi could rationally charge to cover its likely costs and expenses. This decision has implications both for the receivables finance industry and, more widely, for the exercise of discretionary powers under a contract in a commercial context.

The owner and director of BHL was Lord Bilimoria, the founding shareholder of Cobra Beer Limited (Cobra). In April 2008, Cobra entered into the RFA with Leumi, pursuant to which Cobra assigned its unpaid invoices to Leumi at a discount for immediate cash. Cobra experienced financial difficulties and entered into administration on 29 May 2009. On the same day, Cobra Beer Partnership Ltd, in which BHL was a shareholder, acquired the Cobra business, and BHL gave an indemnity pursuant to which BHL agreed to indemnify Leumi in respect of sums due under the RFA.

Leumi then took over the collection

of Cobra's invoices and, in doing so, charged certain additional fees under the RFA. One fee in particular, which lies at the heart of this case, was a "collection fee" of up to 15 per cent on all invoices.

Leumi collected invoices to the value of £8.1 million, yielding a collection fee of £1.2 million. On 11 November 2010 and 9 May 2011, Leumi issued demands to BHL for outstanding collection fees of £400,000 and £550,000, respectively. BHL complained that the fees were excessive but, believing the payment to be due under the RFA, paid them. Leumi claimed this left a further sum outstanding of over £400,000 (later corrected to £271,382.69).

In April 2012, BHL issued its claim against Leumi, alleging that: (i) Leumi was not entitled to charge a collection fee at 15 per cent; (ii) BHL had paid £950,000 of collection fees by mistake of law; and so (iii) Leumi should repay the sum. Leumi counterclaimed for the balance of collection fees.

Accordingly, the court had to determine to what Leumi was entitled under the RFA (including whether the collection fee was an unenforceable penalty) and, if Leumi was entitled to less than the sum that had been paid, whether BHL had overpaid on the basis of a mistake of law.

The RFA entitled Leumi to charge "an additional collection fee at up to 15% of amounts collected", and stipulated that "such fee constitutes a fair and reasonable pre-estimate of Leumi's likely costs and expenses in providing such service". BHL alleged that this allowed Leumi to claim only its actual costs and expenses, which were to be calculated after the exercise had ended and were subject to a cap of 15 per cent; whereas, Leumi contended that it was entitled to charge any fee it wished, subject only to a maximum of 15 per cent. As a matter of practice, in similar circumstances Leumi had always charged the maximum where an agreement provided that its fee could be up to a particular percentage, including in the present case.

The judge did not agree with either party's interpretation, however. Instead, relying on the wording of the clause and what he deemed to be the "target" of the provision, the judge determined that Leumi had a discretion to charge a fee based on estimated or actual costs, but which could go no higher than 15 per cent. This discretion was to be exercised, following the principle in *Braganza v. BP Shipping* [2015] 1 WLR 1661, in a way which was not arbitrary, capricious or irrational in the public law sense (the Braganza Duty).

The judge's decision on the construction of the clause brought into play BHL's secondary argument that the collection fee was an unenforceable penalty. However, the court disagreed on the basis that: (i) the collection fee was not akin to a sum payable instead of damages and therefore was a primary and not a secondary obligation; (ii) even if it was a secondary obligation, it was not a fixed sum but a fee to be arrived at in the exercise of discretion and, in any event, there was a legitimate interest in being compensated for costs; and (iii) Cobra was a large commercial entity that had negotiated the RFA on an arm's-length basis. Accordingly, the clause in question was not a penalty.

Having found Leumi was acting under a discretion, the court considered whether Leumi had properly exercised that discretion. The court found, broadly, that Leumi (i) did not attempt to calculate the likely costs and expenses of the collection exercise; (ii) did not consider whether the collection process would be carried out by third parties and charged under an alternative clause in the RFA; and (iii) acted too quickly in setting the charge. Accordingly, the court considered that Leumi did not exercise the discretion granted under the relevant clause at all and that, even if it did, its exercise of the discretion was wholly defective.

On that basis, it was then left for the court to consider what Leumi would have been entitled to had it properly exercised its discretion. The court first considered what Leumi's actual costs were. This was not because the clause provided for actual costs but in order to provide a useful sense-check for the exercise of discretion. In the absence of any contemporary records, the court relied on a salary-implied hourly rate to conclude that the actual costs were £33,260.

The judge then had to determine the highest percentage fee which Leumi could have charged without being in breach of its Braganza Duty. Taking a holistic approach and giving Leumi the benefit of the doubt, the judge held that four per cent was the maximum Leumi could have charged. Accordingly, BHL had overpaid by £735,000 and Leumi was owed nothing for its counterclaim.

Having determined that Leumi was entitled to less than what was actually paid, the court had to consider whether BHL had overpaid on the basis of a mistake of law. The contemporaneous correspondence showed that BHL believed that the collection fee was payable, and Lord Bilimoria gave oral evidence to the effect that he was mistaken. Further, the mistake was a plausible one to make, and BHL was given advice confirming that the collection fee was payable. Accordingly, the court found that there was a mistake and, but for the mistake, the payments would not have been made. BHL was therefore entitled to recover £735,000 from Leumi and was awarded interim payment on account of costs of £780,000.

Collection fees have been the subject of much controversy in the receivables finance industry. Whilst this case is unlikely to quiet the debate, the days of flat-rate

collection fees of up to 15 per cent are likely to be over.

More broadly, this case is an interesting example of the increasing extent to which courts are willing to challenge the exercise of discretionary powers in a commercial context. Whilst the law in this area is not yet settled, commercial entities should be aware that, if there is any optionality in a contract (for example, charging collection fees of *up to* 15 per cent), the courts may scrutinise the course of action ultimately taken. On that basis, businesses would be well advised to document thoroughly any decisions made in relation to elective contractual rights so that they can demonstrate a rational basis for their actions.

Unwinding a loan participation where the deadline for meeting a condition has expired

VR Global Partners, L.P. v. Exotix Partners LLP [2017] EWHC 2620 (Comm)

In October, the High Court held that the buyer of a portion of a loan facility was entitled to unwind its participation where the deadline for meeting a condition had expired.

In 2007 Citibank arranged a US$55 million loan facility to Ukranian borrowers. In 2014, CVI EMCVF Lux Securities Trading SÀRL (CVI), a participant in the facility, transferred a US$10 million portion of its participation to an inter-dealer broker, Exotix Partners LLP (Exotix), which transferred the participation to VR Global Partners, L.P. (VR).

The transactions were subject to the condition that the National Bank of Ukraine issued a registration certificate relating to the loan transfer (NBU Registration). Under the terms of the transaction, if the NBU Registration had not been obtained by 30 November 2014, VR was entitled to unwind the transaction via a multilateral netting agreement (MNA) returning the parties to the positions they were in prior to the transaction. The contractual terms also stated that the parties may review the situation and agree a further review period, and that VR would, in good faith, take all reasonable actions to assist in obtaining NBU Registration. In addition, the LMA's standard terms, which were incorporated into the transaction, required VR to take any action as may reasonably be requested to effect the transaction.

Ultimately, NBU Registration was not obtained by the deadline, the market moved against VR and VR sought to exercise its option to unwind the transaction. Exotix agreed to enter into the MNA, but CVI refused, alleging broadly that: (i) VR had failed to take reasonable steps to agree an extension; (ii) in exercising its option to unwind the transaction, VR had not acted in good faith; and (iii) as the market had moved since the transaction date, it was not possible for the parties to be returned to the position they were in prior to the transaction.

The court rejected CVI's arguments and found in favour of VR.

The allegation that VR ought to have agreed an extension was advanced on the basis that there was an implied term that VR would take reasonable steps to agree a further review period. However, the court found that the meaning of the relevant clause was clear and that no party was under an obligation to agree to extend the deadline.

In relation to the contractual requirement of good faith, the judge found that it related to the process of unwinding rather than the exercise of the option to unwind. Even if the purpose of VR having the option to unwind was to provide VR with a hedge against the regulatory risk of non-registration, there was no absence of good faith in VR exercising the option when that regulatory risk had not been removed by the agreed date.

Finally, the court found that the parties could be returned to the position they were in prior to the transaction, despite the market moving between the transaction date and the exercise of the option. The position the parties were in prior to the transactions was that CVI owned the asset and Exotix and VR owned the purchase money. The option simply cancelled the sales.

Claim for breach of mandate and failure to operate stop loss protection upheld against discretionary fund manager

Rocker v. Full Circle Asset Management Ltd [2017] EWHC 2999 (QB)

This case concerned the claims of Mr Rocker (a successful businessman) against Full Circle Asset Management Limited (FCAM) for breach of contract, breach of statutory duty and negligence. FCAM provided discretionary portfolio fund management (DFM) services in respect of a £1.5 million investment in its Inner Circle portfolio in 2009 (the IC Portfolio). By 2014, the capital value had more than halved. Mr Rocker sought to recover both the capital loss and the amount by which he argued his investment would have appreciated had FCAM adhered to its instructions (his "opportunity loss").

In particular it was alleged that (i) FCAM invested significant portions of the £1.5 million in highly risky investments which took the overall risk of the portfolio above the agreed risk limits; (ii) the reference to an APCIMS benchmark required FCAM to adopt equivalent asset allocation in the IC Portfolio or achieve equivalent returns; and (iii) FCAM failed to operate a "stop loss" policy that would have limited losses. FCAM's defence was based on having agreed with Mr Rocker a "bear" strategy for the IC Portfolio. It was contended that (i) the portfolio did not exceed the agreed

900
800
700

risk profile; (ii) the benchmark was simply a means by which to assess performance; and (iii) there was no obligation to operate a stop loss policy and in any event this was not breached.

Breach of mandate/COBS claims

In the period in dispute, Mr Rocker's customer risk profile and that of the IC Portfolio was "medium". During this same period, the actual risk profile of the IC Portfolio exceeded the agreed risk profile on nine monthly occasions. Where this occurred, FCAM acted in breach of mandate and/or COBS 9.3.1R and accordingly Mr Rocker was entitled to damages for losses arising as a result of these breaches.

Mr Justice Morris (the Judge) also found that, in breach of COBS 9.2, FCAM did not do enough to ascertain adequately Mr Rocker's attitude to risk, but that this failure did not cause any additional loss. Mr Rocker raised a number of additional COBS rules FCAM had allegedly breached, in particular COBS 2.2, 4.5.2 and 14.3.2 (as regard the adequacy of information provided) and COBS 9.5 (in respect of record-keeping). However, the Judge held that these additional allegations were either unfounded or caused no additional loss.

Benchmark claim

The IC Portfolio agreement provided for an APCIMS benchmark against which to measure performance. Mr Rocker argued that it was implicit from this that FCAM would adhere to the asset allocation in that benchmark – failure to do so resulted in losses in breach of contract and COBS 6.1.6. The Judge swiftly dismissed this claim for several reasons. In particular, it was clear from the wording of Mr Rocker's agreement with FCAM that the purpose of the benchmark was as a performance measure and not as a guarantee of a certain level of performance or asset allocation.

Stop loss

The dispute in relation to Mr Rocker's "stop loss" claim focussed on: (i) whether FCAM was under any legal obligation to operate a "stop loss" protection system; and (ii) if so, what the content of that obligation was.

In relation to the former, the promises FCAM made in respect of operating a "tight" or "aggressive" "stop loss" system were in its suitability letter and made orally in meetings. The Judge agreed with Mr Rocker that it was an express term of the agreement relating to the IC Portfolio, alternatively a collateral contract (but not an implied term) that FCAM was required to operate a "stop loss" system.

Regarding (ii), the Judge also favoured Mr Rocker's view that "stop loss" protection indicated a system by which, where the specified stop loss level was reached, this would trigger a near automatic sale of the investment to prevent further losses, on the basis that it was supported by the natural meaning of the words and dictionary definitions, and was consistent with the limited case law. He rejected FCAM's argument that "stop loss" is an investment management tool used as an internal alert for the portfolio manager to review the investment and consider actively whether to sell or continue to hold it. The trigger point for a "tight" or "aggressive" stop loss policy as promised by FCAM was five per cent. Accordingly, FCAM was in breach of the "stop loss" term in any case where an investment fell by more than five per cent and was not sold at the time when it reached that point.

Quantum

In respect of the "opportunity loss" damages sought by Mr Rocker, the Judge agreed with FCAM that these were "misconceived". The compensation required was intended to put him in the position he would have been in but for the specific breaches that occurred (e.g. the failures to operate the "stop loss" properly). It was not to put him in the position he would have been in had he been in a totally different investment portfolio.

Comment

Although the Judge's findings in respect of the client mandate/ COBS breaches were unhelpful to FCAM, the conclusions in relation to the benchmark claim will generally be of comfort to providers of DFM services both in refusing to impose any requirement as to asset allocation or performance and refusing to award "opportunity loss" damages.

Firms that offer a DFM service and whose agreements or other materials contain references to "stop loss" protections would be advised to give careful consideration to how these provisions are worded and operated in practice, especially if they use these as an internal management tool rather than triggering an automatic sale.

The judgment is also notable in its acknowledgement of both the tensions in applying the COBS provisions around suitability to a DFM service and the pragmatic approach to quantifying losses on a DFM portfolio. To the extent any DFM providers are not applying COBS 9 requirements, this judgment is a clear indicator that they should be.

Successful claim for damages for breach of FCA rules in relation to advice and whether a decision said to amount to "financial suicide" should affect causation

Mahmoud Haji Haider Abdullah (and others) v. Credit Suisse (UK) Limited and Credit Suisse Securities (Europe) Limited [2017] EWHC 3016 (Comm)

This claim related to investment advice allegedly given in breach of FCA rules. The claimants were a wealthy Kuwaiti family comprising a father and his three sons, although the judgment indicates that only two of the brothers dealt with Credit Suisse for present purposes. Each was entitled, as a private person

within the meaning of section 138D of FSMA, to seek damages for breach of FCA rules. The bare facts of the case are that the family invested in notes (Structured Capital-At-Risk Products or SCARPs) issued by Credit Suisse and, in one case, another bank (the Notes). Such investments were made pursuant to the advice of a Mr Zaki, employed at the time by Credit Suisse[9]. The investments were also leveraged and when, following market turmoil in October 2008, Credit Suisse made a margin call in relation to the Notes, the family decided not to meet it, in the knowledge that its positions would be liquidated. This decision, referred to contemporaneously by Mr Zaki as "financial suicide", cost the claimants US$21 million as against retaining the Notes they held to maturity and meeting the margin call (and any future ones).

The issues arising were therefore: (a) whether Credit Suisse had breached the FCA rules as alleged; and (b) even if it had, whether the claimants' refusal to meet the margin call was so unreasonable as to amount to a failure to mitigate loss or a break in the chain of causation.

Breaches of FCA rules

The rules said to be relevant in this case were: (i) COBS 9.2.1R, requiring a firm to take reasonable steps to ensure that any personal recommendation is suitable for the client, including associated information gathering duties; (ii) COBS 9.2.2R, requiring a firm to have a reasonable basis for believing that any specific transaction recommended meets the client's investment objectives and is such that he/she has the necessary experience and knowledge to understand the risks involved; and (iii) COBS 4.2.1R, requiring a firm to ensure that a communication or financial promotion is clear, fair and not misleading.

There were three relevant Notes for the purposes of the claim, and the judge considered the claimants' investment objectives to be different in relation to each. The judge found that they had accepted the second of these Notes (the 19th they had traded with Credit Suisse) as higher risk. The final Note was intended as a restructuring to try to avoid further losses being incurred on previous Notes. In relation to the first of the relevant Notes (Note 18 in the judgment), however, the judge found that the claimants were willing to accept a notional risk to their capital, but only if the events that would give rise to a capital loss were very unlikely to occur. He did not find them to be aggressive investors.

One of the more interesting aspects of the judgment is the judge's consideration of how an adviser should deal with recommending a product that is riskier than one the client has previously traded. The judge said that, in this regard, there was no reason why an adviser could not present such a product, but that he or she would need to take great care in doing so. He added that, "as a practical reality, if a riskier product is presented to an advisory client without its riskier nature being brought squarely to the client's attention and explicit confirmation being obtained from him ... that he is content to be exposed to the greater level of risk, there will be a real prospect that the COBS suitability duties will not have been discharged". In this case, the judge found that the claimants relied on Mr Zaki and trusted his assessment as to the likelihood of a capital loss arising. He declined, however, to find that any incentives available to Mr Zaki in relation to sales of the Notes made it more likely that he would breach the relevant rules.

The judge also found Credit Suisse to have breached COBS 4.2.1R in relation to the last Note sold, in that it led the claimants to believe that the restructuring which resulted in its purchase would not require the injection of new funds from them. This was not, as it turned out, the case, as a result of the way in which the replaced Notes had been marked to market.

Financial suicide/deliberate liquidation of the Notes

Before turning to this issue, the judge conducted an extensive exercise in determining what the claimants would have done had Note 18 not been sold to them, which of the outstanding Notes would have proceeded to maturity, and what (if any) margin calls would have been made in relation to them.

In relation to the decision not to meet the margin call that was actually made, Credit Suisse argued that this was an irrational decision taken by the claimants (and one of them in particular) in a fit of temper. While agreeing that a decision not to meet a margin call can, in principle, break the chain of causation, the judge held that, in this case, the claimants' decision was reasonable. They had been asked to inject a further US$12 million, in circumstances where the worst might not be over. They had also lost confidence in Mr Zaki's advice (and he advised them strongly to meet the margin call). The judge held that it was reasonable for them to decide not (potentially) to throw good money after bad.

Other issues

The judgment makes interesting reading, particularly on the points above, but there are some interesting issues on which it does not touch (because it did not need to). One is that the judge made express criticisms of the fact find process undertaken by Credit Suisse, which he held to be inaccurate in a number of respects. The judgment does not explore the extent to which this was relevant to liability, perhaps because there was no suggestion in the judgment that Mr Zaki

9 The adviser and product type are the same as those considered in Zaki v. Credit Suisse (UK) Ltd [2011] EWHC 2304

actually misunderstood either the claimants' financial knowledge or their objectives. Second, the judge noted on a number of occasions that the claimants advanced their claims en bloc, and he therefore treated them as such. There was therefore no separate consideration (beyond the judge mentioning it with disquiet) of Credit Suisse's effective failure to engage with two of the claimants.

Meaning of financial institution and right of a party already in default under an ISDA Master Agreement to terminate for the default of the other party

In the matter of Olympia Securities Commercial Plc (in administration) – Grant (and others) v. (1) WDW 3 Investments Limited and (2) Arazim (Gibraltar) Limited [2017] EWHC 2807 (Ch)

This claim was brought by the joint administrators of Olympia Securities Commercial Plc (the Company), a property developer. The dispute, however, was in reality between the two defendants. The second defendant (Arazim) was the ultimate beneficial owner of the Company and one of its unsecured creditors. The first defendant (WDW) was a secured creditor of the Company.

The dispute related to finance agreements entered into by the Company and (formerly) Anglo Irish Bank Corporation Limited, which is now Irish Bank Resolution Corporation Limited (IBRC). The relevant agreements were a floating rate facility agreement (the Facility Agreement), three interest rate swaps concluded under an ISDA Master Agreement (the Swaps) and a debenture securing amounts due under both the Facility Agreement and the Swaps (the Debenture).

Various assignments of these agreements took place as part of the restructuring and eventual liquidation of IBRC, the details of which are not necessary for present purposes save as set out below. The assignments gave rise, however, to various arguments on the part of Arazim.

First, it argued that the Facility Agreement could not have been validly assigned to WDW (as it purportedly had been) because WDW was not a "financial institution" as the Facility Agreement required. Arazim argued that, in order to be a financial institution, an entity would need to operate on its own behalf in the field of regulated finance. The judge rejected this argument. He referred to an earlier authority, and said that an assignee would need to have "a legally recognised form or being, which carries on its business in accordance with the laws of its place of creation and whose business concerns commercial finance". The judge held that this definition was wide enough to include WDW. He also rejected Arazim's specific criticisms that: WDW was not trading at the time of the assignment; it had a share capital of only £1; and it should be viewed as a "vulture fund", on the basis that it had taken assignment of the debt at a discount to its face value. Finally, the judge emphasised the fact that, where money is due under a loan, it is due, and it should not matter overly to the borrower to whom.

The second argument advanced by Arazim related to the terms of the ISDA Master Agreement governing the Swaps. The Swaps were terminated by IBRC on 30 June 2014 because the Company did not repay the Facility Agreement. Arazim argued that it was not open to IBRC to do that, because it had itself suffered a bankruptcy event of default on 7 February 2013, and could therefore not be a "non-defaulting party". The judge, unsurprisingly, rejected this argument in short order. He held that the Company could have terminated the Swaps for IBRC's bankruptcy event of default, but had chosen not to do so. It was entirely possible, in those circumstances, for a non-defaulting party itself to go on to commit an event of default which gave rise to a right of termination by the other party. The judge noted, however, the significance of IBRC having terminated because of cross-default provisions, rather than for non-payment of the Swaps (the payment obligation having been suspended upon IBRC's bankruptcy).

There was a further issue as to whether the amount due on Early Termination (within the meaning of the ISDA Master Agreement) was secured by the Debenture. While this was an issue of considerable importance to the parties, it is specific to the terms of the Debenture, and to the particular series of assignments in this case, so we do not consider it here.

The judge's conclusions on each of the points before him are unsurprising, particularly, perhaps, because the issues raised essentially went to the design of the liquidation of Anglo Irish. The judgment reiterates, however, some useful points of construction in relation to fairly standard terms.

Substantially negotiated LMA facility agreements not caught by section 3 of UCTA

African Export-Import Bank (and others) v. Shebah Exploration & Production Company Limited (and others) [2017] EWCA Civ 845

In June, the Court of Appeal handed down judgment in an appeal that considered whether section 3 of the Unfair Contract Terms Act 1977 (UCTA) can catch facility agreements based on the Loan Market Association (LMA) standard form. Section 3 of UCTA prohibits a party from relying on an exclusion clause where such clause is contained within standard written terms, unless such a clause is reasonable. It had

been argued that the claimant banks, in using an LMA form agreement, were dealing on their written standard terms.

The appeal concerned an application for summary judgment in favour of three lenders, African Export-Import Bank, Diamond Bank and Skye Bank (the Banks) against the first defendant (Shebah) and its two guarantors. Summary judgment was given in favour of the Banks following Shebah's defaults. The defendants accepted that the sums claimed by the Banks were due and payable. However, they also asserted that they had counterclaims against the Banks such that they were entitled to set off.

The Banks, in response, relied on provisions in the facility agreement and guarantee which stated that all payments had to be made without set-off or counterclaim. Shebah, in order to bring into question the reasonableness of the provisions relied on by the Banks, and thus make the matter inappropriate for summary judgment, sought to rely on section 3 of UCTA.

The judgment of the court highlighted that the LMA form of the syndicated facility agreement had merely been a starting point for negotiation between the parties. It was also significant that the LMA's own user guide made it clear that it would not be possible to use the form without amendments and additions. Both the court at first instance and the Court of Appeal noted that there had been multiple discussions and drafts of the facility agreement passing between the parties and their respective solicitors. The Court of Appeal held that the fact that there were detailed negotiations "render it impossible to say that either the LMA model form was, or the terms ultimately agreed were, the claimants' standard terms of business".

The court added that the negotiations between the parties do not need to relate specifically to exclusion clauses in order for section 3 of UCTA to be inapplicable. As such, where parties begin with a standard form agreement (such as the LMA), it is not the case that the particular clause which a lender later seeks to rely on must have been specifically negotiated. Regardless of amendments to individual terms, it should suffice to demonstrate that the final contract agreed was not on standard terms. In such circumstances, section 3 of UCTA will not be applicable.

The court highlighted that facility agreements do not usually contain traditional exclusion terms "in the same way that traditional sale contracts ... often do." Notwithstanding that, in the present case, a no set-off clause was interpreted as an exclusion clause.

Unfair relationships under the Consumer Credit Act 1974

Clydesdale Bank Plc v. (1) R Gough (t/a JC Gough & Sons) (2) Anne Michelle Gough [2017] EWHC 2230 (Ch)

In this case, the High Court considered: (1) whether the claimant (the Bank) was estopped from exercising its right to demand repayment and enforce security over the Defendants' assets by virtue of the alleged assurances it had given the defendants; and (2) whether the court had the power to make an order pursuant to section 140B of the Consumer Credit Act 1974 (the CCA) to affect the relationship between the first defendant and the Bank, if the relationship between the second defendant and the Bank under a guarantee was found to be unfair.

The first defendant, Mr Gough (trading as "J C Gough & Sons"), was a potato farmer with an extensive holding in Worcestershire. The second defendant, Mr Gough's wife, assisted him with certain matters in relation to the farm.

During November and December 2012, Mr Gough (and Mrs Gough in relation to a charge over one property that was jointly owned) entered into two loans totalling £4.25 million, an overdraft facility for £650,000, and a legal charge in favour of the Bank over a number of properties. Mrs Gough gave a personal guarantee to the Bank up to the sum of £4,910,000 plus interest. The farm continued to experience financial difficulties, such that the overdraft facility was formally extended a number of times, and by November 2014 Mr Gough had overdraft facilities of more than £1 million more than the original size of the overdraft. Eventually the Bank decided that it no longer wished to support the farm, and on 25 November 2014 it sought repayment from Mr Gough of all sums outstanding under the various facilities, and on the same date the Bank also made demand upon Mrs Gough under the guarantee in an amount of £4,910,000.

By the time of the litigation, neither Mr Gough nor Mrs Gough had made any payment to the Bank in respect of the sums owing, yet continued to live in properties subject to the Bank's charges (and derived an income from the same). The Bank brought proceedings seeking possession of the two properties to be given up to receivers, an order that Mr Gough repay the sums advanced under the facilities, and an order that Mrs Gough pay the sums under the guarantee.

Mr Gough's case against the Bank was that it agreed with him from the outset that he "... would have the opportunity to reduce his indebtedness to a sustainable level by the sale of assets, if the bank was not prepared to continue to support the business" and that the Bank was accordingly estopped from enforcing its rights to demand repayment of the facilities and enforce its security over the property assets. The court found that, on the particular facts, no particular representation or

understanding arose in the parties' course of dealing and Mr Gough's defence accordingly failed.

In her defence to the sums claimed under the guarantee, Mrs Gough argued that, pursuant to section 140B of the CCA, the relationship between her and the Bank was unfair. The court found that, even if that relationship was unfair, that was irrelevant: the relevant relationship was that between the Bank and Mr Gough and Mrs Gough's defence would fail even if the relationship between her and the Bank under the guarantee was found to be unfair (which it was not).

Preliminary ruling on the requirement for "plain intelligible language" in consumer contracts

Ruxandra Paula Andriciuc and Others v Banca Românească SA C-186/16, ECLI:EU:C:2017:703

The Court of Justice of the European Union (CJEU) has made a preliminary ruling in relation to the interpretation of Directive 93/13/EEC on Unfair Terms in Consumer Contracts (the Unfair Terms Directive).

Under Article 3 of the Unfair Terms Directive, a term shall be unfair if "it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer". Article 4 provides an exception to this, in so far as: (i) the term is written in "plain intelligible language"; and (ii) the terms relate to the "main subject matter of the contract".

Between 2007 and 2008, Mrs Andriciuc and others (the Borrowers), whose income was denominated in Romanian lei (RON), entered into loan agreements with Banca Românească SA (the Bank) denominated in Swiss francs (CFH) (the Loans). Under the terms of the Loans, the Borrowers were to make monthly repayments in CFH. Subsequently, the CFH appreciated against the RON, and the Borrowers' obligations under the Loans (when converted into RON) significantly increased. The Borrowers argued that the Bank was in a position to foresee, but did not fully explain, this exchange rate risk. Further, it was said the Bank's presentation by which the Loans were sold was biased, emphasising the advantages but not the potential risks.

The Borrowers argued that, following the appreciation of the CFH, there was a significant imbalance between the rights and obligations of the parties and, therefore, the requirement to make monthly repayments in CFH was an unfair term and was consequently invalid.

The referring court asked the CJEU for a preliminary ruling in relation to the following: (i) whether the term requiring repayment in CFH relates to the "main subject matter of the contract"; (ii) whether the requirement that a contract is written in "plain intelligible language" extends to the need to provide all possible consequences of the term as a result of which the price paid may vary; and (iii) whether the imbalance between the parties is to be assessed at the conclusion of the contract or whether it continues throughout the life of the contract.

First, the CJEU decided that the term requiring repayment in CFH did

relate to the main subject matter of the contract, and so it could not be considered unfair, provided it was written in plain intelligible language.

Second, the CJEU confirmed that the requirement that a contractual term must be drafted in plain intelligible language requires banks to provide borrowers with sufficient information "to enable them to take prudent and well-informed decisions". This information must be such that "the average consumer, who is reasonably well informed and reasonably observant and circumspect, would be aware both of the possibility of a rise or fall in the value of the foreign currency in which the loan was taken out, and would also be able to assess the potentially significant economic consequences of such a term with regard to his financial obligations".

Finally, the CJEU found that the assessment of the unfairness of a contractual term "must be made by reference to the time of conclusion of the contract at issue, taking account all of the circumstances which could have been known to the seller or supplier at that time, and which were such as to affect the future performance of that contract".

As the reader will be aware, although the CJEU provides interpretation of EU law, the national court alone has jurisdiction to find and assess the facts in the case before it and to interpret and apply national law.

Effecting service of proceedings on uncommunicative defendants

(1) Citicorp Trustee Company Limited and (2) Golden Belt Sukuk Company BSC v. (1) Maan Al-Sanea and (2) Saad Trading, Contracting and Financial Services Co [2017] EWHC 2845 (Comm)

In this case, the High Court considered whether valid service had been effected upon two defendants based outside of the jurisdiction who had shown no willingness to be involved in the proceedings.

The main issue in these proceedings was whether valid service had been effected in circumstances where the defendants declined to participate in the proceedings. The relevant agreements nominated L A Investments Limited (L A Investments) as the agent for service of proceedings, whose address was specified as 16B Curzon Street, London. Two issues arose: L A Investments was in voluntary liquidation, and the address specified for service no longer existed and was now 15 Chesterfield Street (and in any event was now occupied by an unrelated company). The court found that the clause did not specify a particular address for service because the address was simply a means to identify the service agent, and service at 15 Chesterfield Street was therefore ineffective. The claimants' solicitors also identified the liquidators of L A Investments and served proceedings on them. The court held that valid service had been effected pursuant to the contractually-agreed method of service because the liquidators were acting as representatives of L A Investments for that purpose.

Although not necessary for his decision, the judge went on to consider what the position would have been if L A Investments had ceased to be the service agent. The relevant agreements provided that should L A Investments cease to be the service agent, the defendants must appoint a replacement agent for service and notify the claimants of the same within a specified time period. Failing that, the claimants were entitled to appoint an agent for service and notify the defendants of the same. The claimants had received no notification from the defendants that they had replaced L A Investments as agent for service and they went on to appoint an alternative agent for service with notification to the defendants. The judge held that this would also have been an effective method for service. For good measure, the claimants' solicitors had also attempted to bring the proceedings to the claimants' attention by a variety of means, including by courier to the addresses given in the leases, by facsimile, and also by email. The judge was satisfied that the claimants had done everything necessary to bring the proceedings to the attention of the defendants and that the proceedings (and also the application for summary judgment, which was served by the same methods) were validly served.

Duty of care owed by Arranger in relation to the execution of sukuk documents

Golden Belt Sukuk Company B.S.C. v. BNP Paribas and FCOF II UB Securities LLC and others v. BNP Paribas [2017] EWHC 3182 (Comm)

This case concerned the inability of the claimants to recover sums pursuant to a promissory note (the Promissory Note) which formed part of the transaction documents for a sukuk financing transaction (the Sukuk) for the Saudi Arabian Saad group, referred to by the judge in the case as "equivalent in economic effect to a Eurobond issue". The claimants were the issuer and trustee of the rights of holders of certain certificates issued as part of the Sukuk (Golden Belt) and funds which had invested in the secondary market, and were specialist investors in distressed debt (the Funds).

BNP Paribas (BNPP) was described as the Arranger and as one of the Lead Managers for the Sukuk. There was some discussion in the judgment as to what this role entailed, but the judge found as a matter of fact that it included the preparation and execution of the transaction documents. The judge declined, however, to find that disclaimers contained in the transaction document relating to BNPP's role as Lead Manager did not apply also to

its role as Arranger, in view of the fluidity of use of these descriptions.

The claimants alleged (and the judge agreed) that it was a requirement under Saudi Arabian law (which governed the Promissory Note) that the Promissory Note be signed with a "wet ink" signature. In fact, microscopic investigation showed that the relevant signature had been added by a laser printer. The judge held that, had the Promissory Note been signed with a "wet ink" signature, Golden Belt would have obtained judgment on it in Saudi Arabia, although he also held that such judgment would not have been paid.

Golden Belt alleged that BNPP owed it (and certificate holders) a duty of care to exercise reasonable care and skill to ensure that the Promissory Note was properly executed – BNPP denied this. The judge considered some of the authorities dealing with the existence of a duty of care in this context. He drew from them the following two points: (1) that BNPP's client was Saad, and that the existence of contractual duties to one party generally meant that a bank would not undertake a duty of care to other parties in relation to the transaction; and (2) that the existence of carefully structured contractual relationships meant that the court should be slow to superimpose a tortious duty on those relationships. Nonetheless, the judge held that this was a case in which it was right to hold that BNPP owed a duty of care, although to certificate holders only, not Golden Belt, which had no economic interest of its own in the transaction. The reasons were, in summary, that:

- unlike the earlier authorities, this case related not to investment advice or information provided to investors (which were covered by disclaimers) but to BNPP's performance of its own responsibilities as Arranger;
- the relevant service performed by BNPP was specific, namely arranging for execution of the Promissory Note. It is interesting to note in this context that the judge stated obiter that he would be minded to find such duty included checking capacity or necessary board/shareholder resolutions, had such issues been relevant in this case;
- it was particularly important that the Promissory Note was properly executed and "there was no room for any slip";
- this service was carried out entirely for the benefit of certificate holders;
- there was no hint that certificate holders were to bear the risk of invalid execution, and they had no independent means of checking this as a risk; and
- BNPP was effectively telling investors that it would arrange the execution of the Promissory Note.

It is interesting to note that the judge rejected an argument that the imposition of such a duty risked putting banks such as BNPP in a position of potential conflict with their clients. He held that, in reality, there was no way that Saad could have given (or BNPP could have accepted) an instruction to execute the Promissory Note invalidly.

Similarly, he rejected an argument that a duty of care should not be found to exist to subsequent investors in the Sukuk, such as the Funds. The judge said that the existence of such a duty was neither for an indeterminate amount, for an indeterminate time, or to an indeterminate class, although he accepted that investors in the secondary market might struggle to prove reliance on BNPP to carry out the relevant service with reasonable care. In practice, however, the judge had no difficulty in finding such reliance on the part of the Funds.

As a matter of fact, the judge determined that BNPP had breached its duty of care. He found that it had not relied on its own legal advisers, but had left execution arrangements entirely to Saad. He agreed with BNPP, however, that the appropriate measure of damages was the difference between the Funds' recovery as matters stand and their recovery had the Promissory Note been validly executed. While quantum was left to a separate trial, it seems plausible that the Funds will recover little if anything by way of damages.
While the judge's reasoning was clear, his conclusions may come as something of a surprise to banks. BNPP is appealing the judgment. As matters stand, however, it is a reminder to banks acting as arrangers to take particular care with execution of documents. There is no reason, however, why the ratio of the judgment should not apply to services other than arranging execution (or, for that matter, outside the Islamic finance context), and it will be interesting to see whether this judgment results in broader drafting of the type of disclaimer that has previously focused on alleged investment advice.

Choice of English governing law upheld over arguments of non-Shariah compliance

Dana Gas PJSC (a company incorporated under the laws of the United Arab Emirates) v Dana Gas Sukuk Ltd and others [2017] EWHC 2928 (Comm)
In 2007, Dana Gas raised US$1 billion of financing (restructured in 2013) through the issue of Trust Certificates (Sukuk). These were structured to be Shari'ah compliant. Under the transaction, Dana Gas Sukuk Limited (the Trustee) entered into a UAE-law-governed mudarabah agreement (the Mudarabah Agreement) with Dana Gas. This provided that Dana Gas would invest the Sukuk issue proceeds in

certain Shari'ah compliant assets (the Mudarabah Assets) in accordance with a pre-agreed investment plan, in order to generate sufficient income to enable the Trustee to make the periodic distribution of amounts to holders of the Sukuk. To ensure that the Sukuk would be redeemed in full on any scheduled or early redemption, Dana Gas and the Trustee also entered into an English-law-governed Purchase Undertaking. Under the Purchase Undertaking, the Trustee had the right following certain events, to require Dana Gas to buy the Mudarabah Assets for a pre-defined exercise price. Dana Gas was required to pay the exercise price into a specified transaction account (which was held on trust by the Trustee for the holders of the Sukuk), and the transfer of title to the underlying Mudarabah Assets was then to take place by way of a separate sale agreement (the Sale Agreement).

In June 2017, Dana Gas announced that it had received a legal opinion to the effect that the Sukuk was not compliant with Shari'ah law, and that the Mudarabah Agreement and the Sale Agreement were therefore unenforceable under UAE law. The judge in the English proceedings accepted, for the purpose of the hearing before him, that this was correct.

Dana Gas asserted that, given the unlawfulness of the transaction under UAE law, the English-law-governed Purchase Undertaking was also unenforceable as a matter of English law, for reasons that: (i) on a proper interpretation of the Purchase Undertaking, the obligation to pay was conditional on a lawful transfer of assets; (ii) the Purchase Undertaking was void for mistake; and (iii) the Purchase Undertaking was unenforceable on the grounds of public policy.

The judge held that, while an English court would apply UAE law to the question of the validity and enforceability of the UAE law-governed agreements, it would apply English law to those issues as they related to the English law Purchase Undertaking.

Dana Gas argued that, as the Mudarabah Agreement was unenforceable, the Trustee never acquired title to the Mudarabah Assets, and that the Trustee's ability to transfer such assets was a condition to Dana Gas's payment of the relevant exercise price under the Purchase Undertaking. The judge disagreed, holding that the payment of the exercise price was a prior step to the transfer of the Mudarabah Assets and was not conditional on it.

Dana Gas also argued that the Purchase Undertaking was void for mistake because the parties entered into it on the mistaken assumption that the Mudarabah Agreement and Sale Agreement were lawful and enforceable under UAE law, and that the Trustee had valid rights to the Mudarabah Assets. The judge noted that, if the parties had expressly or impliedly agreed what would happen if a certain event occurred, there would be no gap in the drafting of the contract and the doctrine of mistake could not apply. On the drafting in this case, there was no gap in the contractual framework. The parties had agreed at the outset that the risk of events of this kind lay with Dana Gas. As such, an argument of mistake was not available.

Dana Gas argued that as a result of Article 9(3) of the Rome I Regulation, the court was required to take into account the enforcability (or otherwise) of the Purchase Undertaking in the UAE. Article 9(3) provides that ...."Effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful"...Dana Gas argued that all of the obligations under the Purchase Undertaking had to be performed in the UAE, and therefore UAE laws were relevant.

The judge disagreed, finding that the place of performance was in England. Accordingly, Article 9(3) was not applicable and the court did not need to consider any overriding mandatory provisions of UAE law when interpreting the Purchase Undertaking.

The case provides an interesting demonstration of how English courts deal with conflicts of laws where more than one legal system applies in relation to the same overall transaction, and there are undoubtedly points of interest for those drafting future sukuk agreements.

Quantum of damages where loan advanced on the basis of a negligent valuation

Tiuta International Limited (in liquidation) v. De Villiers Surveyors Limited [2017] UKSC 77

In what Lord Sumption described as a "perfectly straightforward" result, the Supreme Court has considered the approach to determining the quantum of damages in a case where a property was negligently overvalued.

In the present case, Tiuta was a specialist lender of short-term business finance, which later became insolvent. One of the projects it financed was a development in Sunningdale, in respect of which it entered into two facility agreements with the developer. Both facility agreements were made following valuations by De Villiers. There was no suggestion in the proceedings of negligence in relation to the first valuation (and Tiuta would have had no recoverable loss in that regard anyway, because the facility was discharged). Tiuta alleged negligence in relation to the second valuation, and this was assumed to be the case for the purposes of the summary judgment application that eventually reached the Supreme Court.

The issue here was that the second facility agreement was for a sum of £3,088,252. Almost all of this money was used to repay the first facility. Only £289,000 of the amount advanced was new money. De Villiers argued (and the Supreme Court agreed) that it was only liable in relation to the new money lent.

As Lord Sumption recorded, the basic measure of damages is that which is required to restore the claimant as nearly as possible to the position he would have been in if he had not sustained the wrong. In this case, had Tiuta not entered into the second facility in reliance on De Villiers' overvaluation, the advances it made under the first facility would not have been paid. It would therefore have lost that sum in any event, through no fault of De Villiers. Lord Sumption restated the need in cases of this kind to perform the "basic comparison" explained in Nykredit Mortgage Bank plc v. Edward Erdman Group Ltd (No. 2)[10] as "a comparison between the plaintiff's position had he not entered into the transaction in question and his position under the transaction".

The judgment considers this issue fairly briskly, and is worth reading for its review of the relevant considerations in cases of this kind. Also interesting are Lord Sumption's comments on the potential difference it would have made to quantum if there had been an allegation of negligence in relation to the first valuation. In that case, but for the second negligent valuation, the first loan would have been undischarged, and Tiuta could have sought to recover (much larger) damages in relation to the first (hypothetical) negligent valuation.

Application for summary judgment granted after nine-day hearing

Zumax Nigeria Limited v. First City Monument Bank Plc [2017] EWHC 2804 (Ch)

At first glance, it may seem something of a contradiction to hold a summary judgment hearing over nine days. In this case the court held that it would have been wrong to shy away from looking carefully into whether there was merit to the defences and other complaints raised by the defendant bank. The court decided that, save in relation to one issue, none of the defences had a real prospect of being established and a trial over many months and at substantial cost would have been wholly unwarranted.

The relevant background to this claim, brought by Zumax Nigeria Limited (Zumax) against First City Monument Bank Plc (FCMB), the successor in title to Zumax's main banker, IMB International Bank Plc (IMB), is: (i) in 2002, IMB had appointed receivers to Zumax over a dispute concerning a debenture, which was settled in 2005 and formalised in a consent order; and (ii) Zumax had brought Nigerian proceedings in 2009 against IMB's former managing director, who had also been a director of Zumax at the relevant time and who the parties agreed was a fraudster.

Zumax's claim against FCMB was that 10 money transfers, totalling approximately US$3.7 million, had been made from an account in the name of an Isle of Man-registered nominee entity to accounts at a third party bank that were in the name of IMB or entities under its control, but that those moneys were fraudulently diverted or retained by IMB.

In its defence, FCMB stated that (i) it had repaid the moneys by way of bankers' drafts; (ii) the claim was covered by the 2005 consent order; (iii) the claim had been assigned to IMB and charged to it under the terms of the debenture; (iv) the claim was time-barred; and (v) the claim was an abuse of process in that it should have been raised in the Nigerian proceedings. FCMB also brought a counterclaim for damages on the basis that Zumax had assisted the former director to breach his fiduciary duties to IMB by concealing the conflict of interest arising as a result of his dual role as managing director of IMB and director of Zumax.

The court held that FCMB's argument that the moneys had been repaid by bankers' drafts had no substance whatsoever. The limitation defence failed on the basis that the instructions for the transfers and the surrounding circumstances clearly gave rise to an express trust in Zumax's favour, therefore section 21(1) of the Limitation Act 1980 applied. On the debenture argument, the Judge found that Zumax owed nothing to IMB at the time the receivership began in 2002, and that the appointment of receivers had been unjustified. There was in fact a credit due to Zumax from IMB at the date of the appointment, so there could be no valid assignment by Zumax of the funds that were the subject of the instant claim.

The court held that the consent order and settlement agreement were both unenforceable, because two fraudulent misrepresentations made by IMB underlay Zumax's entry into the agreement: it had been misinformed about the true extent of its indebtedness and about the moneys that had been recovered in the receivership. The court accepted that it was unusual for a finding of fraud to be made in the context of a summary judgment application but the Judge stated that, in his view, the finding was fully justified in the circumstances of this case.

The defence as to abuse of process was not arguable as the Nigerian proceedings had concerned an entirely different dispute over different moneys and neither FCMB or IMB had been a substantive party to those proceedings (the judge accepted that FCMB had been joined as a procedural formality to

10 [1997] 1 WLR 1627

assist with enforcement against Mr Chinye, the managing director of IMB, who had also been appointed as a director of Zumax). The court also held that FCMB's counterclaim could not possibly succeed as it was plain that it had at all times been aware of, and had even approved, Mr Chinye's dual role.

Zumax was entitled to summary judgment in respect of the counterclaim and all but one of the 10 transfers (there was a lack of clarity on the documents over the position in respect of the third transfer that was claimed for).

The hearing required detailed analysis of the documents and written evidence, following which the court was able to conclude that the defences had no real prospect of succeeding and that there was no other compelling reason that the matter should proceed to trial.

Privy Council decision on pre-contract representations in a commercial borrower-lender relationship

Deslauriers and another v. Guardian Asset Management Limited (Trinidad and Tobago) [2017] UKPC 34

In November 2017, the Board of the Judicial Committee of the Privy Council (the Board) gave judgment on an appeal against, inter alia, liability under a commercial loan for TT$18.6 million brought by Mr and Mrs Delauriers from the Court of Appeal of Trinidad and Tobago (the Court of Appeal).

Mr and Mrs Deslauriers (the Appellants) are property developers based in Trinidad and Tobago. They entered into a loan facility with Guardian Asset Management Limited (GAM). GAM was a non-bank lender that administered pension, insurance and investment funds. The loan was repayable in full by 2 April 2009 and interest was payable in quarterly instalments. In 2008, the Appellants applied for further lending from GAM and, in 2009, GAM notified the Appellants that it would not advance a further loan to them. The Appellants made the interest payment due in January 2009 but made no further interest payments and failed to repay the principal by 2 April 2009.

The Appellants did not dispute their default under the loan or the moneys owed by them. They issued a counterclaim that essentially blamed GAM for their inability to access further borrowing. The essence of their claim was that, pre-contract, GAM should have told them that it had lending limitations, but that it failed to do so. The Appellants' claim was for loss suffered as a result of GAM's alleged misrepresentation and/or negligent misstatement. GAM refused their 2008 application for a second loan on the basis that such further borrowing would take them over lending limits. The Appellants said that, prior to entering the loan facility, they told GAM that the loan in question was only the first tranche of funding they required for a development project. They also said that they were aggressively pursued by GAM for their business, and that, when they asked GAM to compare the terms they were offering against those of other lenders, GAM should have told them that the terms on offer included lending limits.

GAM's case was that there had in fact been no discussion of future lending, except that Mrs Delauriers had told GAM that she planned to fund the development project from other resources. The Board upheld the decision of the Court of Appeal and first instance court to reject the Appellants' evidence. The Board affirmed that failure to say something that is immaterial is not a misrepresentation. The Board concluded that, as the first instance court had found that there was no evidence of any discussion of future lending, the Appellants' claim for misrepresentation had to fail. If future lending was never discussed, then it could not be a material subject. There was simply no opportunity for GAM to disclose its lending limits so they were irrelevant.

The Board went on to provide some unsurprising commentary on the relationship between a commercial lender and a commercial borrower. They restated that the relationship is an arm's-length one. It is not a relationship of adviser-client. They said it would be very unusual in such a relationship to assume that a commercial lender has a duty to disclose its internal policies or the external influences on its business practices. The Board said that it would still hold this to be the case, even where a borrower indicated that they intended to borrow further sums in the future.

Regulatory developments

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

Senior managers regime, certification regime and conduct rules (SMCR)

Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms, and extending the SMCR to Insurers

Consultation Paper 17/25 and Consultation Paper 17/26, July 2017

In July, the FCA published its much-awaited consultation in relation to rolling out the SMCR to all authorised firms. The majority of its Consultation Paper is comprised of the 300 pages containing the revisions to its current rules. The specific requirements of the SMCR are complex, but as an overall summary of the FCA's proposed architecture:

- all authorised firms will be SMCR firms;
- there will be different types of firms, with different obligations applying to each: SMCR dual regulated banking sector firms; SMCR insurance sector firms; core SMCR firms; enhanced scope SMCR firms; and limited scope core SMCR firms;
- almost all employees of SMCR firms will be subject to the individual conduct rules (with some carve-outs for non-financial services activities;
- enhanced scope SMCR firms (i.e. those which meet specific financial tests, or which are required to be enhanced scope SMCR firms by the FCA) will have more applicable Senior Management Functions (SMFs) than core SMCR firms, and be required to allocate more prescribed responsibilities. They will (unlike core SMCR firms) need to prepare management responsibilities maps, and have appropriate handover procedures. Linked to this is the point that this is the only subset of firms now joining the SMCR to which the "no gaps" principle, which has been a significant part of the SMCR as it applies to banks, will apply. The no gaps principle requires a firm to allocate responsibility for each business area, activity or management function;
- limited scope core SMCR firms will, by contrast, be subject to fewer requirements than core SMCR firms, which the FCA describes in the consultation as having a "baseline" of applicable requirements; and
- the certification regime will, in principle, apply to all SMCR firms, but to differing extents.

The FCA's consultation in relation to the introduction of the SMCR to banks went through several rounds. The CP stated that the FCA anticipated publishing final rules in summer 2018, but given the scale and complexity of changes proposed, it would not be surprising if there were further rounds of consultation before all the rules are finalised.

Strengthening individual accountability in insurance: extension of Senior Managers & Certification Regime to insurers

PRA Consultation Paper 14/17, July 2017

In this consultation, the PRA proposed changes to its existing rules in SIMR in order more closely to align the accountability regime for insurers with the SMCR in place for banks. Specifically, the PRA proposed changes in relation to Solvency II firms, insurance special purpose vehicles (ISPVs) and large non-Directive firms (NDFs) in order to:

- create a new certification regime;
- apply conduct rules to all employees within the scope of such regime and create notification requirements in relation to conduct rule breaches;
- set out expectations in relation to the duty of responsibility; and
- align terminology in the SIMR with that used in the SMCR and create requirements for handover procedures.

The PRA consulted on various other amendments to align the SIMR and SMCR, and make it easier for individuals to transfer between the two.

The PRA also proposed to make new rules in relation to small NDFs, including the creation of a certification regime. The PRA's approach to identifying those within the scope of its insurance certification regimes is quite different to that of

the FCA, and the PRA says that it intends to align this population so far as possible with those identified in relation to the application of the firm's remuneration policy.

The PRA has also since consulted on, and produced final rules in relation to, amendments to SMCR forms.

Individual accountability: Transitioning FCA firms, insurers, and individuals to the Senior Managers & Certification Regime
Consultation Paper 17/40
and Consultation Paper 17/41,
December 2017

The FCA has recently published its consultation on the transitional arrangements for moving firms to the SMCR. Whilst there are some points of interest amongst the technical provisions, the most notable aspect of the consultation is the FCA's revised expectations around timing. It now expects commencement of the SMCR to be in:

- late 2018 for insurers; and
- mid-to-late 2019 for all other firms not currently within the scope of SMCR.

Previously the Treasury and the regulators had suggested that all firms would move to the SMCR during 2018. The FCA has said that the actual transition dates will be up to the Treasury, which will need to draft legislation amending the relevant provisions of FSMA.

As with banks, SMCR will be introduced on a staged basis: whilst much of the regime will be effective from commencement, firms will have a year from commencement to issue certificates of fitness and propriety to those staff who require them, and conduct rules will only apply to staff who are neither senior managers nor staff requiring certification from the first anniversary of commencement.

Responses to this, and the other SMCR consultation papers published in December and mentioned below, are due by 21 February 2018.

The Duty of Responsibility for insurers and FCA solo-regulated firms
Consultation Paper 17/42, December 2017

The "duty of responsibility" is the name given to the statutory power under the SMCR allowing the regulators to fine a senior manager where an authorised firm has breached its duties in an area for which the senior manager was responsible, and the senior manager cannot show that he or she took reasonable steps to prevent the breach. In its July consultation papers, the FCA suggested that further guidance on the duty of responsibility might be required as part of the roll-out of the SMCR to the non-banking financial services industry.

Having considered the matter, the FCA believes that no changes to the existing guidance are necessary, and so none are proposed in this consultation paper. Instead, the FCA has taken the opportunity to reiterate some of the key points from existing guidance, including that:

- whether a senior manager is responsible for the management of an area will be a question of fact: statements of responsibilities and responsibilities maps will be relevant but not definitive; and
- in considering whether to take action, the FCA will consider the seriousness of the breach, the individual's responsibilities and seniority and the need to use enforcement powers effectively and proportionately.

Strengthening accountability: implementing the extension of the SM&CR to insurers and other amendments
PRA Consultation Paper 28/17,
December 2017

In this consultation paper, the PRA sets out proposed changes to forms, and other consequential changes and minor amendments to its rules and guidance. It also proposes to remove gendered language from the SMCR rulebook text (e.g. replacing "chairman" with "chair").

The changes are largely technical rather than substantive, with some renumbering of SMF roles applying to insurers (this will not affect the existing SMF roles in banks), integration of the lists of prescribed responsibilities applying to banks and insurers, and arrangements to facilitate SMFs moving from insurance firms to banking firms.

Final notices

Breaches of the Disclosure and Transparency Rules EMIR transaction reporting failures

Merrill Lynch International, 18 October 2017

The Financial Conduct Authority (FCA) has reached a settlement with Merrill Lynch International (MLI), under which it has imposed a fine of £34,524,000 on MLI in relation to failures in its reporting of exchange traded derivative (ETD) transactions over a two-year period. The size of the fine reflects the importance the FCA places on accurate transaction reporting. The Final Notice is also interesting for its description of what the FCA considers went wrong at a practical level for MLI – it accepts the genuine difficulties faced by the firm, but illustrates that the FCA expects such difficulties to be overcome.

Unlike previous FCA fines relating to MiFID reporting, the source of the reporting requirement relevant to the Final Notice is the European Markets Infrastructure Regulation (EMIR). Article 9 of EMIR requires counterparties to ETDs, inter alia, to report certain transaction details to a registered trade repository. In August 2013, some six months before its planned implementation date, the European Securities and Markets Authority (ESMA) recommended a delay in implementation of one year for the relevant Article 9 requirement. The European Commission rejected ESMA's recommendation, but did not do so until November 2013. The transaction reporting requirement for ETDs therefore began on 12 February 2014 as originally planned.

The FCA accepted that the bank's ability to carry out testing in the initial period after 12 February 2014 was affected by issues with the data that it received from the trade repositories, themselves suffering from technical issues.

The FCA's fine was imposed both for breaches of EMIR and for breaches of Principle 3, which requires firms to "take reasonable care to organise and control [their] affairs responsibly and effectively, with adequate risk management systems". The FCA's conclusions in this area are of general relevance to firms in relation to transaction reporting, and indeed more widely. The main points to be drawn from the final notice include:

- the bank failed to allocate sufficient personnel, or personnel with the right expertise – these failings continued, in one form or another, until July 2015;
- the bank implemented oversight arrangements for ETD reporting, but such oversight did not scrutinise MLI's compliance in detail; and
- the bank failed to implement adequate completeness and accuracy testing.

FCA fines and bans wife and bans husband financial advisor for lack of integrity

Colette Chiesa and John Chiesa, 12 October 2017

Final Notices have been published by the FCA in respect of Colette and John Chiesa, in connection with integrity failings. Mr and Mrs Chiesa were founders of Westwood Independent Financial Planners (Westwood), which entered sequestration following FCA action in 2011. As partners with unlimited liability in Westwood, Mr and Mrs Chiesa had substantial liabilities arising from claims which had been filed with the Financial Ombudsman Service.

In late 2011, a Trustee was engaged to evaluate the Chiesas' assets and liabilities with a view to allowing them to repay their creditors. The Chiesas made incomplete, inadequate and misleading disclosures to the Trustee. This included failing to disclose that they were in receipt of around £2.6 million from an offshore remuneration trust in the form of loans made between April 2012 and December 2014. The FCA concluded that these loans had never been intended to be repaid.

Westwood's liabilities to customers were ultimately borne by the financial services industry. By late 2016 the Financial Services Compensation Scheme had paid out over £3.8 million in connection with Westwood's activities. During the sequestration, Mr and Mrs Chiesa each paid only £200 per month to their creditors.

Mr and Mrs Chiesa have been banned from working in financial services. In addition, Mrs Chiesa was fined £50,000 for attempting to mislead the FCA during an FCA interview. No settlement discount applies to the financial penalty imposed on Mrs Chiesa. See below for a summary of the decision of the Upper Tribunal in relation to a reference made by Mr and Mrs Chiesa.

Payment of redress by BrightHouse

BrightHouse, 24 October 2017

Following on from engagement with the FCA, Caversham Finance Limited, trading as the rent-to-own provider BrightHouse, has committed to engaging in a customer redress scheme. As part of the redress, BrightHouse has agreed to pay over £14.8 million to 249,000 customers in respect of 384,000 agreements for lending which may not have been affordable and payments which should have been refunded.

Jonathan Davidson, Executive Director of Supervision – Retail and Authorisations at the FCA, stated that BrightHouse "was not a responsible lender" and failed to meet the FCA's "expectations of firms in this sector". One of the key concerns identified by the FCA was that BrightHouse's "lending application affordability assessment procedures and collections processes" did not always deliver good outcomes for

customers. There was a particular focus on those customers who were at a higher risk of falling into financial difficulty at the outset of any agreement.

The customer redress scheme proposed by BrightHouse separates customers into two groups:

- customers who may not have been assessed properly at the outset of the loan. Customers who handed back the goods will be paid back the interest fees charged under the agreement, plus compensatory interest of 8 per cent. Customers who retained the goods will have their balances written off. This seeks to deal with 114,000 agreements entered into between 1 April 2014 and 30 September 2016; and
- customers who made the first payment due under an agreement with the firm which was cancelled prior to the delivery of the goods. The first payment in such cases was not returned to all customers. BrightHouse will refund this first payment plus compensatory interest of 8 per cent. This seeks to deal with agreements entered into after 1 April 2010.

The FCA is aware that some customers are likely to fall into both groups. Furthermore, the FCA has confirmed that BrightHouse will write to all affected customers to explain the refund or balance adjustment that they will receive.

The FCA's treatment of this case is part of a continuum of cases relating to poor sales practices, and demonstrates that its interest in this area is ongoing.

Capita Financial Managers to pay up to £66 million for the benefits of investors in the Connaught Income Fund, Series 1

Capita Financial Managers Limited, 10 November 2017

A Final Notice has been published by the FCA in respect of Capita Financial Managers Limited (CFM). CFM was the Operator of the Guaranteed Low Risk Income Fund, Series 1 which later became known as the Connaught Income Fund, Series 1 (the Fund). The Fund was an unregulated collective investment scheme, operating from March 2008 until it went into liquidation on 3 December 2012. CFM had resigned as Operator on 25 September 2009.

CFM was found to have breached two of the FCA's Principles for Businesses during its time as Operator:

- Principle 2 (Skill, care and diligence) - CFM failed to conduct adequate due diligence on the Fund and also failed to correct this when it became aware of the shortcomings in its procedures. CFM further failed to monitor the Fund adequately during its period acting as Operator.
- Principle 7 (Communications with clients) - the FCA found that CFM failed to communicate with the Fund's investors in a way that was clear, fair and not misleading.

CFM has been publicly censured by the FCA and will be making a payment of up to £66 million, via the FCA, for the benefit of the Fund's investors. The FCA would ordinarily impose a financial penalty but chose not to on this occasion, as this would prevent CFM from making this payment, which aims to return the amount originally invested. The size of the payment has been determined taking account of the £22 million that has already been distributed to investors in the Fund by the liquidators.

FCA imposes fine in relation to market abuse

Paul Axel Walter, 22 November 2017

The FCA fined Paul Walter, a bond trader of some 20 years' experience, £60,090 for engaging in market abuse contrary to section 118(5) of FSMA. The relevant market abuse took place in the summer of 2014. It consisted of Mr Walter placing quotes on an inter-dealer trading platform in relation to six Dutch State Loans (DSLs). The quotes indicated that Mr Walter's intention was the opposite to what it actually was, i.e. when he wanted to sell, he represented to the market that he wanted to buy, and vice versa. So, for example, when Mr Walter's intention was to sell, he placed a high bid quote. This encouraged other market participants who were tracking his quotes using algorithms to raise their own bid quotes, such that Mr Walter was able to sell at a higher price than he could otherwise have achieved. He then cancelled his bid. The FCA found that this created a misleading impression as to the price and supply or demand of the DSLs. It also found that Mr Walter did not appreciate that his actions constituted market abuse, but that he should have done, particularly given the length of his experience and the fact that he was an approved person.

The case is a reminder that market abuse continues to be a high priority for FCA enforcement action. FCA statistics show that numbers of market abuse investigations opened by the FCA have risen in the last year.

FCA brings civil claim based on misleading statements

FCA announcement, 30 November 2017

The FCA has announced that it has started a civil claim in relation to misleading statements made in a pension report service, and is seeking orders for restitution and ancillary declarations and injunctions.

FCA fines Bluefin £4 million for misleading customers

Bluefin Insurance Services Limited, 06 December 2017

A Final Notice has been published in respect of Bluefin Insurance

Services Limited (Bluefin). Bluefin is an insurance broker which was wholly owned by a large insurance group until 31 December 2016 but had held itself out to be "truly independent" during the period between 9 March 2011 and 31 March 2014. This was despite having a policy (which was not disclosed to customers by Bluefin brokers) that focused on increasing the business placed with its parent company. The FCA found that Bluefin failed to implement adequate controls to manage this conflict, meaning there was a risk that customers were misled into believing the Bluefin brokers would conduct an unbiased search of the market.

As a result, Bluefin was fined £4,023,800 (including a 30 per cent discount for early settlement). The Final Notice is a further example of the FCA's ongoing concern, over a number of years, in relation to conflicts of interest and their potentially prejudicial effects.

Complaints in relation to the FCA

Application for disclosure of FCA internal documents refused

Chiesa v FCA [2017] UKUT 0275

The Upper Tribunal dismissed an application for disclosure of materials relating to the FCA's internal decision-making processes around initiating and pursuing action against approved individuals.

Mr and Mrs Chiesa were founding partners of FCA-authorised Westwood Independent Financial Planners (Westwood). In May 2011 the FCA took enforcement action against Westwood for mis-selling geared traded endowment policies and fined it £100,000. As a result of numerous customer complaints liabilities Westwood became insolvent and entered sequestration. The Chiesas were partners of Westwood with unlimited liability and a trustee was appointed to establish the value of their assets and liabilities so that an assessment could be made that would allow payments to creditors (one of whom was the FCA). The assessment process required the Chiesas to make full disclosure. During this process they remained approved persons. The FCA instigated an investigation and in October 2016 issued Decision Notices banning them and finding that they made inadequate, incomplete and misleading disclosures to the trustee about their financial situation to avoid the trustee inquiring into, and potentially recovering, assets for the benefit of their creditors. In addition, a £50,000 penalty was imposed on Mrs Chiesa for making misleading statements during a compelled interview.

In November 2016 the Chiesas referred the FCA's decision to the Upper Tribunal. In March 2017 they applied for disclosure of FCA internal decision-making materials under rule 5(3)(d) of the Tribunal Procedure (Upper Tribunal) Rules 2008. The Chiesas' argument was essentially that the FCA proceedings against them were instituted and pursued in bad faith; they were a means to enable the FCA to impose a financial penalty as a way of recovering the fine they imposed on Westwood and disclosure was necessary for the Tribunal to deal fairly and justly with the case.

In his 13 July 2017 judgment Judge Sinfield refused the application on the following grounds:

(1) Relevance: the disclosure sought was not relevant to the issues before the Upper Tribunal. The Tribunal's remit was the Chiesas' fitness and propriety and the appropriate action to be taken. Adopting the approach of Judge Berner in *Ford & Ors v FCA* [2016] UKUT 41 (TCC), it was held that the Tribunal does not have jurisdiction to deal with complaints about the FCA's conduct of investigations which should be dealt with through the FCA complaints processes. The cases the Chiesas relied upon in arguing that there were real concerns of an abuse of power by the FCA that led to unfairness, or brought the Tribunal proceedings into disrepute, were very different in that in those cases the alleged abuse affected the facts forming the basis of the claim or was such that no proceedings could have taken place without it.

(2) Lack of evidence of bad faith/improper motive: even if he had been persuaded that the FCA's conduct was relevant, in any event the Judge was not satisfied there was evidence of bad faith or improper motive on the part of the FCA (on the balance of probabilities). Absent such evidence, there could be no duty on the Tribunal to order disclosure wherever bad faith or improper motive was alleged. Judge Sinfield considered some of the Chiesas' supporting evidence as "based on suspicion and supposition". In particular, he disagreed that the FCA approach to Mrs Chiesa's interview was designed to trick her into giving misleading answers and commented that it seemed "perfectly fair and proper".

Following this decision, the Chiesas agreed to settle the case in September 2017 with final notices published on 12 October 2017 (as to which see above).

Over recent years it has become more common for subjects of FCA enforcement action to contend bad faith/impropriety by the regulator and to seek disclosure of internal documents. This decision follows that of Judge Berner in the Ford case and Judge Herrington in *Hussein v FCA* [2016] UKUT 0549 (TCC) in refusing to order such disclosure. Essentially, since the Tribunal is a de novo hearing concerned with the subject's behaviour it is clear that it will be extremely difficult to show that the regulator's conduct is of sufficient relevance to justify ordering disclosure. Whilst this judgment does not completely rule out the possibility, it is very clear that

the situations where the regulator's conduct may be relevant are very limited and likely to be extremely rare (e.g. where it affects the facts forming the basis of the FCA's case). Although similar applications may continue to be made for tactical reasons, we would generally expect to see fewer of them in future.

Upper Tribunal upholds FCA fine and ban

Charles Anthony Llewellen Palmer v. Financial Conduct Authority [2016] FS/2015/017

In September 2015, the FCA issued a decision notice to Mr Palmer imposing a fine of £86,691 and a full prohibition order against him. The prohibition order prevented him from holding a position in an authorised firm where he could exert significant influence on the carrying out of a regulated activity. Mr Palmer referred this to the Upper Tribunal. On 8 August 2017, the Upper Tribunal upheld the FCA's decision.

Mr Palmer was the majority shareholder and CEO of Standard Financial Group Limited. He was also a director and de facto CEO of Financial Limited and Investments Limited (the Firms). The Firms' business was the operation of a network of adviser firms. This network comprised 397 appointed representatives (ARs). Each of the ARs had its own customer base and the ARs acted as financial advisers. Under an agreement between each of the ARs and the Firms, the Firms accepted responsibility for the conduct of the ARs.

The FCA found that Mr Palmer failed to exercise due care, skill and diligence in his controlled function in managing the business of the adviser firms that he was responsible for. It considered that there was a critical lack of systems and controls in place for the activities of the approved individuals within the Firms, such that the Firms could not effectively monitor (and therefore control and mitigate) the risk of unsuitable advice to underlying customers.

Mr Palmer referred the FCA's decision to the Upper Tribunal based on three main grounds:

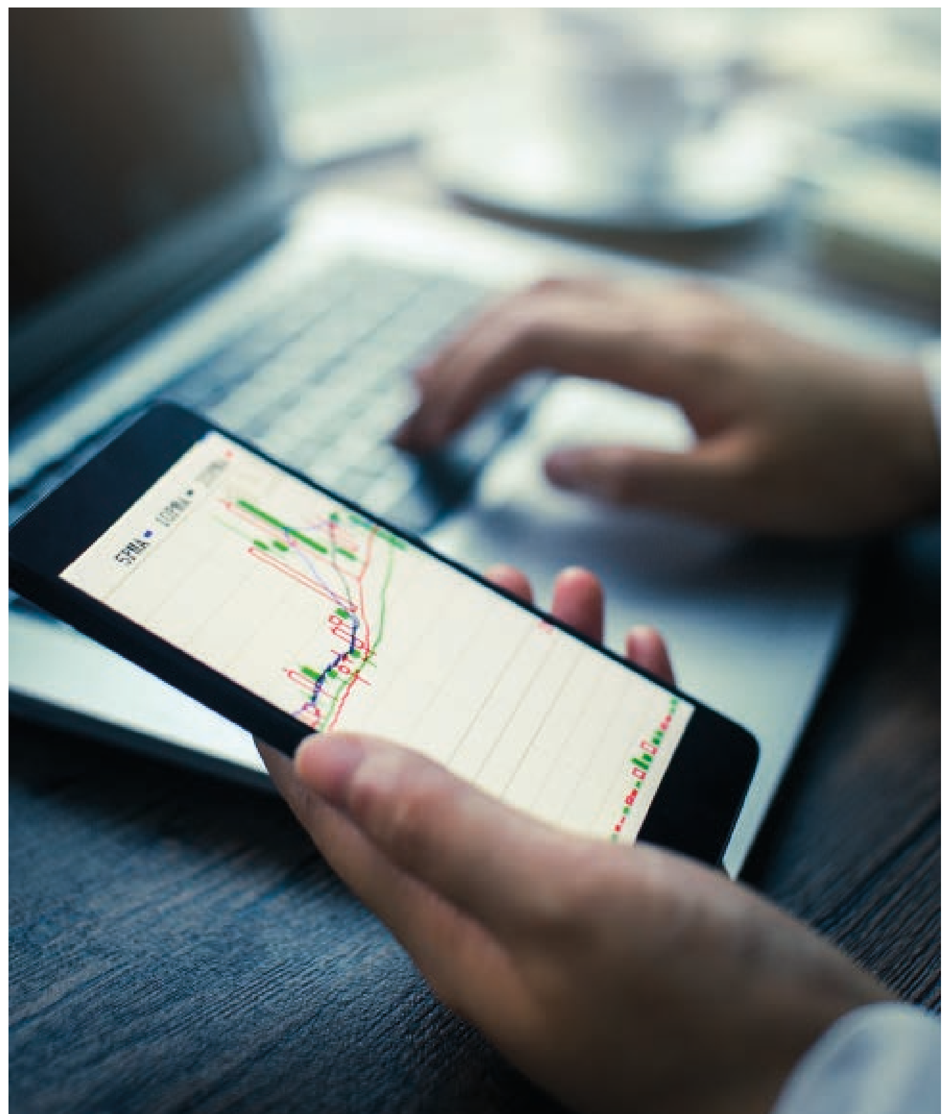
(a) the adviser firms having been disciplined by the FCA in relation to the failings, he was not personally culpable for them;

(b) in any case, these failings were the responsibility of the compliance systems and controls manager; and

(c) the FCA had "cherry-picked" examples of incidents so as to seek to paint a picture of an inappropriate culture.

The Upper Tribunal paid particular attention to Mr Palmer's role within and across the Firms and observed that his role, in reality, was quite different from that which he had described in his evidence. He denied have a controlling function and suggested that the Firms' board collectively controlled the group. In fact, Mr Palmer founded the group and devised and took ownership of the very business model on which the Firms operated. Mr Palmer had also accepted that he was aware of the enhanced risks of the model, associated in particular with the flexibility and the freedom afforded to each AR.

The Upper Tribunal held that, while the Board had overall responsibility for the Firms' systems and controls, it agreed with the FCA that Mr Palmer was responsible for ensuring that such systems and controls were effective and as robust as the business model required. As a result,



the FCA's penalty and its severity were justified. In its conclusions, the Upper Tribunal noted that it did not find Mr Palmer to have the necessary competence to carry out the regulatory role and, perhaps more damagingly, that he did not see the value in the controls and compliance required by the regulations.

This is not the first time that Mr Palmer has been the subject of regulatory enforcement. He was issued with a final notice by the FSA in 2010 as an alternative to the FCA imposing a penalty on Financial Limited. The FCA did not consider that Mr Palmer responded adequately to the 2010 decision notice. His general history of compliance and the fact that the FCA had previously taken action were aggravating circumstances that weighed against him in the FCA's calculation of his penalty.

It is open to Mr Palmer to take his case to the Court of Appeal.

Findings of Complaints Commissioner – Failure by FCA to disclose documents during an investigation

Complaints Commissioner Response, 15 September 2017

The Complaints Commissioner has published his findings in relation to a complaint brought against the FCA with respect to shortcomings in the way it handled an investigation and the subsequent complaints process. The (then) FSA's Enforcement and Financial Crime Division (the Enforcement Team) started an investigation into the complainant on 29 November 2012. This investigation ultimately led to the Regulatory Decisions Committee (RDC) issuing a Warning Notice in 2014. This was done in reliance upon documents which had been requested by the US Commodity Futures Trading Commission (CFTC) and which had been provided by a bank to the FSA over several months starting from 2 November 2010.

Prior to the issue of the Warning Notice, the Enforcement Team had not raised with the RDC that the receipt of those documents potentially undermined the case against the complainant due to limitation. The limitation issue came to light later, resulting in the FCA dropping its case. This was notified to the complainant on 25 July 2014, with an explanation and apology following on 3 October 2014.

The Complaints Commissioner looked into: (i) the limitation matter, given the complainant's allegations that the Enforcement team had deliberately withheld/failed to disclose relevant material; and (ii) the FCA's subsequent delays in dealing with the complaint. The complainant requested a full independent and detailed explanation of what went wrong, an apology, and damages for distress/inconvenience.

In relation to the limitation issue, the Complaints Commissioner:

- found that there was evidence that the FSA had been aware of the potential significance of the limitation issue as early as the first half of 2011;
- concluded that the problem had not been a lack of awareness, but that a decision had been made early on to treat some of the documentation as having no impact on the limitation period, despite others in the Enforcement Team holding a different view;
- found no evidence that the FCA had deliberately withheld information from the RDC, but was critical of the fact that no one had alerted the RDC to the differing arguments on the limitation issue;
- agreed with the final decision of the FCA that the failure to alert the RDC to the limitation issue had been a serious mistake, rather than evidence of bad faith; and
- was critical of what he perceived to be the FCA's "closed minded attitude" and a "lack of rigour in important proceedings".

The Complaints Commissioner then considered the FCA's delay in handling the complaint. He considered that the delay between the initial FCA letter on 25 July 2014 and the explanation and apology on 3 October 2014 was unsatisfactory, and that the apology did not go far enough. His letter also notes that he had to intervene on several occasions when the FCA postponed its investigation, stating that in his view the FCA's view on investigating the complaint while related proceedings were ongoing had been unnecessarily cautious.

In light of his findings, the Complaints Commissioner stated that the FCA's failings in the case had been considerable. However, he did not believe the complainant's request for damages was justified.

Benchmarks

Powers in relation to LIBOR contributions

Consultation Paper 17/15, June 2017

The FCA consulted on the way in which it would use its powers under FSMA (sections 55L, 137A and 137F) or the Benchmarks Regulation (BMR) to compel firms to contribute to LIBOR. The BMR power has not yet arisen, but the FCA's consultation is intended to be compatible with it. In particular, the FCA referred to one of the tests for compulsion under the BMR, being the firm's "actual and potential participation in the market that [LIBOR] intends to measure". This test requires the FCA to define the relevant market for these purposes and this formed part of its consultation.

Some interesting points, as to the FCA's general approach as well as specific proposals, include:

- the FCA does not rule out making firms contribute to LIBOR even

where they are not already contributors, or do not contribute to the relevant currency;

- the FCA envisages that it would require contributions only from large banks that have good credit quality (issued debt of investment grade) and a presence in the UK;
- the FCA is consulting on its proposed criteria for measuring actual market participation, but is simultaneously gathering the data such criteria contemplate; and
- the FCA's estimate of the ongoing cost of contributing to LIBOR (£2.4 million each year) and the initial one-off cost to set up the infrastructure for doing so (£3.5 million).

While the FCA initially proposed to publish responses to the consultation and final rules in September 2017, it has not done so, probably because of the later announcement of the demise of LIBOR from 2021.

Handbook changes to reflect the application of the EU Benchmarks Regulation

Consultation Paper 17/17, June 2017

The Benchmarks Regulation (BMR) will, for the most part, apply from 1 January 2018. In this Consultation Paper, the FCA has set out its proposed amendments to the Handbook to make sure that it is consistent with the BMR. The areas of proposed change include:

- application of the SMCR (Senior Managers and Certification Regimes) and Approved Persons regime to benchmark activities;
- prudential requirements for administrators of benchmarks;
- expectation that administrators should forward to the FCA all suspicions of benchmark manipulation;
- provisions relating to a right of those compelled to contribute or continue administrating a benchmark to make representations to the FCA;
- application of BMR provisions to contributors that are UK branches of third country (i.e. non-EU) firms; and
- how the FCA intends to deal with applications for authorisation or registration under the BMR.

The FCA published final rules in late December 2017, which we will cover in the next edition of rules update.

End of LIBOR

Speech by Andrew Bailey, 27 July 2017

In a speech on 27 July 2017, Andrew Bailey announced that LIBOR would be supported for a further five years, to the end of 2021, with a transition away from it taking place by the end of that time. He said: "We do not think we will complete the journey to transaction-based benchmarks if markets continue to rely on LIBOR in its current form. And while we have given our full support to encouraging panel banks to continue to contribute and maintaining LIBOR over recent years, we do not think markets can rely on LIBOR continuing to be available indefinitely." (Please click here for our note on that speech.)

Since then, the FCA has confirmed (on 24 November 2017) that all 20 panel banks have committed to ensuring the sustainability of LIBOR until the end of 2021. It has since announced the start of the next phase of sterling LIBOR transition work, together with the Bank of England (announcement of 29 November 2017). The announcement refers to the expanded, market-led Working Group, and its role in catalysing the change to SONIA as the primary sterling interest rate benchmark by the end of 2021.

Advice and customer understanding

Advising on Pension Transfers

Consultation Paper 17/16, June 2017

In this Consultation Paper, the FCA consults on changes to COBS 19 designed to secure better outcomes for those affected by the pensions freedoms introduced in 2015. In particular, the FCA is concerned to protect those who might be encouraged to exchange pensions with safeguarded benefits for investments with no safeguards. The FCA's proposals are summarised in five key points:

- all advice on the conversion or transfer of a safeguarded benefit must result in a personal recommendation (which the FCA believes reflects common current practice anyway);
- additional guidance in relation to such personal recommendations;
- amendment to the definition of a pension transfer specialist and guidance in relation to the same;
- replacement of the transfer value analysis requirement (TVA) (amidst concerns that advice had become focussed on it) with an appropriate analysis of the client's options, including a prescribed comparator indicating the value of the benefits being given up;
- the application of additional requirements in respect of pension opt-outs to cases where there are potential safeguarded benefits.

However, the Consultation Paper raises a number of other issues for discussion, including the risk that additional requirements will result in firms ceasing to provide this type of advice. Final rules are expected in early 2018.

FCA published findings from its Ageing Population Project

FCA Occasional Paper 31 – Ageing Population and Financial Services, September 2017

The FCA published an occasional paper setting out the key findings and outcomes from its "Ageing Population Project". The paper also outlines the FCA's strategy for mitigating potential harm which might arise in the way in which financial services are provided to the elderly.

The FCA found that, overall, there was scope for financial services firms to do more to enable elderly customers to access financial services easily and safely. The project and resulting report identified particular issues relating to retail banking, third party access, later life lending and long-term care. The issues identified largely fell under the following three broad headings:

Product and service design

The FCA found that many products and services appeared to have been designed with an "average" consumer in mind, and only a small minority of products were designed with an anticipation of the needs of an ageing population.

To this end the FCA suggested that firms try to understand the needs of older customers and take them into account when developing distribution channels. It also suggested involving older and vulnerable customers in testing and product design.

Customer support

The FCA recognised that not all processes can or should be built around the specific needs of an ageing population. However, where other considerations have taken priority firms should consider the support they offer older customers and how this should change over time.

To this end, the FCA suggests firms could:

- better understand how to help older customers find the most appropriate products and services for their needs;
- help customers to identify when they are struggling and encourage them to seek help; and
- take greater steps to mitigate risks and provide appropriate support as consumer needs and circumstances change.

Continuously review and adapt strategies

The FCA suggests that firms could:

- consider whether they need to adapt or retain access channels for groups who depend on them; and
- continuously review strategies, business models, supporting policies and controls to ensure they remain appropriate in light of demographic change or changing consumer behaviours and needs.

At present, the FCA is treating this issue as part of firms' obligation to treat customers fairly, but this paper may be something of a shot across the bows, if firms do not take steps to address the issues identified by the FCA.

Customer understanding: Retail banks and building societies

FCA TR17/1, 17 July 2017

Building on the results of a survey commissioned in response to the recommendations of the Parliamentary Commission on Banking Standards, the FCA has published a thematic review on customers' understanding of the products they buy.

The FCA based the review on information requested from 18 banks and building societies and obtained by conducting visits to a sample of these firms. Examples provided by banks were about mortgage, credit card and cash savings account transactions. In particular, the review identified that:

- firms are increasingly aware of the importance of assessing customer understanding. Many have embedded (or are in the process of developing) systems which allow them to assess their customers' understanding of particular products throughout their lifecycle;
- some firms are confusing customer understanding with customer satisfaction;
- the most developed systems and practices for checking customer understanding are undertaken after a sale is made; and
- practices are least developed in online sales.

The review report also gives examples of differing pre-sale, point-of-sale and post-sale practices, to help other firms develop their approaches in this area. Initiatives taken by firms included:

- simplifying products and information;
- nominating individuals to be accountable for customer understanding (in some firms, this aligned with those performing relevant senior management functions);
- implementing online web-based chat systems; and
- having a team of qualified advisers to conduct post-sale follow-up calls.

The FCA does not have any specific rules regulating the assessment of customer understanding. However, it is worth nothing that it considers Principles 6 (customer's interests) and

7 (communications with clients) to be relevant. The findings will be used to inform the FCA's Strategic Review of Retail Banking Business Models.

Information about current account services

Consultation Paper 17/24, 25 July 2017, and Policy Statement 17/26, 12 December 2017

In July 2017, the FCA opened its consultation on introducing new rules for business current account (BCA) and personal current account (PCA) providers to publish information on service and performance. The Executive Director of Strategy and Competition at the FCA had suggested that, as information may not be as readily available as it could be, customers are "discouraged from looking for current accounts offering better performance".

The FCA's aim was to "promote effective competition" and empower customers to make effective comparisons between providers of PCAs and BCAs by requiring providers to publish information in the following categories:

- account opening, including account opening processes and information on the time it takes to open an account;
- time taken to replace lost, stolen or stopped debit cards;
- service availability – how and when services can be accessed; and
- major incidents – information about the number of operational and security incident reports to the FCA.

The consultation closed on 25 September 2017, and the FCA has now published a Policy Statement containing its feedback to the consultation, which has shaped the final rules. PS17/26 affects the majority of participants in the PCA and BCA markets, as well as those interested in the market. This includes firms that accept deposits (for example, banks and building societies) and those that provide payment accounts as defined by the Payment Accounts Regulations. It is also of interest to organisations that offer comparison services.

The response to the consultation was broadly supportive, although concerns were raised in some areas and some respondents submitted that the proposals could actually go further. The main changes to the rules consulted on in CP17/24 are as follows:

- In response to concerns about the suitability of the metrics relating to powers of attorney as an indicator of the service provided to vulnerable customers, these data will not be required to be published. Instead, UK Finance and the Building Societies Association are to coordinate development of an industry agreement to publish comparable information voluntarily.
- Transitional provisions will be put into place allowing firms not to publish account opening metrics and debit card replacement metrics until 15 February 2019. Firms will need to begin recording the time taken to open accounts and replace debit cards from 1 October 2018.
- Information about current account services is to be presented in a series of standardised tables in a set order. The FCA believes that this will make it easier to compare the information as published.

The full rules will come into force on 15 August 2018, when providers will be required to publish standing data in relation to account opening, service availability and major incident metrics.

Financial Advice Market Review (FAMR): implementation Part II and insistent clients

Policy Statement 17/25, December 2017

FAMR's final report, published in March 2016, set out to tackle the barriers facing consumers in accessing financial advice in relation to three main areas (please click here for our summary of FAMR's final report). One issue identified by firms in that context was their hesitation in providing customers with guidance, in case they were held to have given advice, albeit inadvertently.

As a result, FAMR recommended that the definition of advising on investments in the Regulated Activities Order be changed in line with the MiFID definition, such that most firms would only be carrying out the regulated activity if they provided a personal recommendation. In its Consultation Paper 17/28 the FCA consulted on the Handbook changes necessary as a consequence (including in relation to access for consumers to the FOS and FSCS).

The Policy Statement largely implements the consequential changes proposed in the consultation paper, and issues new guidance on how firms should process requests from "insistent clients" (i.e. those who have received a personal recommendation and decide to do something other than follow it).

The Consultation Paper had proposed extensive changes to PERG, including such scenarios as pre-purchase questioning (including decision trees), filtering on websites, and how the narrowing in scope of regulated advice (described above) will apply. Rather than implementing these changes at this stage, the FCA is considering these further and aims to publish guidance on these points early in 2018.

The Policy Statement also consults on retiring two pieces of non-Handbook Guidance: on inducements and conflicts of interest (FG14/1), and on independent and restricted advice (FG12/15).

Streamlined advice and consolidated guidance

Finalised Guidance 17/8, September 2017

Like the policy statement summarised above, this Finalised Guidance relates to recommendations made by FAMR. In this case, the guidance relates to two specific issues: streamlined advice, and the fact-find process.

For firms which have been following the development of the FCA's guidance in this area, it is worth noting that two key pieces of guidance (FG15/1 and FG12/10) will be retired from 3 January 2018. The Finalised Guidance now produced by the FCA replaces or restates certain parts of those two documents.

The term "streamlined advice" is used to describe a personal recommendation limited to one or more of a client's specific needs, that does not involve analysis of the client's circumstances not directly related to those needs. The FCA's guidance in relation to the provision of streamlined advice focuses on firms' provision of automated advice services, and it is clear that such services will need to be designed, tested and analysed carefully to ensure that customers use them appropriately. The guidance is detailed and the FCA has included examples of good and poor practice by firms.

The FCA also raises the possibility of "porting" a fact find from one firm to another, and anticipates that this might have advantages if done appropriately. It is clear, however, that each firm relying on the fact find would need to have suitable arrangements in place to confirm the accuracy of data before they are used.

Asset management

Asset Management Market Study (AMMS)

Final report, June 2017

The final report of the AMMS is extensive, and will have been pored over in some detail by those in the sector. It emphasises the importance of the asset management industry in managing some £6.9 trillion in assets. The FCA's own summary of its findings indicates:

- weak price competition in a number of areas, which has a material impact on investors through the charges they pay for asset management services;
- no clear relationship between charges and the performance of retail active funds;
- sustained, high profits in the asset management industry over a number of years;
- lack of clarity as to fund objectives and inappropriate measure of performance;
- heavy reliance by some investors on the advice of consultants, and concerns as to the way in which the investment consultant market operates; and
- retail investors do not appear to benefit from economies of scale when pooling their investments.

Some of the specific remedies proposed are summarised below, but in addition, the AMMS final report refers to continued support for consistent disclosure of costs and charges. The FCA also indicated that it would chair a working group to consider how to make objectives clearer and more useful to investors. It further announced its intention to recommend that HM Treasury consult on bringing investment consultants within the regulatory perimeter.

Consultation on implementing asset management market study remedies and changes to Handbook

Consultation Paper 17/18, June 2017

The FCA's consultation builds on the findings of the AMMS, and contains proposals on three specific areas: governance; moving investors into better value share classes (and the circumstances in which the Authorised Fund Manager (AFM) could undertake a mandatory conversion); and risk-free box profits (where the AFM makes a risk-free profit on holding fund units sold in a "manager's box" before selling them at a higher price within the same valuation point). The FCA also launched a discussion as to whether it should consider introducing an end to the payment of trail commission, and whether remedies outlined in the Consultation Paper should be applied to other retail investment products.

The most interesting of these proposals is arguably governance, in relation to which the FCA focused on the boards of AFMs. The FCA proposed that the boards of AFMs should be required to assess (and document) annually whether value for money had been provided to fund investors. The FCA set out various points that the value for money assessment would need to include. Further, the FCA proposed that AFMs should be required to appoint a minimum number of independent directors. The Consultation Paper also indicated that the FCA would consult, as part of the Senior Managers and Certification Regimes (SMCR), on the introduction of a prescribed responsibility on the chair of the AFM board to act in the best interests of investors, but such prescribed responsibility does not appear in the list of those the FCA proposes as part of the extended SMCR (as to which see above).

The FCA's actions in relation to asset management since the publication of the AMMS final report, including first use of its competition enforcement powers

In September, the FCA announced a final decision to make a market investigation reference on investment consultancy and

fiduciary management services to the Competition and Markets Authority, and to reject proposed Undertakings in Lieu.

The FCA went on to publish the Investment Platforms Markets Study Terms of Reference (MS17/1.1).

Finally, at the end of November, the FCA announced that it had provided a statement of objections to four asset management firms, alleging breaches of competition law as a result of sharing information relating to the prices they intended to pay for shares in forthcoming IPOs. As the FCA put it, the bilateral sharing of information allowed firms to know the other's plans during the IPO or placing process "when they should have been competing for shares". It does not seem to be alleged that the firms actually agreed to bid at specific prices. Given the fact that buy side market practice in this area has been varied, and in light of the economic dynamics of the current IPO market, it will be interesting to observe how the case proceeds.

This marks the FCA's first use of its competition enforcement powers. The statement of objections procedure is drawn from the Competition and Markets Authority's enforcement procedure, and the statement of objections itself is broadly equivalent to a combined warning notice and investigation report under the FSMA procedure.

AML

The treatment of politically exposed persons for anti-money laundering purposes

Finalised Guidance 17/6, July 2017

The FCA has finalised its guidance on how firms should approach politically exposed persons (PEPs), their families and known close associates. The guidance is issued under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, and the FCA considers that it will satisfy the requirement for the FCA to issue guidance under section 333U of FSMA, when that provision comes into force.

The guidance is detailed in a number of respects, and should generally be helpful to firms in determining what procedures are appropriate in particular cases. It should also be helpful to individuals, in that the guidance sets out instances where firms ought not to treat a person as a PEP (e.g. because the office they hold is too junior), or ought to treat a PEP as posing a lower risk. The guidance also reiterates the FCA's position that firms are not expected to "de-risk" by refusing to have PEPs as customers, simply because they are PEPs

The FCA has produced detailed considerations as to: who a PEP is; who the family members of a PEP are; who the known close associates of a PEP might be; risk factors pointing to a PEP posing either a lower or higher risk; and steps that the firm might consider taking depending on the level of risk posed by a PEP. The guidance also contains useful information as to the level of sign-off firms should obtain in respect of high risk and low risk PEPs and how this interacts with the Senior Managers Regime.

It is clear from all this guidance, however, that firms will have to consider the detail of each case in order to determine how to proceed and document this carefully. The FCA has also since produced further draft guidance (in Consultation Paper 17/39) in relation to the Financial Crime Annual Return (REP-CRIM), including guidance to the effect that firms need only report in relation to PEPs (including their family and known close associates) whom they identify as high risk. The FCA says that this means, in practice, that firms will not need to make reports in relation to UK PEPs.

Proposed guidance on a sourcebook for professional body supervisors on anti-money laundering supervision

Guidance Consultation 17/7, July 2017

In March 2017, the government announced that it planned to introduce the Office for Professional Body AML Supervision (OPBAS), to be hosted by the FCA. As a result, in July 2017, the FCA launched a consultation process, part of which relates to the introduction of a "sourcebook for professional body supervisors", setting out guidance on how professional body supervisors should carry out their anti-money laundering supervision work.

The draft sourcebook (at Appendix 1 to the Guidance Consultation) includes the following expectations of professional body supervisors:

- that they allocate responsibility within the organisation for supervision of AML;
- that there is adequate management information in relation to the supervision of AML;
- that they allocate their resources as regards supervision on a risk-based approach (maintaining a risk profile for each member) and support their members in doing so;
- suggestions as to how ongoing supervision should be undertaken, such suggestions indicating that the burden of supervision is likely to be relatively heavy for professional body supervisors; and
- specific guidance on information sharing.

Responses to the consultation have been lukewarm – both the Law Society and the Bar Council have been critical of a lack of clarity as to how the relationship between OPBAS and professional body supervisors will actually work, and it is true that the FCA's proposed sourcebook is far more focused on its expectations of professional body supervisors than on the practicalities of OPBAS's role.

The consultation process closed in late October 2017, and it remains to be seen what the FCA makes of responses it receives.

Other developments

Investment and corporate banking: prohibition of restrictive contractual clauses

Policy Statement 17/13, June 2017

The FCA published final rules (in COBS 11A.2) to prohibit UK firms from including restrictive clauses in written agreements with their clients (whether based in the UK or overseas). The prohibition extends to clauses which give firms a: "right to act", i.e. the right to provide any future primary capital market or M&A services to the client, or; "right of first refusal", i.e. the firm has the right to choose to provide such services before anyone else can.

The following features of the FCA's final rules are also worth noting:

- the ban only applies to written agreements containing clauses relating to unspecified and uncertain future services – there is no restriction on firms agreeing terms for specific and known future work;
- "right to match" clauses are acceptable – this covers clauses that allow firms the chance to match an offer made to a client by another firm, so long as the client retains the right to choose either firm to provide the service;
- the ban applies to clients of all sizes;
- the ban only affects primary market services;
- restrictive clauses contained in bridging loan agreements or agreements for warehouse facilities are excluded from the ban because there are legitimate commercial reasons for their inclusion;
- the FCA rejected the argument that the ban (and its geographic scope in particular) would prejudice UK firms at the expense of their international counterparts (who, it was said, would be able to price initial work more cheaply because of the use of restrictive clauses ensuring income from future work).

The ban will take effect from 3 January 2018.

Staff incentives, remuneration and performance management in consumer credit – findings from the FCA's thematic review and proposed new rule and guidance

Consultation Paper 17/20 and Guidance Consultation 17/6, July 2017

The FCA has consulted on the introduction of new rules and guidance in CONC, in order to try to improve on incentives, remuneration and performance management in consumer credit firms following a thematic review. The new rules would not apply to firms already subject to any of the remuneration codes in SYSC 19A to SYSC 19F inclusive, or

to remuneration provisions made by an EEA regulator pursuant to specific EU legislation.

For those firms affected by the Consultation Paper and Guidance Consultation, the key points are:

- a rule requiring firms to put in place adequate arrangements to detect and manage any risk of non-compliance with their regulatory obligations arising from their remuneration or performance management practices;
- a requirement that firms take account of the nature, scale and complexity of their businesses, and the range of financial services and activities undertaken in the course of that business, when deciding how to comply;
- guidance on the purpose of the new provisions, including their relationship with existing requirements; and
- specific examples of good and poor practice.

The outcome of this consultation should be to focus the minds of consumer credit firms on an area that was subject to considerable scrutiny and reform in banks in particular, in the wake of the financial crisis. Given that scrutiny, it is perhaps surprising that the FCA found some of the higher risk incentives that it identified among consumer credit firms. Final rules are expected in early 2018.

Markets in Financial Instruments Directive II Implementation – Consultation Paper VI

FCA CP17/19, 03 July 2017

In July, the FCA published a Consultation Paper on its sixth set of implementation proposals for MiFID II and proposed changes to the FCA Handbook. In this Consultation Paper, the FCA published proposals:

- to bring recognised investment exchanges operating multilateral trading facilities and organised trading facilities within the scope of the Financial Services Compensation Scheme (as required by Article 5 of MiFID II);
- to amend the changes proposed to DEPP and the Enforcement Guide (as described in CP17/8), in order to comply with the final legislation introduced by the Treasury to implement MiFID II; and
- to make consequential changes to the Prospectus Rules and Glossary in the Handbook, to comply with legislative changes introduced by the Treasury to implement MiFID II.

The Consultation Paper once more reflects the significant amount of regulatory change currently underway, not least as a result of the imminent introduction of MiFID II. The necessary rule changes were due to be finalised by November 2017, but had not yet been published by the time this update was finalised.

FCA issues Policy Statement on implementation of the revised Payment Services Directive (PSD2)

PS17/19 – Implementation of the revised Payment Services Directive, September 2017

The FCA issued a Policy Statement setting out its approach to implementation of PSD2 and the changes which will consequently need to be made to the FCA Handbook. The FCA plans to implement the changes to the FCA Handbook and the Approach documents as consulted on in CP17/11 and CP17/22 earlier in the year.

The FCA considers the changes to be of particular interest to payment services providers, banks, e-money issuers, money remitters, non-bank card issuers and merchant acquirers among others.

The Policy Statement covers changes in the following areas:

- Perimeter Guidance;
- authorisation and registration;
- complaints handling and reporting;
- conduct of business;
- regulatory reporting, notifications and record keeping;
- account information services, payment initiation services and confirmation of availability of funds; and
- payment providers' access to payment account services.

The Policy Statement also sets out the specific changes to be made to the Approach document and the approach that will be taken to regulation and enforcement by the Payment Services Regulator post-implementation.

The appendices contain the text of the changes which will be made to the FCA Handbook and non-Handbook directions for excluded providers.

FCA's Annual Report and Accounts 2016/2017

Annual Report and Accounts

The body of the FCA's Annual Report focused on how the FCA furthered its three key objectives over the course of the past year, highlighting notable achievements as follows:

Securing protection for consumers

The FCA's work in this area included:

- investigating the markets in packaged bank accounts and contracts for difference;
- new rules requiring insurers to encourage consumers to shop around when policies expire;
- taking measures to ensure mortgage and consumer credit customers in arrears are treated fairly;
- capping pension exit charges;

- helping firms prepare for the impact of an interest rate rise on vulnerable customers;
- continuing to seek redress for consumers mis-sold PPI while bringing in a deadline for complaints of 29 August 2019; and
- investigating unfair treatment of small business customers.

Protecting and enhancing the integrity of the UK financial system

The FCA referred to ongoing supervision work, including:

- consulting on a range of measures designed to improve the access to information for investors on an IPO;
- undertaking a range of preparations for MiFID II implementation including publishing four consultation papers and holding a number of workshops;
- taking action against market abuse;
- conducting an ongoing review of rules relating to crowdfunding;
- addressing concerns in relation to "dark pools"; and
- implementing measures to support and encourage whistleblowing.

This section of the report also contained more in-depth analysis of the FCA's work in relation to wholesale financial markets; financial crime and anti-money laundering and firms' culture and governance.

Promoting competition for consumers

The FCA also reported on the following work related to its competition remit:

- market studies into the investment and corporate banking, credit card, asset management, insurance add-on and mortgage markets;
- the New bank Start-up Unit in conjunction with the PRA; and
- support for an effective implementation of the Second Payment Services Directive.

The FCA also noted that it is providing impartial technical advice to the government in relation to Brexit, and is working with firms to plan for the future.

FCA Mission – Our Future Approach to Consumers

FCA Mission Paper, 6 November 2017

In April 2017 the FCA published "Our Mission 2017", which provides a framework for the FCA's framework choices. As part of that Mission, the "Future Approach to Consumers" paper has been published to explain the approach to regulating for retail consumers in greater depth.

In this paper, the FCA offers its insight into "who are consumers in 2017" and lays out its vision for a well-functioning market that works for consumers. In all markets it wants to see:

- that consumers are enabled to buy the products and services they need because the environment in which they are sold is clear, fair and not misleading, with a good choice architecture; and
- high-quality, good-value products and services that meet consumers' needs.

Additionally, the FCA states that, where markets work well for consumers, it should be possible to observe:

- inclusion – everyone is able to access the financial products they need and the needs of vulnerable consumers are taken into account; and
- protection – consumers are appropriately protected from harm.

This approach has been developed using a wide range of research, including the results of the Financial Lives Survey (published on 18 October 2017). It is based around five core ideas: consumer and firm responsibility; keeping pace with a changing environment; regulating for vulnerable consumers; having regard to access and tackling exclusion; and delivering better outcomes for all consumers.

The FCA states that its approach will be based on an appropriate balance of its existing range of tools and convening powers, used to diagnose and remedy harm. The intention is to prioritise the needs of all types of retail consumers in the FCA's interventions and other decisions.

One additional point firms should note is that the paper mentions that a number of stakeholders have identified a potential need to introduce a new duty of care. This would impose an obligation on firms to exercise reasonable skill and care in the provision of services to customers. However, the FCA has stated that this will require detailed consideration, best done following Brexit. At that time, a Discussion Paper will be published to explore the issue separately. It is questionable, however, what such a duty would add to the obligations already on firms.

It is worthwhile noting that the FCA has stated that this paper is not its final and definitive approach – in addition to setting out the general approach, the paper contains six consultation questions. The FCA will consider responses to this consultation, with a final Approach to Consumers due to be published in 2018. Responses to the consultation should be submitted by 5 February 2018.

PRA Policy Statement in relation to regulatory references

Policy Statement 19/17, 20 July 2017

In February 2017 the PRA published the Occasional Consultation Paper (CP2/17), setting out proposed

changes to PRA rules and existing Supervisory Statements (SS). The consultation was relevant to all PRA authorised firms. In this Policy Statement, the PRA has published feedback to CP2/17. PS19/7 includes the final rules and updated SS34/15 "Guideline for completing regulatory reports" and SS9/13 "Securitisation".

The PRA has given feedback and set out its final policy decisions as follows:

- Regulatory references – minor amendments are to be made to the language relating to the regulatory references rules in the Fitness and Propriety, Insurance – Fitness and Propriety and Large Non-Solvency II Firms – Fitness and Propriety parts.

- Non-Solvency II firms – external audit reporting and supplementary notes. Rule 2.5 of the Insurance Company – Reporting Part is to be amended to exclude from the scope of external audit the reporting that is required under Insurance Company – Reporting 4.24 to 4.25.

- Remuneration – committees and deferral periods. Minor amendments are to be made to Remuneration 7.4, as proposed in the CP. However, the PRA has decided to leave Remuneration 15.17(1)(b) as it is currently drafted. This is because a response was received indicating that the proposed amendment would not clarify the provision.

- Ring-fencing – residual reporting requirements for ring-fenced bodies (RFBs). Amendments and additions are to be made to the reporting requirements for RFBs, and amendments are to be made to the reporting requirements set out in the Regulatory Reporting Part of the PRA Rulebook. In addition to the changes which are to be made, the PRA confirmed that there will be no need to submit duplicate data to meet IFRS 9 reporting requirements where an RFB sub-group already reports the same data under FINREP reporting requirements.

- Securitisations – implicit support and external credit assessment institution mapping. Changes are to be made to SS9/13 to align the Implicit Support and SRT chapter (5) with the EBA guidelines on implicit support for securitisation transactions. Chapter 7 "Mapping of ECAI credit assessments to credit quality steps" is to be deleted.

The PRA is also considering the responses received to Chapter 2 "Credit risk mitigation – secured guarantees" and has said that feedback is to be provided in a separate PRA document.

Bank of England seeks views on details of the procedure for the Enforcement Decision Making Committee (EDMC)

Bank of England Consultation Paper – Procedure for the Enforcement Decision Making Committee, November 2017

The Bank of England (the Bank) has published a consultation paper on the procedure for the EDMC, which has been set up following the outcome of an earlier consultation paper issued in July 2016.

The Bank now proposes that:

- the remit of the EDMC will be to make decisions (which can be appealed to the Upper Tribunal) on behalf of the Bank in contested enforcement cases with respect to Prudential Regulation, Financial Market Infrastructure and Resolution as defined in the draft statutory provisions annexed to the Consultation Paper;

- members of the EDMC will be independent of the current Bank executive (and not employees of the Bank), appointed for fixed three-year periods by the Court of Directors of the Bank (the Court) with a term limit of two consecutive terms, removable prior to the expiry of their fixed term by the Court only where they are unable or unfit to discharge their function;

- the EDMC will eventually consist of nine members, of whom three will be legally qualified, but the Court will appoint an initial five, of whom two will be legally qualified, it will be chaired by one of its legally qualified members and all members will receive reasonable remuneration and expenses; and

- a panel of at least three EDMC members, of whom one must be legally qualified, should be convened to hear and resolve each contested enforcement case by majority vote, with a nominated "Panel Lead" (chosen from the legally qualified members) having a casting vote in the event of a split vote.

The Bank invites feedback until 2 February 2018. The structure and procedure proposed by the Bank will not be entirely alien to those familiar with the Regulatory Decisions Committee of the FCA, but these proposals mark an interesting further step in the development of the Bank's enforcement procedures.

Consultation Paper on Industry Codes of Conduct and Discussion Paper on FCA Principle 5

Consultation Paper 17/37, November 2017

The proposals in this consultation paper are closely related to the Fair and Effective Markets Review (FEMR) in relation to fixed income, currency and commodities (FICC) markets. One of the main recommendations of FEMR was the development of new industry codes of conduct, including in relation to the global spot FX market.

The FCA is now consulting on industry codes in relation to unregulated activities. Its proposals are, in summary:

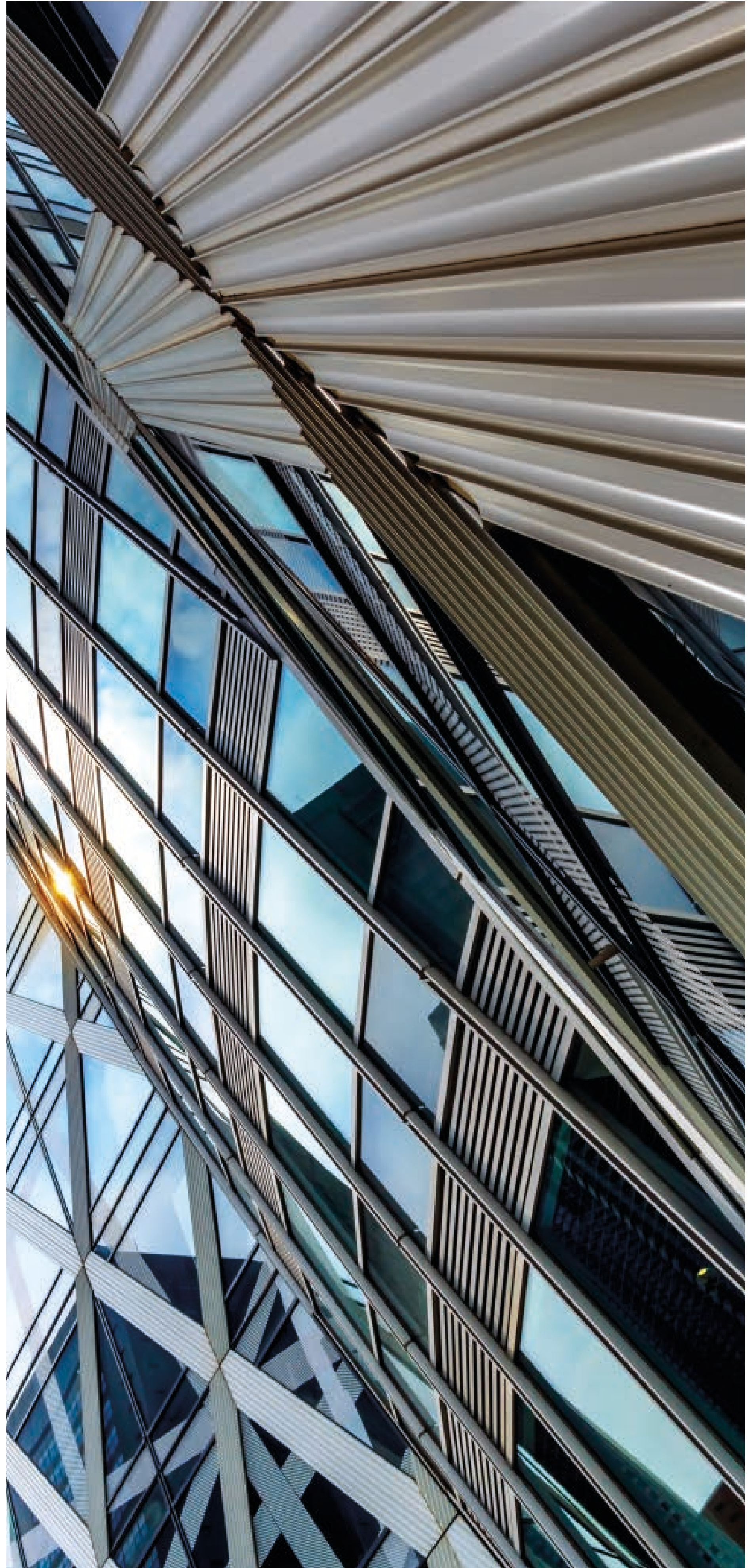
- to recognise certain industry codes in relation to unregulated activities, with the effect

that compliance with such codes would tend to indicate compliance with applicable FCA rules that reference "proper standards of market conduct"; and

- to set out the criteria and outline process it would apply to deciding whether or not to recognise a particular code.

The FCA also seeks views on whether its approach to enforcement in the context of the Senior Managers and Certification Regimes (SMCR), including the conduct rules, is sufficiently clear in relation to the relevance of industry codes.

Finally, the FCA has started a discussion as to whether Principle 5 (requiring a firm to observe proper standards of market conduct) should be extended to unregulated activities. This is clearly a possibility that the FCA favours.



About Dentons' Financial Markets Disputes and Regulatory Practice

Our dedicated team, comprising lawyers exclusively devoted to banking and finance regulatory and disputes work, represents major financial sector clients in a wide variety of complex and often high-profile disputes and regulatory matters. We support a range of domestic and international clients, providing swift, concise and practical advice that secures the best possible outcomes.

Recognised for our pragmatic and hands-on approach, we are increasingly engaged by long-standing clients of the Firm to support them on financial regulatory matters. We closely monitor regulatory developments and continue to enhance our practice to meet client needs and advise across national, regional and global platforms.

If you have any queries, or would like to receive regular technical updates or information on client training initiatives from this team, please contact any of the individuals listed below. For more information, visit

dentons.com

Daren Allen
Partner, London
D +44 20 7246 7651
daren.allen@dentons.com

Felicity Ewing
Partner, London
D +44 20 7320 6066
felicity.ewing@dentons.com

Adrian Magnus
Partner, London
D +44 20 7320 6547
adrian.magnus@dentons.com

Craig Neilson
Partner, London
D +44 20 7320 8804
craig.neilson@dentons.com

Kerry Talbot
Partner, Watford
D +44 1923 206611
kerry.talbot@dentons.com

Katharine Harle
Senior Associate, London
D +44 20 7320 6573
katharine.harle@dentons.com

Celyn Armstrong
Partner, London
D +44 20 7246 7174
celyn.armstrong@dentons.com

Tom Leyland
Partner, London
D +44 20 7246 7471
tom.leyland@dentons.com

Steven Mills
Partner, Watford
D +44 1923 215036
steven.mills@dentons.com

Clare Stothard
Partner, Watford
D +44 1923 690033
clare.stothard@dentons.com

Michael Wainwright
Partner, London
D +44 020 7246 7735
michael.wainwright@dentons.com

Alexandra Doucas
Senior Associate, London
D +44 20 7246 7030
alexandra.doucas@dentons.com

Thanks to Ami Ndukwe, Harry Stewart, Ksenija Radonic, Christina Rocher, Sam Claydon, Tom Hanson, Victoria Goodsell, Fergus Nolan, Duncan Scott.

If you have any queries, or would like to receive regular technical updates or information on client training initiatives from this team, please contact any of the individuals listed above.

For more information, visit dentons.com

Dentons is the world's largest law firm, delivering quality and value to clients around the globe. Dentons is a leader on the Acritas Global Elite Brand Index, a BTI Client Service 30 Award winner and recognized by prominent business and legal publications for its innovations in client service, including founding Nextlaw Labs and the Nextlaw Global Referral Network. Dentons' polycentric approach and world-class talent challenge the status quo to advance client interests in the communities in which we live and work.

www.dentons.com

© 2018 Dentons.

This publication is not designed to provide legal or other advice and you should not take, or refrain from taking, action based on its content. Attorney Advertising. Please see dentons.com for Legal Notices. Dentons is an international legal practice providing client services worldwide through its member firms and affiliates.

Dentons UKMEA LLP is a limited liability partnership registered in England and Wales under no. OC322045. It is authorised and regulated by the Solicitors Regulation Authority. A list of its members is open for inspection at its registered office: One Fleet Place, London EC4M 7WS. Any reference to a "partner" means a person who is a partner, member, consultant or employee with equivalent standing and qualifications in one of Dentons' affiliates.

CSBrand-6632-Six Month Update Newsletter - Financial Markets Disputes and Regulatory Update Edition 6 — 16/01/2018