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BANKING DISPUTES
QUARTERLY

Q2 2016

Welcome to the Q2 2016 edition of our Banking Disputes Quarterly, designed to keep you up to date with the latest news and legal developments and to inform you about future developments that may affect your practice.

ON THE HORIZON

Brexit: what impact might leaving the EU have on the UK's financial services industry?

By Jean-Pierre Douglas-Henry (Partner), Tony Katz (Partner), Hugh Evans (Partner), Stewart Plant (Partner), Alexandra Kamerling (Partner) and Camilla Macpherson (Senior Lead Professional Support Lawyer)

Now that the results of the EU referendum are in, we consider the potential implications of a Brexit on the financial services industry.

1. Passporting

At the moment a range of authorised businesses, such as banks, insurance companies and asset managers, are able to operate across the EU as long as they have a base in the UK. This is called "passporting".

Passporting means that a British bank can provide services across the EU from its UK home. Importantly, it also means that a Swiss or an American bank can do the same from a subsidiary established in the UK. Goldman Sachs and JPMorgan both gave evidence to the Parliamentary Commission on Banking Standards before the referendum, flagging up the importance of the UK's EU membership in providing a base from which non-EU businesses can passport across the EU.

Passporting into the EU from the UK will not be possible following a Brexit unless a special arrangement can be negotiated. Financial services businesses wanting to continue to provide services across the EU may well have to establish subsidiaries in mainland Europe (to the extent that they do not already have them).

2. Red tape

Financial services is a highly regulated industry. Although much of this regulation emanates from Brussels, it is unlikely that regulation is going to lessen following a Brexit. While there are some examples of financial regulatory requirements which have been resisted by the UK (e.g. the bonus tax) many of the EU-derived requirements reflect the perceived need in the UK. It is therefore unlikely that the UK will repeal or amend significant parts of the financial regulatory law. Where the requirements have had direct effect in the UK, through Regulations, then the UK would need to decide whether to adopt these requirements or allow them to lapse on a Brexit.

If the UK wants to continue to do business with the remaining EU Member States following a Brexit, it will almost certainly need to comply with EU regulations in order to meet an equivalence assessment – but unfortunately without the ability that it previously had to negotiate, influence or challenge those regulations. Banks may also be faced with having to comply with UK as well as EU legislation, which may well diverge over time or at minimum be applied inconsistently.

3. Continuing the UK's relationship with the EU

Various models have been proposed for how the UK and the remaining Member States of the EU might manage their relationship following a Brexit. Could the UK be the new Norway (by becoming a member of the EEA and EFTA)? Or Switzerland (accessing the EU by way of bilateral agreements)? Or Turkey (which has a customs union with the EU)?

No doubt plenty will be said about the advantages and disadvantages of these and other options in coming weeks and months as the alternatives are assessed in more detail. Focussing solely on the financial services perspective, however, it is only the Norway model which is appealing for the sector, but it is unlikely to be politically appealing.

Switzerland's 120+ bilateral agreements with the EU require constant renegotiation. None of these agreements allows Switzerland full access to the EU's internal market for financial services. As a result, Switzerland tends to do banking business by passporting – often from the UK.

Turkey's customs union is limited to trade in goods. It does not extend to trade in services (financial or otherwise) and is intended as a pre-cursor to EU membership, not an alternative to it.

It is likely therefore that the UK will now be looking to set up a bespoke arrangement going forward.

4. Legal framework

The UK's legal system has become tightly enmeshed with that of the EU over a period of forty years. The unravelling process is likely to be a long and expensive one. Which European legislation and regulation does the UK like or need and therefore want to keep? What should be replaced? Where are the gaps? New UK legislation might also be incompatible with EU legislation. Over time, it is almost inevitable that the two banking environments would drift apart.

There may also be an impact on existing contracts. For example, contractual parties will be asking:

- Will a contractual requirement to comply with a particular piece of EU legislation still be binding following a Brexit?
- What principles of EU law will still influence English courts?
- How will a judgment from an EU Member State now be enforced in the UK?
- How will a choice of English law be interpreted if EU law was part of English law at the time the contract was made but not by the time of performance?

Comment

The UK's decision to leave the EU raises significant uncertainty for the financial services sector. For this sector, continued access to the single market is a priority. On the one hand, UK institutions, which are heavily reliant on the EU as the destination for UK exports of financial services, will be seeking to support and influence the UK Government in the important exit negotiations.

On the other hand, these institutions will be seeking to implement their contingency plans to achieve continuity of access to the single market.

For more information on any of the issues, facts and figures in this piece, please contact the authors.

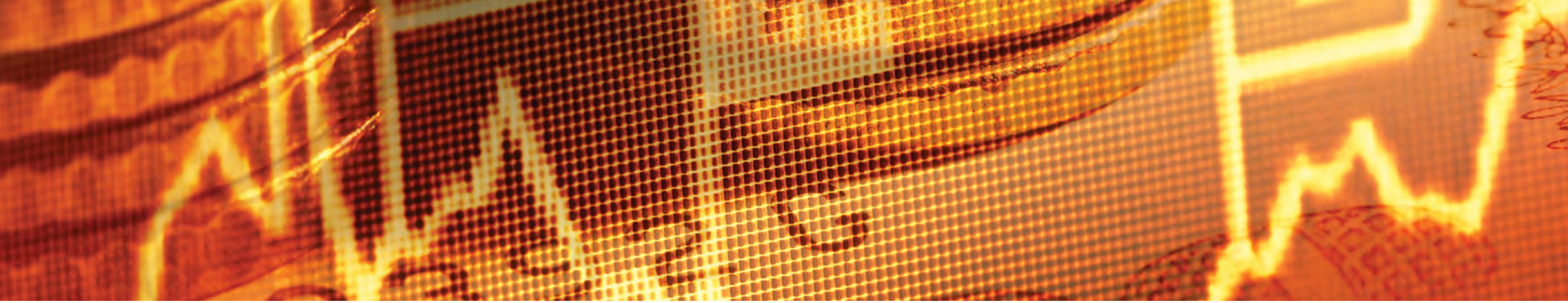
The potential impact of the referendum decision on a range of other commercial areas and sectors is considered in more detail on DLA Piper's dedicated Brexit pages.

Third Party (Rights Against Insurers) Act 2010 – benefits for lender claims

By Hugh Evans (Partner) and Rachel Tookey (Senior Associate)

Lenders contemplating potential claims against insurers of insolvent professionals will welcome the fact that the *Third Parties (Rights Against Insurers) Act 2010* (**2010 Act**) is to finally come into force from 1 August 2016, having been updated by the *Third Parties (Rights Against Insurers) Regulations 2016*.

This legislation will assist lenders who are looking to make an informed decision about whether to pursue claims against the insurers of insolvent professionals, such as valuers or solicitors. The 2010 Act improves



upon the rights afforded by the 1930 Act of the same name, by allowing third parties to claim directly against the insolvent party's insurer. The 2010 Act will also give potential claimants rights to access information from the outset which will help determine whether an insurance policy is likely to respond to a claim.

Difficulties faced by lenders under the 1930 Act

The 1930 Act provides a mechanism by which claimants can obtain the following from an insurer of an insolvent party:

(a) an indemnity under the policy, but only having first obtained judgment against the insured; and

(b) information about an insolvent party's insurance.

It is however unclear whether the claimant first has to establish the liability of the insured in order to obtain the information referred to at (b) and this has been subject to judicial debate. *In the Matter of OT Computers Ltd (In Administration), First National Tricity Finance Ltd v OT Computers Ltd (In Administration) [2004] EWCA Civ 653* Longmore LJ overruled previous authorities and held that establishing liability is not a pre-requisite. He noted that the Law Commission had decided that the position should be reversed in legislation. Ultimately this is what led to the 2010 Act.

It is also unclear precisely what information the claimant is entitled to under the 1930 Act. In the *Re OT Computers* case the claimant only sought disclosure of the policy document.

Consequently, under the present legislation, lenders frequently find themselves in the invidious position whereby they have a negligence claim against an insolvent professional but do not have clear rights to obtain information to establish whether there is insurance in place to meet the claim. They run the risk that if they embark on litigation it could prove fruitless. Often an insurer will decline cover for the professional without providing any reasons, leaving the lender in ignorance as to whether the decision to decline cover could be challenged.

The process the lender has to embark upon to obtain the required information and pursue the insurer direct is lengthy and costly. First, the lender has to incur the time and expense of obtaining a judgment establishing the insured's liability. In the case of an insolvent company, the lender may first have to obtain the court's permission to issue a claim and, if the firm is a company which has been struck off the register of companies, may have to apply to restore the company to the register. Once a judgment against the insured has been obtained a claim against the insurer can then be pursued. It may not be until this point that it transpires that cover has been exhausted or properly declined and the lender will have endured a pointless, costly battle.

The difficulties faced by lenders were highlighted in the case of *Goldsmith Williams (a firm) v Travelers Insurance Company Limited [2010] EWHC 26 (QB)*. GW acted for a lender in two residential purchases and the borrower, Mr A, whose firm, J, acted in the purchase, stole the mortgage funds. J was a two partner firm and its insurer, Travelers, declined cover on the basis that the second partner, U, had condoned A's dishonesty but it did not provide detailed reasons for the declinature. GW did not accept that U had been involved in the fraud and wished to challenge the insurer's decision to decline cover.

The lender brought a claim against GW for the stolen mortgage funds, and assigned its claim to GW, who in turn obtained a judgment against J. J had entered insolvency proceedings and therefore, having obtained a judgment, under the 1930 Act GW obtained the right to pursue Travelers directly. The court found that the insurer's decision to decline was justified as U had been engaged in separate mortgage fraud and was undoubtedly aware of the transaction in question and helped to facilitate it. GW's claim therefore failed. GW had not been aware of this information prior to bringing proceedings against Travelers. The case demonstrates that a lack of information provided by insurers can result in lenders bringing fruitless claims.

Improvements under the 2010 Act

The 2010 Act makes some key changes which will assist lenders in future actions.

1. Removal of the requirement to first establish liability

A claimant suing an insolvent defendant will be able to pursue a claim against an insurer directly, without first having established the insolvent insured's liability in separate proceedings. A lender will therefore be able to ask the court for a declaration regarding both the insured's liability and the insurer's potential liability under the insurance policy in the same action. This means the lender need only bring a single set of proceedings against the insurer and will be able to establish if there is insurance cover in place before having to proceed with the underlying claim. Beneficially, this also means the lender no longer has to restore an insolvent party to the register.

If the insurer does not accept the professional's liability, the lender will still have to prove liability before enforcing against the insurers but the rights afforded by the 2010 Act give the lender the opportunity to consider coverage issues and any defences raised by the insurer at an earlier stage and before the considerable costs of establishing liability are incurred.

2. Access to information

The 2010 Act provides a new regime for the provision of information. A third party is entitled to request details about the insolvent party's insurance cover before it decides whether to bring a claim, removing uncertainty and cost. A request can be made for details of:

- the identity of the insurer;
- the terms of the policy;
- the limit of cover;
- whether cover has been declined previously (and if so, details of any proceedings); and
- whether any aggregate indemnity limit has been eroded.

A response should be provided within 28 days, otherwise the third party can apply to the court for an order compelling compliance. The request for information can be made not only to the insurer but also to brokers, insolvency practitioners and former officers of the insolvent company.

This represents a welcome shift in the dynamic between third parties and insurers. Helpfully, it means a lender is now able to obtain information about coverage issues before going to the expense of establishing liability and pursuing a claim against the insurer.

3. Insurer not able to avoid cover for insured's failure to provide information

Another improvement worth noting is that once liability has been established and a third party is seeking to enforce his rights under a policy, an insurer can no longer seek to avoid liability based on a failure of the insolvent

insured to provide information and assistance to the insurer. The third party can fulfil any obligations under the policy itself to prevent the policy from being breached and declared void. This prevents insurers relying on purely technical defences to defeat a third party's claim.

Is the 2010 Act the complete answer for lenders?

The 2010 Act only applies where there has been an event of insolvency in relation to the insured. Consequently, if insurance cover has been declined in relation to a professional who is not yet insolvent, in order to obtain information under the Act the lender will still have to obtain a judgment against the insured then enforce that judgment and put the insured into insolvency for non-payment of the judgment debt.

Furthermore, there is no requirement under the 2010 Act for the insurer to disclose specific reasons for a refusal to indemnify, or the arguments advanced by the insured in response. A lender will still face difficulties reaching an informed view regarding the justification for the declinature. The information may become available during disclosure, or could be requested by way of a Request for Further Information after service of the defence, but to reach that stage of proceedings against the insurer, the lender will have had to incur significant costs – and therefore lack of information at an early stage remains a problem. This could be overcome if prior to proceedings the lender seeks pre-action disclosure but this could be costly if an application and hearing is required.

It should be noted that the 2010 Act will not apply to any current claims; the 1930 Act will continue to apply where the insured was subject to an insolvency procedure, or liability to a third party was incurred, prior to 1 August 2016.

Comment

The 2010 Act provides an easier route by which third parties, including lenders, can consider and bring claims against insurers following the insolvency of the insured defendant. Any legislation that prevents good money being thrown after bad and allows claimants to make better-informed decisions before embarking upon litigation should most definitely be welcomed.

Claimants have been waiting six years for this legislation to come into force. Lenders may be disappointed that it has taken so long, especially as the peak of lender claims against professionals during this cycle has largely passed. However, lenders must consider its introduction to be better late than never, even if the information to be provided is not as wide as might have been desired.

Claims management companies to face tougher regulatory regime

By Adam Ibrahim (Partner) and Paula Johnson (Senior Professional Support Lawyer)

The Government is to clamp down on the poor practices of Claims Management Companies (**CMCs**) by introducing a more robust regulatory regime. Under the new regime, regulatory responsibility for CMCs will pass from the current Claims Management Regulator (**CMR**) to the Financial Conduct Authority (**FCA**). All regulated CMCs wishing to carry on trading will need to be re-authorised and CMC managers will become personally accountable for rule breaches for which they are responsible. Perhaps more importantly, CMCs operating in the financial claims sector can also expect to see caps imposed on their fees, which may act a commercial disincentive to continue with the more dubious practices reported.

Despite previous reforms in this area, the current regime overseen by the CMR is perceived to have been ineffective, with reports persisting of widespread

misconduct by CMCs. In particular, complaints continue to be made about aggressive and nuisance marketing, consumers being given poor value for money, consumers being baffled by confusing fee structures and lenders facing large numbers of entirely speculative claims.

Often CMCs add little value to the claims process at all but typically charge between a quarter and a third of any compensation subsequently paid. This has resulted in consumer bodies such as Which? advising that complainants are usually better served by simply making their claim direct without any CMC involvement. Indeed, in our experience, the involvement of CMCs can often hinder the efficient resolution of complaints, with a conflict of interest sometimes becoming apparent between the CMCs' commercial objectives and those of their clients. The National Audit Office estimates that between April 2011 and November 2015 CMCs received fees of between £3.8 and £5 billion out of compensation paid to consumers in relation to Payment Protection Insurance (**PPI**).

The Brady Review

Against that backdrop, the Government commissioned an independent review (**Brady Review**) to examine the nature and extent of the problem and to make recommendations. Published in March 2016, the Brady Review made the following recommendations:

1. All CMCs wanting to continue trading should apply to be re-authorised under a new stricter authorisation process.
2. All individuals who perform a "controlled function" for a regulated CMC (i.e., those in roles with a particular regulatory significance such as a director or a person responsible for regulatory compliance) should have to:
   - pass a fit and proper person test, which will consider honesty, integrity and reputation, but also competence and capability and financial soundness;
   - be personally accountable for rule breaches for which they are responsible.
3. CMCs should be required to record all calls with clients and retain them for a minimum of 12 months following the conclusion of the contract with that client. This would allow the regulator to audit customer service levels.
4. The regulator should develop a concise standardised disclosure document which all CMCs would have to use to disclose their key product information. This would help consumers compare services and fee structures offered by different CMCs.
5. The regulator should make wider use of warrants and seizure powers.
6. The regulator should consider using smaller fines or mandatory training as a credible deterrent to minor breaches.
7. CMCs should signpost consumers to alternative claim resolution channels at appropriate times when communicating with consumers.
8. Outcome-based conduct rules should be introduced in each area of core CMC activity.
9. CMCs should be obliged to disclose the source of their referrals.

10. The regulator should publish all appropriate information on enforcement activity.
11. The regulator should help educate and empower consumers by providing impartial information about CMCs and the services they provide on its website.

The Brady Review was also asked to consider where regulatory responsibility should lie in the future. It considered a number of possible options including: leaving responsibility with the existing Claims Management Regulation Unit (**CMRU**); creating a new independent regulator; dual regulation between the CMRU and the regulator; dual regulation between the CMRU and the FCA; and transferring responsibility for regulation to the FCA. In the end it concluded that each of these had drawbacks and there was no perfect solution. Ultimately the only two really workable and effective solutions were either to stick with the CMRU, which already has considerable expertise, or, if more of a step-change were required, to transfer responsibility to the FCA. The Government has decided to opt for the latter.

The transfer of claims management regulation to the FCA will require primary legislation and other significant changes and will involve detailed policy work on the precise design of the new authorisation and personal accountability regime. Government has not yet indicated any likely timescale.

Ministry of Justice Consultation

Separately, the Government has also been consulting about capping the fees that CMCs can charge. In February 2016 the Ministry of Justice published its "Claims Management Regulation Consultation – Cutting the costs for consumers – Financial Claims" (**Consultation**). The Consultation takes a critical look at the claims management industry operating within the financial claims sector and concludes that whilst a CMC might add some value in certain circumstances, the current high level of fees charged by some CMCs for some claims are neither proportionate nor demonstrate value for money for consumers.

The Consultation highlights the fact that on average CMCs take £300 for every £1,000 of compensation paid. Whilst there are some complex claims, such as claims for mis-sold pensions and mortgages or interest rate swaps, where significant work might be required in investigating whether a consumer has a potential claim, the vast majority of PPI claims and Packaged Bank Account (**PBA**) claims do not generally require significant work and could be pursued by consumers themselves, either directly with their lender or with the Financial Ombudsman, at no cost.

The Consultation stresses the importance of ensuring that consumers who do opt to use a CMC are not taken advantage of and receive better value for money. It proposes restrictions on the charges and manner in which CMCs can contract with consumers. It anticipates that these restrictions will reduce the incentives for CMCs to collect marketing leads and that the number of nuisance calls and speculative claims will reduce as a result. This in turn should ease the considerable administrative and financial burdens felt by lenders and the Financial Ombudsman.

The proposed restrictions vary according to the type of claim.

In all financial claims there will be a ban on any upfront fee being charged to the customer.

For PPI claims and PBA claims:

- where the value of the claim is £2,000 or less CMC fees should be capped at 15% (including VAT) of the final compensation awarded;
- where the value of the claim is more than £2,000 there should be an overall total cap of £300 (including VAT);

- where a consumer cancels their contract with a CMC after the initial 14 day cooling off period there will be a maximum cancellation fee of £300 (including VAT). CMCs will be required to ensure that all charges are reasonable and will be required to provide consumers with an itemised bill showing what the charges relate to;
- where it transpires that the consumer does not have a relationship or relevant policy with the lender, the CMC will be banned from charging the consumer at all; and
- CMCs will be banned from making or receiving any financial payment for referring or introducing a client to a third party.

For all other financial claims which are not PPI claims or PBA claims:

- there will be a fee cap of 25% (including VAT) of the net amount of the final compensation awarded per product.

The Consultation on these proposals closed in April and the Ministry of Justice is currently considering the responses it received. It intends to publish a response later this year but has indicated that it expects any rule changes to come into effect during the second half of 2016. The changes are not intended to have retrospective effect and will only apply to contracts agreed with consumers after the date of implementation. Breaches of the new rules will amount to misconduct and a breach of conditions of authorisation. Non-compliant CMCs will find themselves subject to a number of enforcement measures ranging from financial penalties to the variation, suspension or complete cancellation of authorisation to provide regulated claims management services.

Comment

It is hoped that these tough new measures will force CMCs to work more efficiently. Some CMCs may conclude that the business is no longer profitable and they may leave the market. The changes could also cause consolidation in the market and increased professionalism. This may have come too late in the context of PPI and PBA claims but could improve the position for lenders should other "bulk" claims arise in the future.

If the FCA does decide to introduce a time bar on consumers bringing PPI claims this is likely to lead to a spike in marketing activity by CMCs. In fact the recent consultation paper on a possible time bar has already seen a noticeable change of approach in CMCs' advertising seeking to identify those last remaining PPI claims. It will be interesting to see what effect the proposed fee caps and other measures proposed by the Consultation will have and whether any of the other proposals can be introduced before this happens.

The proposals definitely have the potential to help reduce the heavy administrative and financial burdens on lenders who currently have to waste valuable resource and time in dealing with speculative and poorly evidenced claims. The proposals should be welcomed by lenders and consumers alike.

RECENT DEVELOPMENTS & CASES

Unfair relationships and undisclosed commissions – the Court of Appeal looks at section 140a of the Consumer Credit Act 1974 again

By Stewart Plant (Partner) and Leontia McArdle (Senior Associate)

In yet another illustration of how the courts are looking at unfair relationships and undisclosed commissions, the Court of Appeal recently handed down judgment in the case of *Nelmes v NRAM PLC* [2016] EWCA Civ 491, classing the use of 'procuration fees' in a lending transaction, as an occurrence of an 'unfair relationship' pursuant to section 140A of the Consumer Credit Act 1974 ("**CCA**"). This article explains what procuration fees are, and why the court determined that they can lead to the existence of an unfair relationship.

What are 'procuration fees'?

The FCA Handbook defines a "procuration fee" as an amount paid "*by a home finance provider to a home finance intermediary, whether directly or indirectly, in connection with providing applications from customers to enter into home finance transactions with that home finance provider.*"

In essence, a "procuration fee" is a commission paid by a lender to a mortgage broker for introducing business.

The payment of procuration fees has been criticised by some as it could act as an incentive for brokers to recommend certain lenders' products over others in order to earn higher fees. This would put the brokers' interests in conflict with those of the borrowers they represent. Despite those concerns, the payment of such fees has not been uncommon and they are frequently not disclosed.

Nelmes v NRAM PLC [2016] EWCA Civ 491

This particular case related to loan arrangements worth approximately £2.5 million arising from negotiations which took place during 2007 between Mr Nelmes (a buy to let landlord), Mr Blair of ASC West Yorkshire (broker), and Northern Rock Plc (now NRAM Plc – the lender).

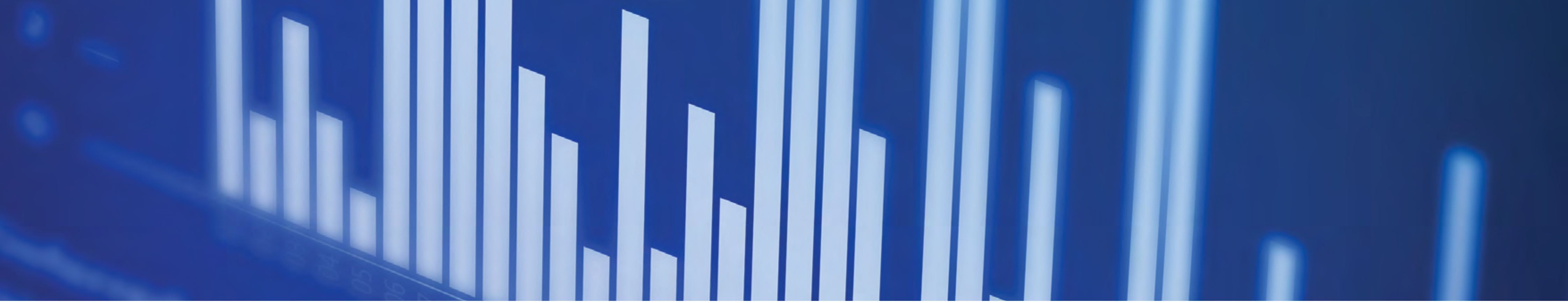
Mr Nelmes agreed to pay the broker a fee of 0.75% for his services. Mr Nelmes also agreed to pay the lender an arrangement fee. However, the lender was also to pay a 0.5% 'procuration fee' to the broker. Mr Nelmes was not made aware of the existence or the terms of such a payment. He argued that the lender and the broker were working together to mislead him and to ensure that the lender got the deal.

The court disagreed with this aspect of Mr Nelmes case. It held that the "*effect of the non-disclosure of the procuration fee* ***did not mean that Mr Nelmes was not in a position to assess the value for money offered by the proposed deal***" (emphasis added). There was nothing to suggest that the broker or the lender had concealed **any of the terms of the deal**; only the procuration fee between the lender and the broker went undisclosed.

However, it was the court's view that in acting as agent for Mr Nelmes in his dealings with the lender, Mr Nelmes was entitled to expect to receive "*undivided loyalty*" from the broker.

Northern Rock's payment of the fee to the broker, and its acceptance by the broker were kept secret. This amounted to a breach of the broker's duty of care to Mr Nelmes and was brought about by the lender's payment of the fee.

On classic principles this would entitle Mr Nelmes to recover the amount of the secret commission from either the broker or the lender. But what Mr Nelmes was seeking here was relief on the basis that the relationship between the parties was unfair.



What is an unfair relationship?

The statutory provisions relating to unfair relationships are contained in sections 140A to 140C of the CCA. If the terms or the operation of an agreement between a lender and a borrower are considered to be unfair, the court has the power to make an order to improve the 'fairness' of the relationship between the parties. The CCA provisions also reverse the burden of proof. This means that once a borrower alleges that the relationship is unfair, it is for the lender to prove to the court's satisfaction that the relationship is fair. Given the range of relief which the court may order (see below), this provides borrowers with a powerful weapon.

A court may determine that a relationship between a debtor and a creditor is unfair because of one of the following:

- any of the terms of the agreement or of any related agreement;
- the way in which the creditor has exercised or enforced any of his rights under the agreement or any related agreement; and/or
- any other thing done (or not done) by, or on behalf of, the creditor (either before or after the making of the agreement or any related agreement).

If the relationship is unfair, the court may:

- require the creditor, or any associate or former associate of his, to repay (in whole or in part) any sum paid by the debtor or by a surety by virtue of the agreement or any related agreement;
- require the creditor, or any associate or former associate of his, to do or not to do (or to cease doing) anything specified in the order in connection with the agreement or any related agreement;
- reduce or discharge any sum payable by the debtor or by a surety by virtue of the agreement or any related agreement;
- direct the return to a surety of any property provided by him for the purposes of a security;
- otherwise set aside (in whole or in part) any duty imposed on the debtor or on a surety by virtue of the agreement or any related agreement;
- alter the terms of the agreement or of any related agreement; and/or
- direct accounts to be taken.

Why did the Court of Appeal determine that payment of the procuration fee rendered the relationship unfair?

When assessing whether a relationship is unfair, the court will look at all aspects of the transaction and the relationship between the parties. In this particular case, the court was satisfied that the relationship was unfair because of a combination of these factors:

1. it was a term of the credit agreement that the borrower had to pay an arrangement fee to the lender;
2. there was a related agreement that the lender should pay commission of half of that amount to the broker;
3. the lender made that payment to the broker; and
4. the lender failed to tell Mr Nelmes about that payment.

The court did not evaluate whether Mr Nelmes would have entered into the transaction had he been made aware of the commission arrangements between the broker and the lender. Mr Nelmes alleged that having agreed to pay the broker a commission, he expected the broker to be acting solely in his interests. The Court of Appeal agreed, holding that the secret commission was unfair because "*a relationship between lender and borrower which involves such a payment* ***deprives the borrower of the disinterested advice of his broker*** *and is, for that reason, unfair*" (emphasis added).

Arguably, this determination raises some questions about 'agency' and the extent to which an agent is required to promote its client's interests above his own but the court did not elaborate or provide any further guidance on this point.

What relief did the court order?

Once the court concludes that the relationship is 'unfair', there generally needs to be a good reason for the court to refuse to grant a remedy that makes the relationship fair. Accordingly, in this particular case, the Court of Appeal ordered the lender to account to Mr Nelmes for all the commission it had paid to the broker, together with interest from the date of payment.

Comment

This was a significant lending deal between an established buy-to-let investor and a well-known mortgage lender. An unfair relationship was not implied because the borrower was vulnerable, or the lender or broker took advantage of the borrower. The unfairness was inferred because of the existence of a commission arrangement between the lender and broker which was not made known to the borrower prior to entering into the lending transaction and which had the effect of depriving the borrower of the disinterested advice of his broker.

Mr Nelmes had raised a whole raft of other arguments as to why his relationship with Northern Rock should be deemed unfair and had sought a wide range of relief. Fortunately the court took a robust approach and gave these additional arguments very short shrift, refusing to extend the borrower's remedy beyond reimbursement of the commission amount. NRAM will however have been put to considerable expense in having to deal with the points that he raised.

The real significance of the case is that it may encourage other disenchanted borrowers, who have also relied on intermediaries, to question whether they have the right to pursue similar claims. This could present difficult challenges for lenders who have relied on the broker community to introduce business.

Court of Appeal confirms effect of non-exclusive jurisdiction clause and forum non conveniens waiver *(Standard Chartered Bank (Hong Kong) Ltd & Anr v Independent Power Tanzania Ltd & Ors)*

By Jamie Curle (Partner) and Sean McGuiness (Associate)

The Court of Appeal recently delivered a ruling in *Standard Chartered Bank (Hong Kong) Ltd & Anr v Independent Power Tanzania Ltd & Ors [2016] EWCA Civ 411* in which it upheld the first instance decision of Flaux J on the effect of a non-exclusive jurisdiction clause with a forum non conveniens waiver in a complex jurisdiction challenge. The decision highlights the importance of fully considering jurisdiction clauses when entering into financing arrangements.

Background

In 2005 Standard Chartered Bank (Hong Kong) Limited (SCBHK) purchased a debt from Danaharta following which it became sole lender and security agent under a

facility agreement and related security documents with a Tanzanian company, Independent Power Tanzania Limited (IPTL) arising from the project financing of a power plant in Tanzania. Standard Chartered Bank Malaysia Berhad (SCBMB) was appointed facility agent.

VIP Engineering & Marketing Limited (VIP), another Tanzanian company and 30% shareholder of IPTL, had entered into a Shareholder Support Deed along with the 70% shareholder Mechmar Malaysia Berhad Corporation (Mechmar), under which the shareholders agreed to use best endeavours to procure that IPTL complied with its obligations under the finance documents, and separately agreed not to dispose of their shares in IPTL. Notwithstanding this, VIP later purported to sell its shareholding to Pan African Power Solutions (T) Limited (PAP).

The facility agreement and related security documents were governed by English law and contained non-exclusive English jurisdiction clauses as well as a *forum non conveniens* waiver by which the parties waived their rights to argue that any forum in which proceedings were brought by the other party were not convenient. The clauses went further and expressly contemplated concurrent proceedings taking place in different jurisdictions.

In 2007 IPTL failed to make payments owing under the facility and the loan entered default. SCBHK commenced proceedings in Tanzania involving IPTL, VIP and its majority shareholder, Mechmar Malaysia Berhad Corporation (Mechmar), under which SCBHK sought to enforce its security rights against IPTL and VIP/Mechmar in the Tanzanian Courts. These proceedings continued from 2009 until 2013, at which point VIP brought proceedings in the New York Courts against Standard Chartered Bank (SCB) (the English parent company of SCBHK) on the grounds that VIP had suffered loss as a result of SCB falsely claiming to be a creditor and having rights in VIP's shares in IPTL. The New York Courts dismissed the case on *forum non conveniens* grounds, concluding that Tanzania was the appropriate forum for the claim. VIP then commenced proceedings in Tanzania against SCB, SCBHK and others on similar grounds as the claim brought in New York.

Later in 2013 SCBHK and SCBMB commenced proceedings in England against VIP, IPTL and PAP, the company purporting to be 100% shareholder in IPTL having purchased shares from VIP and Mechmar. SCBHK and SCBMB sought a money judgment in England and, amongst other declaratory relief, a declaration that SCBHK is a valid, secured creditor of IPTL. In 2014 the defendants in the English proceedings challenged the jurisdiction of the English court, applying for a stay on the ground that Tanzania was the most appropriate forum for the claim or alternatively, on case management grounds.

First instance decision on jurisdiction application

In his judgment on the jurisdiction application of April 2015, Flaux J held that where a contract contains a non-exclusive jurisdiction clause in favour of the English courts, a party to that contract must show strong grounds, not foreseeable at the time of contracting, that England is not a convenient forum. Only where such strong grounds exist will the court decline to enforce the right to sue in the specified jurisdiction. Flaux J then considered the more complex position where a contract includes a non-exclusive jurisdiction clause in addition to a FNC waiver.

He dismissed the defendants' jurisdiction application, holding that whilst the combination of a non-exclusive jurisdiction clause and FNC waiver does not necessarily preclude granting a stay on FNC grounds, a stay will only be granted where "*strong or exceptional grounds*" are demonstrated which can properly be described as "*unforeseen and unforeseeable*" at the time the agreement was made. He held that a party to a contract which

contains an FNC waiver has agreed not to argue that a forum is inappropriate on FNC grounds where those grounds were foreseeable at the time of contracting.

He further held that parallel proceedings in another jurisdiction were expressly contemplated by the finance documents, and so clearly foreseeable at the time those agreements were entered into. Accordingly, the Tanzanian proceedings were not "*unforeseen or unforeseeable*" grounds on which the defendants could rely in seeking a stay.

Flaux J also held that the combination of both the FNC waiver and the non-exclusive English jurisdiction clause overwhelmingly pointed against granting a stay of the English proceedings on case management grounds in favour of the Tanzanian proceedings, particularly where that would lead to issues being decided in another jurisdiction, in this case Tanzania.

Defendants' Appeal is dismissed

The appellants appealed on the basis that:

1. the proceedings should be stayed on account of the time and money spent on the Tanzanian proceedings;
2. SCB, the Respondents' parent company with which the Respondents' had an alleged privity of interest, accepted that Tanzania was the most appropriate forum for the proceedings in New York and this constituted an issue estoppel; and /or
3. the English proceedings should be stayed as a matter of case management.

The appeal was dismissed by a panel consisting of Longmore LJ, Black LJ and Hamblen LJ in April 2016.

The Court of Appeal, in upholding the decision of Flaux J, held that a FNC waiver did not preclude an application for a case management stay, citing Bingham LCJ in *Reichhold Norway ASA v Goldman Sachs International* [2000] 1 WLR 173 in affirming that such stays could be granted in "*rare and compelling cases*". However, in this case there was no good reason to stay the English proceedings, which SCBHK and SCBMB were entitled to bring under the finance documents.

The court further held that Flaux J had been justified in concluding that, whilst the parties had indeed spent time and money in Tanzania, these were on interlocutory proceedings and that, upon issue of the English proceedings, the Tanzanian proceedings were nowhere near ready for trial, and so there was no justification for seeking a stay of the English proceedings on case management grounds.

Turning to the argument that there was an issue estoppel arising from the New York proceedings, the court found that whilst SCBHK and SCBMB had a commercial interest in the outcome of the proceedings in New York, that, on its own, was insufficient to make them privies of SCB for the purposes of founding an issue estoppel. To find in the alternative would lead to a piercing of the corporate veil where it was not justified. The court held that, in any event, the issue before the New York court was not the same as that in the English proceedings. For those reasons, Flaux J was correct in holding that no issue estoppel arose and, accordingly, there was no abuse.

Comment

This case once again highlights the importance of carefully considering jurisdiction clauses when entering into finance agreements or any other commercial contracts. Failure to agree dispute resolution mechanisms at the outset may result in lengthy jurisdiction challenges, as well as having to proceed in multiple jurisdictions. Where parties do wish to reserve the right to bring proceedings in more than one jurisdiction, careful thought should be given as

to how that mechanism will operate and how clauses can be drafted to avoid recalcitrant parties taking advantage of ambiguity or uncertainty in clauses to delay and confuse proceedings.

DLA Piper UK LLP act for SCBHK and SCBMB on this matter.

Mis-selling – no duty to advise on onerous terms – *Finch v Lloyds TSB Bank Plc*

By Paul Smith (Partner) and Sohail Ali (Senior Associate)

Following a long line of recent successes for banks in mis-selling cases, there has now been another significant success, this time for Lloyds Bank (**Bank**), in a fixed rate loan dispute relating to the issue of break costs. The decision in *Finch v Lloyds TSB Bank Plc* [2016] EWHC 1236 (QB) (***Finch***) is significant for a number of reasons but perhaps most importantly for the court's observation that there is no general duty in tort for a bank to advise a customer and that there would need to be "*exceptional circumstances*" before a court would conclude that a bank came under a duty to advise. In mis-selling cases where borrowers regularly assert that an advisory duty was assumed by their bank, this represents another significant obstacle that they will need to overcome.

Facts

The case concerned a 10 year fixed rate loan that was taken out in January 2008 by a hotel business operated by the claimants. The claimants were advised by a corporate finance advisor, who had acted as a finance broker to the investors in soliciting offers of funding from various banks, and by solicitors, who negotiated the terms of the loan agreement ultimately entered into with Lloyds.

The loan agreement contained a fairly typical clause which required the borrower to pay break costs in the event of a prepayment. The claimants alleged that it was only when they sought to refinance in 2009 that they discovered this "*concealed time bomb*" i.e. c.£1.5 million break costs which then prevented them from refinancing.

In other swaps mis-selling claims, such as *Crestsign Ltd v National Westminster Bank Plc and Anor* [2014] EWHC 3043 (Ch) and *Thornbridge Ltd v Barclays Bank PLC* [2015] EWHC 3430 (QB), the claimants alleged that their banks gave negligent advice. In *Finch* however, the claimants alleged not that the Bank had given advice which was negligent but rather that the Bank had **offered to provide advice** to the borrower (which offer was accepted) but that the Bank had then **failed to provide that advice**. Specifically the claimants alleged that the Bank had failed to advise as to the existence of any onerous terms and the effect of such terms on a prepayment prior to entering into the loan.

Issues

The key issue for the court to determine was whether the Bank had a contractual or tortious duty to advise in this case. If it did, the question was whether the Bank had breached that duty by failing to advise on the risks of the prepayment clause.

The claimants also alleged that the Bank had negligently misrepresented that the loan was "tailored" to the borrower's specific needs and requirements (in particular in circumstances where the investors wished to exit from their investment prior to the loan maturity date).

Decision

HHJ Pelling QC dismissed the claim in its entirety.

Contractual Duty

The judge held there was no contractual duty on the Bank to give advice and the claimants had not evidenced any contract to support such an advisory duty.

He rejected the argument that a contractual duty arose by implication under s.13 of the *Supply of Goods and Services Act 1982*. He said s.13 had the effect only to imply a term by operation of law into a "*relevant contract for the supply of a service*". To rely on this section the claimants had to plead and prove a contract under which the Bank had agreed to provide a service that included the provision of advice. They had not done so and therefore the claim on this point failed.

Tortious Duty

The judge rejected the allegation that the Bank had voluntarily assumed a tortious duty to advise. He reaffirmed the principle that banks have no general duty to advise customers and that there would have to be "*exceptional circumstances*" before it could safely be concluded that a Bank, which was pitching for the business of a potential customer, came under a duty to give advice in relation to the product it was offering. This was particularly so in a case such as this where the customer had its own professional advisers and the giving of any advice by the Bank might have been contrary to its own commercial best interests.

The judge also said that the Bank's use of the phrase "trusted advisor" in its marketing materials had no significance other than the fact that it was a phrase adopted by the Bank as part of a marketing strategy to distinguish it from its competitors.

Breach of duty

Because of the finding that there was no advisory duty, the judge did not consider the question of breach i.e. whether on the facts Lloyds had discharged any duty of care to ensure that the loan was suitable for the borrower's needs.

Misrepresentation

The judge rejected the claim that the Bank negligently misrepresented that the loan would be "tailored" to the borrower's needs. He noted that the Bank was never informed that the investors wished to exit within five years. In any event the loan was tailored to the borrower's needs because it met its requirements for the amount and term whilst offering a repayment holiday as requested. The judge also preferred the witness testimony given on behalf of the Bank.

Causation

Having dismissed the claimants' claims, the judge did not grapple in any detail with causation save to note the difficulties the claimants had in relying on indicative offers from other banks to evidence alternative financing available to them. The judge said that those offers were merely indicative and were made before any formal market valuation of the claimants' businesses had taken place.

Fraud

A separate allegation of fraud made against the Bank and its relationship manager was withdrawn during the course of the trial. The judge was very critical of the fact that the allegations had not been dropped earlier and that the claimants had not taken the opportunity to apologise to the relationship manager when he had finished giving evidence given the serious nature of the allegations.

Conclusion

The case is particularly helpful for the following reasons:

1. It serves as another reminder that the courts are reluctant to imply terms into a contract. To demonstrate a contractual advisory duty, claimants will need to point to an express term in the contract.

2. Recognising the fact that banks have their own commercial interests to pursue, the court reaffirmed the principle that banks have no general tortious duty to advise customers. There would have to be "*exceptional circumstances*" to find otherwise. This is particularly helpful in cases where a bank is dealing with a new (or relatively new) customer or where the customer is represented by a broker. The position may be different where there is a long standing relationship with the customer.
3. It is another stark reminder that, given the potential reputational and regulatory risks for banks, the courts will treat allegations of fraud very seriously. Allegations of fraud should not be advanced lightly without substantial supporting evidence.

Financial sanctions and de-risking: lessons from recent developments in Iranian sanctions restrictions

By John Forrest (Head of International Trade and Government Affairs), Stewart Plant (Partner) and James Moss (Senior Associate)

Recent developments and relaxation of EU sanctions against Iran have opened up significant business opportunities for manufacturers and exporters. Whilst in principle it should now be easier to trade with Iran, this is proving challenging in practice given the understandably cautious approach taken by financial institutions. Whilst there are challenges arising from the disconnect between US and EU sanctions, there are potentially significant benefits to greater involvement in this area of business.

One of the current 'Hot Topics' in the legal regulatory sanctions space relates to the relaxation of financial sanctions restrictions against Iran. Since the coming into force of the Joint Comprehensive Plan of Action in July 2015, leading EU countries, with the involvement of China, Russian and the US, have been working towards introducing a phased lifting of the long standing sanctions against Iran in return for commitments regarding their nuclear programme. Since the successful commencement of the process on 16 January 2016 (Implementation Day) there has been a considerable degree of interest within the business community regarding the possibilities of engaging or re-engaging with trade in Iran. It has however become apparent that whilst the primary limiting factor in doing business with Iran is no longer sanctions restrictions, banks do now face significant compliance difficulties in relation to processing the necessary transactions to allow businesses to be paid.

To summarise the legal changes in simple terms, whilst many but not all EU sanctions have been relaxed, most of the US sanctions in relation to Iran remain in force. Since Implementation Day, the EU has significantly reduced asset freezing provisions, in particular removing many of the previously sanctioned Iranian Banks from the list of asset freeze targets as well as a number of individuals. This means that previous restrictions on being able to do any business with those institutions and people have been removed. Restrictions on products have also been reduced and the onerous and complex fund transfer restrictions which previously caused considerable practical difficulties in allowing for payments to be received from Iranian businesses have been lifted in their entirety. It should therefore be significantly easier for EU businesses to trade with Iranian ones; that is however not necessarily proving to be the case.

One of the key structural problems for businesses and financial institutions seeking to navigate the new landscape in relation to Iranian sanctions is the disconnect between the relaxed EU position and the much stricter

US position. In essence the US has retained all of its primary measures (those applicable to US persons) and has focussed sanctions relief on the suspension of its secondary sanctions (applicable to non-US persons). It remains the case that US financial institutions and their foreign branches are entirely prohibited from Iran-related transactions. This presents obvious practical difficulties for financial institutions which have both a US and EU footprint and a significant compliance headache in trying to navigate the now increasingly conflicting requirements of the respective trans-Atlantic sanctions regimes.

Anecdotally what the recent changes in sanctions appear to have produced is a position where EU based financial institutions are having to take a stance on doing business with Iran which is potentially significantly stricter than that actually required by EU and UK law. Whilst this is entirely understandable given the significant risk of fines and other penalties in the EU and more importantly in the US, such an approach brings into focus related issues arising from the process of de-risking, which has previously been more obviously focussed on the risks associated with Money Laundering and Financial Crime.

In February 2016 the Financial Conduct Authority (FCA) published a detailed report it had commissioned from consultants John Howell & Co entitled "*Drivers and Impacts of De-risking*". Whilst the report contains little direct mention of financial sanctions it makes it apparent that such risks are often, correctly, treated as an analogous risk to the core concerns of money laundering and financial crime, not least given that breaches of financial sanctions can be prosecuted as a criminal offence. It is also apparent from the tone of the report and previous commentary from the FCA that it is concerned to ensure that banks take a nuanced and case specific approach to managing their de-risking processes such as closing down bank accounts. The report quotes from the FCA's own 2015 report, "*De-risking: Banks' management of money-laundering risk – FCA expectations*" which states:

> *"(but) the risk-based approach does not require banks to deal generically with whole categories of customers or potential customers: instead, we expect banks to recognise that the risk associated with different individual business relationships within a single broad category varies, and to manage that risk appropriately."*

Conclusion

It is clear that financial institutions continue to face difficult challenges in understanding and managing risk in relation to financial sanctions provisions particularly in areas of recent change such as the measures against Iran. However, as identified by the Howell & Co. report, there appears to be no 'silver bullet' for the de-risking issue. Potential solutions may lie in the balancing of costs and risks between banks and high risk sectors and a better developed understanding of how to measure risk on a 'case by case' basis

The key conclusions here are that:

- EU and Iranian businesses are keen to work together;
- changes in the legal landscape now allow them to do so much more easily than before;
- an unintended limiting factor now appears to be the understandable reluctance of the financial community to facilitate such business given concerns surrounding compliance risk management; and
- an important factor to take into account within the necessary balancing act of a risk based assessment is the potential impact of de-risking.

Legal risks for banking challengers and FinTechs

By John McKinlay (Partner)

The banking market is being shaken up by digital innovation. New entrants, whether they are designated as FinTechs or challenger banks, are beginning to make their mark. At the same time, the established banks are responding rapidly with their own digital platforms and collaborations with innovators. Among the factors that can be used to predict the winners are how they are able to respond to the current legal challenges – including the following key questions.

How widely can customer data be used?

To be truly successful, banks and FinTechs will need to deal with a particular dilemma – to balance the need to maintain trust in their products and services, with the need to use personal data in a new way to drive customer acquisition and revenue. Banks face a unique challenge in this regard – due to the particular relationship we all have with money. In the absence of bricks and mortar to demonstrate "stability", trust is more vulnerable. Pushing the boundaries of data use too far could be a quick way to destroy it. At the same time, the ability to use data to enable predictive and tailored marketing, in the way most obviously exploited at the moment by Facebook and Amazon, will be a key differentiator. The challenge is made all the greater because of the current "shifting sands" in relation to data sharing between UK and US, and the new Data Protection Regulations in Europe. Steering the correct path through these will be crucial.

It is possible to be fully digital?

As soon as banks digitise the customer experience, any break with that – whether the need for a face to face meeting, a telephone call or printing a document – runs the risk of degrading the process and turning off customers. For example, it is possible to have the vast majority of processing work in relation to mortgages done on-line, but regulation in many jurisdictions still requires paper based records to be kept and physical documents to be signed. At present there is a disconnect between the app based systems and the traditional processes which will act as a brake on the ability to maximise cost savings.

Are regulatory changes a threat or opportunity?

Europe's new payment services directive, PSD2, has accelerated something that is already underway – the move to develop a business model around the use of APIs. APIs are the links between banking systems and apps. In practical terms, customers will soon be able to control accounts at different banks, move money and conduct banking business through a single app. PSD2 will require banks to open up their systems using APIs. Europe (and indeed the UK through the Open Banking Working Group) is at the forefront of this, and there is a clear opportunity for the industry here to take a lead in development of the technical processes which the regulations require. At the same time, there is a real challenge for those who derive value through being the primary account holder – no longer will this give primacy of data use and control. Both the established banks and challengers will be competing to come up with the best strategy to deal with this issue.

In the UK alone there are anywhere between 50 and 100 organisations staking a viable claim that their approach to delivering banking services will result in a leading market position. Finding a way to manage these legal risks and turn them into opportunities will be vital for success.

SPOTLIGHT ON ...

Japanese law on payment services

By Stewart Plant (Partner) and Yoshiko Kawanami (Associate)

An earlier version of this article first appeared in the April 2016 issue of Butterworths' Journal of International Banking and Financial Law.

In recent years many EU based payment service providers including merchant acquirers and funds transfer service providers have entered the Japanese market. However, the differences between the regulatory framework in Japan compared to the EU has been creating difficulties for payment service providers looking for a smooth entry into the Japanese market. In Japan, payments services are regulated by two separate pieces of legislation and there is no equivalent of the Payment Services Directive (**PSD**) as in the EU.

Overall direction of future reforms

The progress of technology in Japan has seen settlement processes expanding to entities other than banks and the "unbundling" of traditional banking services. In light of this change, various players are now included in the settlement process. A working group of the financial consultation council of the Financial Services Agency (**FSA**) of Japan proposed that Japan should consider establishing a cross-sectoral regulatory regime in order to provide a flexible environment for the development of various payment services. The cross-sectoral framework that the Payment Service Directive in the EU has developed was considered as a good reference for re-examining the Japanese legislation at the above working group of the FSA.

The EU PSD and the framework of relevant Japanese law

The cross-sectoral approach of the EU PSD

The EU PSD, provides for the regulation of all Payment Institutions, Credit Institutions, and Electronic Money Institutions. Payment service providers are able to provide various services including bank account settlement services, funds transfer services, and online settlement services.

Merchant acquiring service under Japanese law

On the other hand, under Japanese law, merchant acquirers which provide settlement services of credit card transactions are regulated under the Instalment Sales Act (which was initially promulgated and enforced in 1961). As credit card transactions are a feature of instalment sales, the regulation of credit card issuing has been included in this Instalment Sales Act through its amendments, and together with issuing, merchant acquiring, which historically was always provided by the issuers in Japan, was also regulated under the Instalment Sales Act. Since merchant acquiring was not actually expected to be provided independently from issuing, while issuing requires a licence registration, providing acquiring only does not require an independent licence under the Instalment Sales Act. Therefore, even when a payment service provider is providing the same acquiring services in Japan as in the EU, it is not required to be licenced under Japanese law. As the Instalment Sales Act is a consumer protection law, the Ministry of Economics, Trade and Industry of Japan is the supervisory agency of the Act and thus regulates the licenced issuers.

Funds transfer service under Japanese law

Separately, funds transfer service providers are regulated under the Payment Services Act, which was promulgated in 2009 and enforced in 2010[1]. Funds transfer service is defined as a service provided by an entity other than a bank that involves a "Funds Exchange Transaction" (i.e., a business to undertake or undertake and actually conduct a request by a client to transfer money using a system to send money to a remote place without sending cash[2]) of JPY 1 million or less. In Japan, Funds Exchange Transaction was only permitted to banks[3], and the main purpose of the Payment Services Act was to enable entities other than banks to conduct small amounts of funds exchange transaction. If the content of the service fits the definition of Funds Exchange Transaction above, the provision of the service will need to be licenced under the Payment Services Act. It is worth noting that credit card transactions are considered out of the scope of this definition since it is already regulated by the Instalment Sales Act. The FSA of Japan is the supervisory agency for the Payment Services Act, and thus the licensees under this Act will be regulated by the FSA.

As of January 2016, 43 service providers including Western Union Japan and PayPal had registered as funds transfer service providers under the Payment Services Act. While the scope of regulated activity under this Act was intentionally kept vague to enable a flexible operation

[1] Issuing of pre-paid payment instruments are also regulated by the Payment Services Act.

[2] As interpreted in a Supreme Court case.

[3] Banking services are regulated under the Banking Act.

of the new regulation, it also provides confusion as to whether a licence is required for a specific payment service/business model.

A gap between the legislative framework

Since the Instalment Sales Act and the Payment Services Act were separately established and are regulated by separate governmental agencies, the scope of both Acts do not actually work together. It is worth noting that there are instances where both of the Acts do not apply to a certain business model of a payment service. For example, the Instalment Sales Act does not regulate transactions that are shorter than 2 months. This means monthly clearing services such as charge cards transactions are out of the scope from the Instalment Sales Act (and possibly not regulated under the Payment Services Act as well depending on the business model of the payment service). Therefore, depending on the content of the payment service, charge card transactions may be performed without requiring any license in Japan.

Advice to EU based payment service providers

When a EU payment service provider wishes to enter the Japanese market to provide the same payment service in their home jurisdiction, it means that the service provider has to carefully examine the content of its service and consider under which Japanese law the entity's business model will be subject to[4]. It may be the case that the contemplated activity does not require a licence, but requires a consultation with the respective regulators to confirm that the licence is actually unnecessary. Generally speaking, when the regulators are asked about the need to file a licence application, they will give an indication as to whether it believes:

- registration is required;
- not required; or
- it is not clear to them but they will accept a voluntary application, and the applicant will decide whether to apply based on this informal guidance.

Licence application procedures in Japan

Length of period of licence application process

When considering obtaining a funds transfer business licence, clients often question the length of period of the whole licence application process. The length totally depends on how quickly the applicant can prepare itself to start operating under full condition. As a matter of practice, applicants consult with the regulators on an informal basis where the regulators repeatedly provide detailed comments to the applicant entity until the applicant will be equipped with sufficient human resources, funds (i.e., minimum capital and deposits) and technology (capability to smoothly operate the service) to carry out the regulated business. The process of this “prior consultation” in Japan generally represents a substantive review by the regulators of the application. Once the applicant has revised the application per the regulators comments and the regulators confirm it has no further comments, the application can be formally filed and approval is largely a formality. In theory, the application and approval period (inclusive of prior consultation) may take approximately six months. In practice, the process may take longer depending on how quickly an applicant responds to

[4] Either legal framework may apply but not both – this is because government agencies tend to avoid interfering with areas once another agency is in charge.

the regulator’s questions, suggested revisions or requests for additional information. The application documents need to be in the Japanese language or at least accompanied with a Japanese translation.

Foreign funds transfer business providers

A foreign entity can register as a fund transfer business provider in Japan, provided that the entity establishes a branch in Japan. In this case, the offshore entity will mainly be subject to review as to whether it fulfils the requirements as a licensee.

Tendency of regulator‘s response when necessity of licence is in question

Where it is difficult to tell whether a licence registration is necessary for a particular payment service from the definition of Funds Exchange Transactions under the Payment Services Act, the regulators tend to leave the decision to the businesses whether or not to voluntarily register as licensee. This is because the regulators wish to receive as much information as possible from the entities so that they can supervise the market with more knowledge.

Recent discussions of government consultation councils

Production of final FSA report

The Working Group for Advancement of Settlement Services, one of the financial consultation councils of the FSA in Japan, has produced their final report on strategic approach towards sophistication of settlement services on 22 Dec 2015. The report includes proposals of amendments to the Payment Services Act of Japan, in order to respond to the development of the currently provided payment services in Japan.

Proposals in the FSA report

The report proposes that Japan should consider establishing a cross-sectoral regulatory regime in order to provide a flexible environment for the development of various payment services. This intends to include the banks, funds transfer business providers, and pre-paid payment instrument issuers under a common platform. Although the report only covers the areas where the FSA is the supervisory entity (i.e., the report does not contemplate including the settlement services associated with merchant acquiring services), it is meaningful that a proposal for a cross-sectoral regulatory framework has been made for the areas supervised by the FSA.
The report also mentions that intermediary service providers in the settlement process are important players that should be considered together when structuring a cross-sectoral regulatory approach. Further, the report adds that, it is important to make sure that any development of innovation will not be disturbed when structuring this cross-sectoral approach.

Future directions

The Japanese government is keen on the developments and proposed reforms to the payments legislation in the EU and other countries, and emphasises the importance of preparing an environment for the robust development of the settlement services. Further discussions and proposals are expected.