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Insight

Financial Markets Disputes and Regulatory Update

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In this edition of the *Financial Markets Disputes and Regulatory Update*, we have considered the key financial markets cases, and banking-related regulatory action, from the second half of 2015, and distilled them into a list of points which are worth taking away. We hope this will provide readers with a digestible account of new developments that may feed into ongoing work.

Contents

What is worth remembering from the second half of 2015, and what to watch out for

Court decisions / impacts

As anticipated in the last edition of this update, the Commercial Court has handed down judgment in relation to two claims involving complex derivative transactions entered into by an Italian public authority, and an Italian pension fund respectively. Both illustrate circumstances in which local law has been said to impact on agreements with English governing law and jurisdiction clauses.

There have also been two judgments dealing with issues arising in the context of CMBS transactions, and both these and a further judgment in the litigation between Merchant International Company Limited and Naftogaz may be of interest to security trustees.

Attention has continued to focus on claims made on the basis of the unfair relationship provisions of the Consumer Credit Act 1974 (as amended), although the cases so far do not indicate that lenders have as much to fear as might have been suggested. This has been an area in which decisions by judges and regulators have coincided, in that the FCA has also produced revised guidance in relation to PPI claims in the light of *Plevin v. Paragon Personal Finance*.

Contingent convertible securities (CoCos) have also been the subject of decisions by both the FCA and the courts, although the issues they have respectively considered, and their conclusions, have been different.

Regulatory developments

In some respects, the buzz of the SMR had largely passed in the second half of 2015, as observers grew more acclimatised to the regulators' intentions in creating the new regime. Some issues, however, still attracted attention, in particular the decision to abandon the proposed presumption of responsibility. While the broad intentions and approach of the new regime may have seemed more familiar, the details of the rules to be implemented, for UK banks and UK branches of overseas banks, were new and required considerable scrutiny.

The Fair and Effective Markets Review completed its report, which in turn led indirectly to an announcement that a version of the SMR would be rolled out to all authorised firms.

There have also been a variety of cases in which the FCA has used its enforcement powers, including in relation to individuals, where their firms (or former firms) have already faced disciplinary action.

What to watch out for

Litigation

The appeal in the *Deutsche v. Cheyne* litigation (we summarise the first instance decision below) is likely to be heard in May. The first half of the year should also see the trial of claims by the Bank of St Petersburg against Vitaly Arkhangelsky, said to be worth £30 million. The trial of claims by Property Alliance Group against RBS, which include allegations relating to LIBOR manipulation, will begin in May. The Libyan Investment Authority's claim against Goldman Sachs for undue influence in respect of investments made by the sovereign wealth fund is to come to trial in June, as is the trial of a claim brought by Terra Firma against Citi. It is likely that judgment will be handed down in these claims in the second half of 2016. Leave to appeal was granted in relation to one of the more significant judgments of 2014, between UBS, KWL and Depfa, but that appeal is not due to be heard until late 2016 or early 2017, which is indicative of our understanding of the Court of Appeal's current workload.

Regulatory and other developments

The first half of 2016 will see the SMR, and parts of the certification and conduct rules, rolled out. It will be interesting to see how this

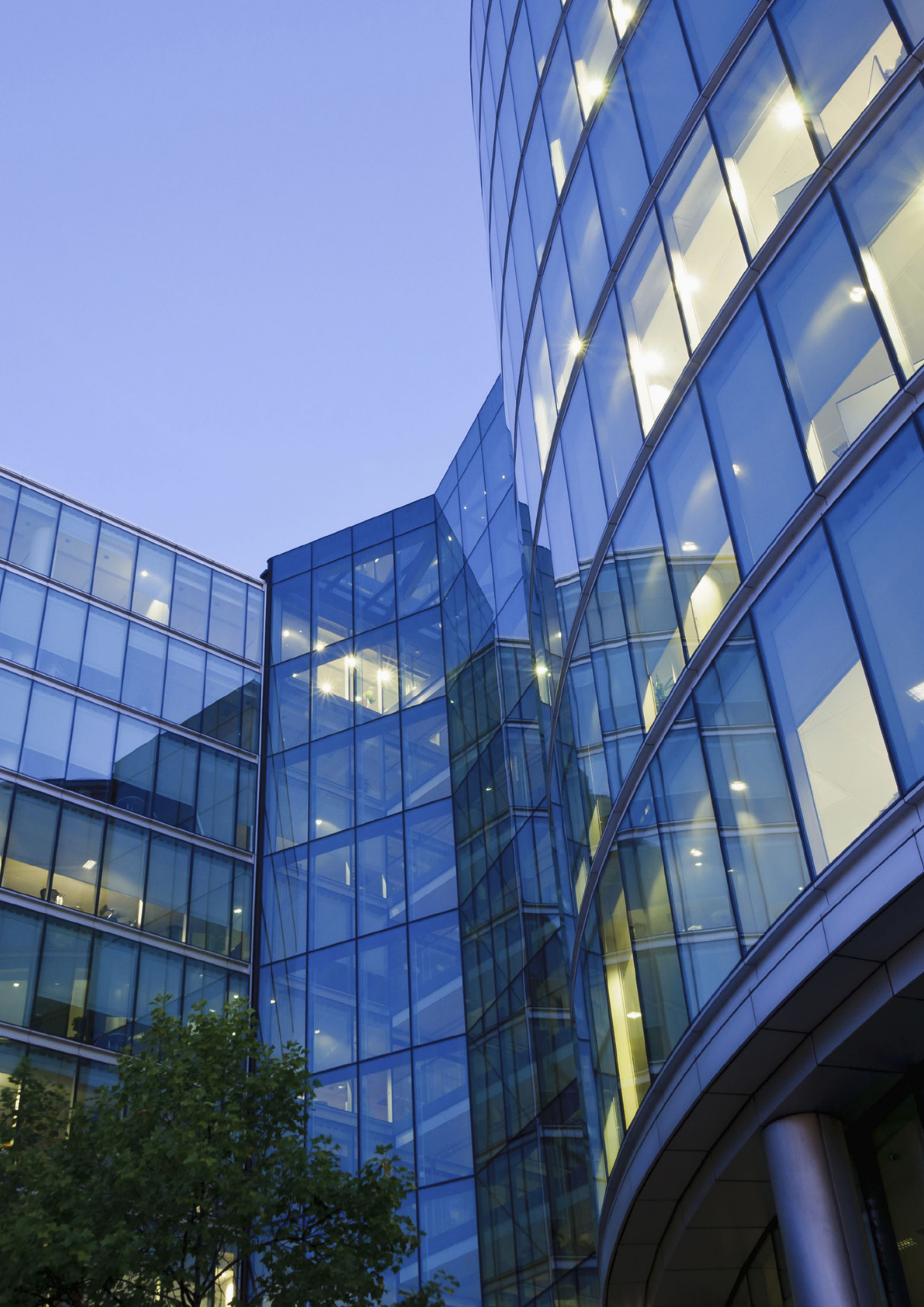
process goes, and what rules are finally made in relation to those areas where HM Treasury or the regulators have announced a change in approach. Key among those areas are the new duty of responsibility, the final rules in relation to regulatory references, new conduct rules for non-executive directors, and the scope of the certification regime. Both regulators have already begun to address changes to the reporting requirements in relation to breaches of the conduct rules.

Some form of clarification by the regulators as to the UK position regarding the application of proportionality to the CRD4 remuneration principles is expected following the EBA's publication of remuneration guidelines.

The FCA has appealed its loss in the Macris case to the Supreme Court in November 2015, and the outcome of that appeal (while it may not be known in early 2016) is likely to have a significant effect. First, the success of Mr Macris has led a number of other individuals to make similar referrals of FCA final notices. Second, if the Court of Appeal's reasoning stands, it may have implications for the FCA's future conduct of investigations.

A judicial review by Holmcroft in relation to KPMG's role as a skilled person is to be heard in June.

Finally, there remains some uncertainty in relation to the FCA itself. Its decision not to proceed with a review in relation to banking culture (which seems reasonable in view of the many changes that are still to be implemented in that regard), is seen by many as symptomatic of a wider question as to its future approach to regulation.



Judgments

CMBS transactions – whether to treat receipts as principal or interest, and what to do where a ratings agency will not provide a required confirmation

CBRE Loan Servicing Ltd. v. Gemini (Eclipse 2006-3) PLC and others [2015] EWHC 2769 (Ch)

The dispute in this case was, in reality, between the holders of Class A notes issued by the defendant issuer on the one hand and the holders of the subordinated notes in Classes B to E on the other. The proceeds of issue of the notes were used to acquire a loan secured upon a portfolio of commercial properties. The Claimant (CBRE) was the "Special Servicer" in respect of that loan. The income derived by the borrowers from the portfolio was to be used in order to service the loan. This would also allow the issuer to service the notes. The loan was accelerated on 6 August 2012, such that the full amount became payable by the borrowers. There was, however, no default by the issuer in relation to the notes.

At the time of the hearing before Henderson J, some of the property portfolio had been sold in accordance with a disposal programme, and CBRE continued to collect rent in respect of the remainder. Henderson J was asked to decide whether CBRE should treat as income or principal receipts from the following sources: (a) rents received; (b) the proceeds of sale of the properties; and (c) any surrender premiums paid by the tenants of the properties.

This question was important because the way in which receipts were applied in practice, under a Cash Management Agreement (CMA), depended on CBRE's characterisation of them. The CMA provided for two discrete "waterfalls" of payment – if the receipts were treated as interest, there was a specific order in which they should be applied, interest due to the Class A noteholders being paid in priority to interest due to the subordinated noteholders. If, however, the receipts were treated as principal, then the subordinated noteholders would not be entitled to receive anything from them (including by way of interest) until the principal due to the Class A noteholders had been fully paid. The CMA was silent on the question of how CBRE was to distinguish between principal and interest.

The Class A noteholders accepted that rental income from the unsold properties should be treated as interest. It argued, however, that the proceeds of sale of properties, and any surrender premiums, should be treated as principal. This argument was advanced on the basis of various provisions of the CMBS transaction documents, and was consistent with the subordination of other classes to the Class A notes. The holders of the subordinated notes relied on a provision of common law (that was accepted by the Class A noteholders to be correct, albeit inapplicable), that a payment is to be applied to the discharge of interest before principal, unless the debtor or the creditor has appropriated it otherwise.

Henderson J considered this issue as a matter of contractual construction, holding that the receipts should be characterised as principal or interest depending on their source and the role they played in the context of the loan. He held that it would be inappropriate to require the kind of close analysis of the receipts that would be necessary in the context of deciding on their tax treatment. On that basis, he agreed with the Class A noteholder that the proceeds of sale and surrender premiums should be treated as principal, and that rental income should be treated as interest. The key element in Henderson J's reasoning appears to have been that he felt the debtor/creditor analogy to be inapposite to the question of how CBRE ought to characterise the relevant sums.

Henderson J's approach to this issue should be relevant in the context of other CMBS transactions, and his conclusions may also be relevant where the contractual drafting is materially similar.

Deutsche Trustee Co Ltd v. Cheyne Capital (Management) UK (LLP) and another [2015] EWHC 2282 (Ch)

This judgment, of Arnold J, also relates to difficulties in relation to a CMBS transaction (the judgment provides a useful summary of the nature and key features of such transactions generally).

In this case, the subordinated Class G notes were agreed to be the "Controlling Class" for the purposes of the transaction. This entitled Class G (represented by Cheyne as operating adviser to the Controlling Class) to exercise certain rights. Specifically, Cheyne had notified the claimant trustee of the issue (Trustee) that it wished to replace the Special Servicer appointed in relation to defaults that had occurred in the underlying loan. The difficulty with this request was that the Issuer Servicing Agreement (which was the relevant agreement for these purposes) provided that no termination of the appointment of the Special Servicer would take effect unless (in effect) each of Moody's, Fitch and S&P had been informed of the identity of the proposed replacement, and had confirmed that such replacement would not result in a downgrade of the notes. Alternatively, each class of noteholders could approve the replacement by extraordinary resolution. There was no difficulty in practice in obtaining the required confirmations from Moody's or S&P but, consistent with a general policy statement made in 2012, Fitch indicated that it would not respond to any request for confirmation of this kind.

Cheyne submitted (in summary) that the relevant provisions of the Issuer Servicing Agreement did not contemplate a situation in which a ratings agency refused on principle to provide confirmations. On that basis, Cheyne said that the agreement should be construed as requiring confirmation to be provided by such of the ratings agencies as were willing in principle to provide them.

The Trustee argued that this was not what the Issuer Servicing Agreement said. The agreement required that all three agencies provide confirmation, and provided a solution (the recourse to an extraordinary resolution of noteholders) if that was not possible. The drafting of the CMBS documents meant that, in practice, an extraordinary resolution of Class A noteholders would bind the other classes anyway, making the use of that route as an alternative to ratings agency confirmation less onerous than it might appear. In addition, the Trustee said that the agreement specifically contemplated a situation where Moody's was unwilling to provide a confirmation – on that basis, it could not be said that the draftsman had ignored contingencies of that kind.

Arnold J agreed with the Trustee's interpretation. He held that Cheyne's preferred construction of the document effectively ignored the terms in which it was actually drafted, whereas the Trustee's interpretation accorded with the ordinary meaning of the language used. He was also unpersuaded by Cheyne's argument that a decision in the Trustee's favour would produce a commercially absurd result.

The judgment is likely to be significant to other transactions of this kind, as Fitch's policy in relation to confirmations is of general application, and this is unlikely to be the only transaction in which the contractual drafting will not achieve the result that the Controlling Class (usually the most subordinate noteholders) would wish. In addition, the judgment is interesting in the context of *U.S. Bank Trustees v. Titan (Europe)*. In that case, the judge held that it would make no commercial sense for the Special Servicer to have to remain in post because of a general policy of Fitch. The relevant contractual wording was, however, different in a number of respects, including the omission of the option for an extraordinary resolution. The *Deutsche Trustee* judgment will be appealed.

Status of money left in the hands of a paying agent once notes are redeemed, and appointment of a receiver by way of equitable execution

Merchant International Company Limited v. Natsionalna Aktsionerna Kompaniia Naftogaz Ukrainy [2015] EWHC 1930 (Comm)

The Claimant (MIC) got judgment against Naftogaz in February 2011. The amount currently outstanding under that judgment is almost US$25 million, which Naftogaz has not paid. MIC's application was for a receiver to be appointed by way of equitable execution in respect of (in summary) any and all of Naftogaz's rights in relation to a sum of US$25 million held by BNY Mellon.

This money was the remainder of a larger sum paid by Naftogaz to BNY Mellon, in order that BNY Mellon (as paying agent) could distribute it to the holders of notes issued by Naftogaz. A previous, unsuccessful attempt by MIC to obtain a third party debt order in relation to these funds led to a judgment of Blair J in 2014 (upheld by the Court of Appeal), that there was no debt due or accruing due to Naftogaz from BNY Mellon in respect of the money. In other words, BNY Mellon was not obliged to repay the money to Naftogaz in the same way that, for example, a banker would normally be obliged to repay money on deposit to a client. The status of funds like this, held by security trustees and paying agents for onward distribution to noteholders, can often be the subject of dispute where the issuer of the notes is also a judgment debtor.

In this case, between the judgment of Blair J and the present application, the relevant notes were redeemed and cancelled, although BNY Mellon still retained the balance of funds transferred to it. The judge accepted that, on the evidence, there were indications that BNY Mellon would repay this sum if asked to do so.

MIC said that in the circumstances, a receiver should be appointed because: (a) BNY Mellon had an express obligation as Naftogaz's agent to act in good faith and that, once the notes had been redeemed, there was no purpose in BNY Mellon holding the money, which it would therefore have to repay; (b) BNY Mellon must account to Naftogaz for the money in order to avoid being unjustly enriched; and (c) BNY Mellon had absolute discretion whether to account to Naftogaz for the money or not, and there was only one way in which it could properly exercise that discretion, given the requirement to act in good faith.

Naftogaz argued that the contractual documentation made it clear that any liability of BNY Mellon to account for the money was expressly excluded, and that, as a matter of law, there could be no restitutionary claim for unjust enrichment by Naftogaz against BNY Mellon in circumstances where there was a contractual arrangement dealing with the issue.

The judge held that, once the notes had been redeemed, the basis for the contractual exclusion of the obligation to account for the money was extinguished. He therefore held that it "follows as an incident of the relationship of principal and agent between Naftogaz and [BNY Mellon]" that BNY Mellon must account to Naftogaz for the money.

Naftogaz also argued that a receiver could only be appointed over property, and that there could be no property where there were no ownership rights. The judge was not required to decide this, in that he had found an obligation on the part of BNY Mellon to account to Naftogaz, but he said that he accepted that making the order sought would be an incremental development of the court's jurisdiction in this area, but that this would be appropriate in the circumstances.

This judgment contains a useful reminder of the principles relating to the appointment of receivers by way of equitable execution, and should also be interesting reading for those holding funds for issuers. Permission to appeal has been granted, and the appeal will be heard in December 2016.

Should a bank be ordered to allow access to accounts in the name of the wife of an individual subject to sanctions?

Hmicho v. Barclays Bank plc [2015] EWHC 1757 (QB)

Mrs Hmicho was the wife of a Syrian businessman who, from March 2015, was added to a list of designated people for the purposes of EU sanctions regulations in relation to those supporting the Government of Syria (as defined in those regulations). The EU regulations, while having direct effect in the UK, were supported by domestic regulations, referred to in the judgment as the "UK Regulations".

In early May 2015, Barclays froze two accounts in Mrs Hmicho's sole name. Mrs Hmicho applied for a mandatory injunction requiring Barclays to restore her access to those accounts. Barclays resisted the application on the basis of the following provisions of the UK Regulations: (a) reg. 3, which states that a person (P) must not deal with funds "belonging to, or owned, held or controlled by a designated person", if P has reasonable cause to suspect that this is what P is doing; (b) reg. 4, which states that P must not make funds available, directly or indirectly, to a designated person, if P knows, or has reasonable cause to suspect, that this is what P is doing; and (c) reg. 5, which states that P must not make funds available to any person for the benefit of a designated person, if P knows, or has reasonable cause to suspect, that this is what P is doing. In addition, Barclays relied on its own terms and conditions, which stated that it was entitled to refuse an instruction where, if it followed such instruction, it might break the law, or be exposed to legal action or censure from any government, regulator or law enforcement agency.

Barclays maintained that it had the "reasonable cause for suspicion" referred to in regs. 3-5, and particularly that the money in the accounts belonged to, was owned, held or controlled by Mr Hmicho. It argued that the application ought to be refused because: (a) almost all the deposits into the account had come from Mr Hmicho; (b) there had been a series of unusual payments into and withdrawals from the accounts that suggested an attempt by Mr Hmicho to circumvent the sanctions regulations, and that suggested that he controlled the accounts; (c) it would be inappropriate for the court to require Barclays to do something that would expose it to the risk of committing a criminal offence; (d) Barclays's terms and conditions meant, in any event, that it was entitled to refuse an instruction where this "might" entail the consequences described; and (e) as Mrs Hmicho accepted, the court should not make an order of this kind unless it had a "high degree of assurance" that Mrs Hmicho would succeed at trial.

It was argued on behalf of Mrs Hmicho that: (a) Barclays had focused excessively on where the funds in the accounts had come from, as opposed to where they were to go, and the evidence showed clearly that Mrs Hmicho used the accounts to maintain herself and her children, and not for her husband's benefit; (b) only reg. 3 could be relied upon to freeze an account completely, whereas regs. 4 and 5 only allowed Barclays to refuse specific transactions; (c) Barclays

had been insufficiently precise as to how the money was said to belong, be owned, held or controlled by Mr Hmicho, and had not addressed the true (and different) meanings of those terms; (d) the court should not assume that, just because Mr and Mrs Hmicho were married, she would make funds available for his use; (e) the balance of convenience lay with Mrs Hmicho, bearing in mind the draconian effect on her and her children of refusing her access to her accounts; (f) damages would be an inadequate remedy for the losses Mrs Hmicho and her children might suffer, such as interruption to the children's education; and (g) there was some doubt as to whether Mrs Hmicho could apply successfully for a licence in respect of all the categories of expenditure she might wish to undertake.

The judgment relates only to Mrs Hmicho's application for an interim injunction, and the issues raised above will therefore only be finally determined at trial. The judge held that: (a) there was not the necessary "high degree of assurance" that Mrs Hmicho would succeed; (b) Barclays had reasonable grounds for suspicion; (c) it would be inappropriate to require Barclays to take steps that might render it criminally liable; (d) while damages would not compensate Mrs Hmicho for all the losses she might suffer, they were an adequate remedy; and (e) the points made in relation to the limited scope of a licence were not compelling.

The judge made no conclusive finding as to whether regs. 4 and 5 allowed Barclays, in principle, to freeze an account. Nor was any reasoning provided in relation to the suggestion that Barclays had failed to specify precisely how it believed reg. 3 applied. The judge rejected the suggestion (described as unrealistic) that Barclays had focused excessively on the source of the funds in the account. The judge was clearly persuaded that Mr Hmicho had tried to circumvent the sanctions regulations, and held that, while the fact of him doing so was significant, his motives (to maintain his family) were not.

The decision overall is not surprising and should be of some interim reassurance to banks that they may be supported by the court in taking a cautious approach to sanctions compliance. The judgment of the court at trial will, however, be interesting in relation to how a bank should approach issues of this kind.

Resolving competing jurisdiction claims

Barclays Bank v. Ente Nazionale di Previdenza ed Assistenza dei Medici e degli Odontoiatri [2015] EWHC 2857 (Comm)

In this application, Blair J heard cross-applications in relation to jurisdiction from the Claimant (ENPAM), an Italian pension fund, and Barclays. Starting from 2007, ENPAM took part in an asset exchange, in which it exchanged assets it held for CDO securities. ENPAM alleged that the CDO securities were wholly inappropriate for its investment objectives, and that Barclays (among others) provided ENPAM with advice in relation to them.

Such advice is alleged to have been provided without Barclays and ENPAM having a prior written framework agreement in place for the provision of investment services, and ENPAM also claimed that the contractual documents in place between the parties did not articulate ENPAM's right to withdraw from the transaction. ENPAM claimed that both these omissions were breaches of Italian statute, properly justiciable in the Italian court, and therefore issued proceedings in Milan for: (a) by way of main claim, damages for pre-contractual and extra-contractual liability (agreed to be, effectively, a claim in tort); and (b) as a secondary claim, but also reliant on the alleged omissions referred to above, a claim for nullity of the asset exchange transaction. ENPAM claimed that the jurisdiction clauses in the transaction documents (in favour of the English court) were ineffective because of the lack of a pre-existing framework agreement. It also said that, as a matter of Italian law, only the proper jurisdiction of its main claim was relevant to the Italian court's decision on whether it had jurisdiction to dispose of the proceedings as a whole.

Barclays then issued proceedings in England, relying on the contractual documents relating to the asset exchange in support of its reliance on the exclusive jurisdiction and indemnity clauses they contained. Barclays claimed breach of those clauses by ENPAM and sought a declaration, damages and the enforcement of its contractual indemnity.

Blair J was required to consider: (a) ENPAM's application for the English court to decline to exercise jurisdiction based on Articles 27 or 28 of Council Regulation (EC) No. 44/2011 (the Judgments Regulation); (b) whether to hear an application by Barclays for summary judgment in respect of its claim for breach of the jurisdiction clauses; and (c) if so, how to determine such application.

The judgment contains a useful reminder as to the differences between Article 27 and Article 28, and the different considerations the court should apply to each. In summary, under Article 27, the court must decline jurisdiction if another court is first seised and the proceedings are between the same parties and involve the same cause of action. By contrast, Article 28 gives the court second seised a discretion to stay its proceedings where related actions are pending in the two courts.

In relation to Article 27, Blair J noted that the issue was whether the Milanese and English proceedings involved the same cause of action, which had an independent and autonomous meaning under European law, and required that the proceedings involve "*le même objet et la même cause*". The judgment provides useful guidance on resolving this issue, but Blair J concluded by agreeing that "the essential question is whether the claims are mirror images of one another". He also noted that jurisdiction clauses were generally treated as agreements separate from the contracts containing them. There was an established line of English

cases that, where a party sued for breach of a jurisdiction clause in one jurisdiction, and sued in another for a breach which would fall within that jurisdiction agreement, the two causes of action were not the same. On that basis, he held that Barclays's claims relating to breach of the jurisdiction clause were not the same as ENPAM's claims in Milan. He did, however, find that the position in relation to Barclays's claim in respect of the indemnity in its transactional documents was different, in that it did amount to a claim under a contract that the Italian proceedings alleged to be void. Barclays indicated that it would not pursue that element of its claim.

The argument in relation to Article 28 was different, in that the parties agreed that the two sets of proceedings were related, and the discussion related to how the English court should exercise its discretion. Blair J decided this point in Barclays's favour, in part on the basis that there was a previously agreed jurisdiction clause in favour of the English court.

In relation to the question of whether the court would determine Barclays's summary judgment application at all, Blair J agreed that it was only in rare cases that the court would consider a summary judgment application at the same hearing as a jurisdiction challenge relating to the proceedings. He held, however, that this was such a case, particularly bearing in mind that ENPAM had indicated that it had no more evidence to serve in relation to the application.

Blair J also determined the summary judgment application itself in Barclays's favour, save in relation to one element of it. Various of the reasons for his decision are very much specific to the case, but there are some useful general considerations. First, Blair J did not accept ENPAM's argument that, by awarding damages for breach of the jurisdiction clause, he would be tying the hands of the Italian court in any way in determining the Milan proceedings. Second, he rejected ENPAM's argument that the relevant jurisdiction clause was not exclusive in favour of the English court. This argument was premised on the fact that the clause purported to be exclusive as regards claims by ENPAM only, but permitted Barclays to bring proceedings in jurisdictions other than England. This drafting is relatively common, and it is interesting to note that Blair J found it to be enforceable according to its terms.

This case is worth consideration, because situations involving claims like these, designed to play the game of competing jurisdictions, are relatively common, albeit that the introduction of the Recast Brussels Regulation in relation to claims started after 10 January 2015 will give the court chosen by the parties the primary opportunity to take jurisdiction, even where it is not first seised. While Barclays was successful in its application, the judgment is also a reminder that different elements of a claim of this kind will be treated differently, and each will require careful consideration.

Swaps dispute with Italian local authority

Dexia Crediop SpA v. Comune di Prato [2015] EWHC 1746 (Comm)

This judgment considered the liability of an Italian local authority (Prato) to make payments due under an interest rate swap it entered into with Dexia. Dexia was appointed as Prato's adviser in relation to debt restructuring and interest rate swaps in November 2002, following a tender process. At around the same time, Dexia and Prato entered into an ISDA Master Agreement (1992 version), pursuant to which they entered into six interest rate swap transactions between December 2002 and June 2006. From late 2010, Prato stopped making payments due under the sixth (and only outstanding) swap. Dexia started proceedings claiming the sums due to it. Prato defended those proceedings 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 issue of capacity has been considered in a number of other cases involving derivative transactions entered into with public bodies, or quasi-public bodies. It will usually depend, in terms of outcome, on the relevant provisions of local law, and the precise nature of the transaction entered into. In this case, Prato relied on various provisions of Italian local government law, and was unsuccessful in relation to each. Its capacity defence therefore failed.

A more unusual outcome, perhaps, was that relating to Prato's arguments based on mandatory rules of Italian law. It said that: (a) Dexia had been obliged, in circumstances where the swap transactions were not concluded "on-site" (apparently referring to whether the contracts were concluded at Dexia's offices or not), to include a specific contractual provision allowing Prato a seven-day cooling off period, following which it could cancel the contracts with no penalty; and (b) Dexia had been obliged to include provision for certain specific matters in the contract between the parties.

The swaps agreed between Dexia and Prato were expressed (in the Schedule to the Master Agreement) to be governed by English law. However, because the relevant contracts were all made between 1 April 1991 and 16 December 2009, the Rome Convention (as implemented in the UK by the Contracts (Applicable Law) Act 1990 applied to them. Under article 3(3) of the Rome Convention, if all the elements relevant to the situation at the time when a choice of law is made relate only to one country (and it is not the governing law of that country that has been chosen), the parties must still comply with any mandatory rules of the laws of the relevant country. In this case, Walker J did not accept that either 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 (rules which could not be contracted out of). On that basis, he held that Dexia had breached the first of the rules identified by Prato, and that Prato was accordingly entitled to treat the relevant agreements as null and void (only at the option of Prato).

This judgment provides an interesting contrast to the outcome of the ENPAM case referred to above, where ENPAM ran a similar point in relation to Italian law. It leaves open the question of what consequences follow, as Walker J held that he had not heard sufficient argument on these points. The remaining issues to be determined, however, were complex. While the Rome Convention has been replaced, in relation to contracts since December 2009, the type of provision which caught Dexia out is replicated in its replacement. Banks (and others) should be careful to ensure that they still pause to consider any mandatory local rules when concluding contracts with clients overseas, even where those contracts are agreed to be subject to standard terms and a choice of law clause.

The Consumer Credit Act 1974, including provisions relating to unfair relationships

Barclays Bank plc v. L. Londell McMillan [2015] EWHC 1596 (Comm)

Since the judgment of the Supreme Court in *Plevin v. Paragon Personal Finance Ltd*, there has been a considerable amount of interest in the provisions of sections 140A and 140B of the Consumer Credit Act 1974 (the Act), which deal with unfair relationships between debtors and creditors. In this judgment, and the one summarised below, the court considered the Act in light of *Plevin*, but in relation to loan agreements rather than PPI.

With effect from 2007, the Act was amended so as to give the court (at section 140B(1)) a range of powers in relation to a credit agreement, including the power to alter its terms and to reduce or discharge any amount payable by a debtor or a surety. Such powers can only be exercised where the relationship between debtor and creditor has been found to be unfair under section 140A of the Act, because of (in summary): (a) any of the terms of the credit agreement or related agreement; (ii) the way in which the creditor has exercised or enforced any of its rights; or (iii) any other thing done or not done, by or on behalf of the creditor, before or after the making of the credit agreement.

In this case, Mr McMillan was a former partner in the firm Dewey & LeBoeuf LLP (the Firm) in its New York office. The Firm negotiated with Barclays to provide partner capital subscription loans (PCSLs) to its partners. Broadly, the terms of the PCSL were that Barclays would pay the required amount of the relevant partner's capital subscription to the Firm, which would service the interest payments, deducting them from the partner's drawings. In normal circumstances, the loan would be repaid to Barclays by the Firm out of the partner's capital account if the partner left the firm. The PCSL was governed by English law.

The Firm became insolvent, and the issue in these proceedings was whether Mr McMillan was required to repay to Barclays the US$540,000 plus interest which it claimed was due. Mr McMillan advanced a number of defences to Barclays' claim. One such defence was that the relationship between him and Barclays was unfair under the terms of the Act.

The judge considered some of the key points arising out of the judgment in *Plevin*, and went on to apply them to the facts of the case. In this context, the burden of proof is on the creditor to show that the relationship alleged to be unfair is not. The judge held that Barclays had done so by reason of the following:

- the terms of the PCSL were negotiated between the bank and the Firm, and the bank was entitled to assume, and did assume, that the Firm was acting in the best interests of its partners;
- Mr McMillan was not a naïve or vulnerable consumer; he was a partner in a major international law firm and could reasonably be expected to understand the clear terms of the agreement he signed, and its financial implications;
- the structure of the PCSL was standard, and there was nothing in its terms that was unusual or unfair;
- Mr McMillan could have chosen to fund his capital contribution by means of a loan from another bank, or through any other source available to him.

The judge's reasoning shows that the borrower's ability to understand the terms of what is being offered have a direct bearing on whether his or her relationship with the creditor is unfair. The judgment also shows the application of Lord Sumption's consideration as to whether the borrower had genuine freedom of choice or not – in this case, Mr McMillan did. A further issue raised by the judgment concerns the relevance of whether provisions in a credit agreement are standard, or whether they are unusual in nature.

This is an area which will doubtless be developed in other cases.

McMullon v. Secure the Bridge Ltd [2015] EWCA Civ 884

The judgment in *McMillan* provides a useful contrast to this case in that, while the provisions of the Act relied on were the same, the facts (and the nature of the borrower) were very different. The bare facts of this case might seem unfavourable to the creditor. Mrs McMullon was the carer for her disabled granddaughter, and her husband's business had gone into administration. Her income was solely derived from benefits because, while she owned a buy-to-let property in Huddersfield, it had been unoccupied for some time and provided no income. Mrs McMullon also had substantial credit card debts, some of which related to the costs of courses she undertook with a business called The Wealth Intelligence Academy, her apparent objective being to set up a property business with which she could solve her financial problems.

Her coach on these courses was a Mr Hopkins, who was also the principal of a financial planning business called Trafalgar Square, and a director of, and a shareholder in the creditor in this case, Secure the Bridge Ltd. Secure the Bridge specialised in providing fixed-term bridging loans. Mrs McMullon discussed her financial difficulties with Mr Hopkins, who introduced her to Trafalgar Square, where one of his colleagues sought to assist Mrs McMullon in obtaining a remortgage of her buy-to-let property, so that she had funds to buy more rental properties from which she could derive an income. Preliminary indications were that she would not be able to obtain a mortgage, and a possible reason for this was Mrs McMullon's large credit card debts. Mr Hopkins therefore suggested that she take out a bridging loan of £25,000 in order to reduce her credit card bill, in the hope of encouraging a mortgage lender to take her on. Mrs McMullon signed a credit agreement with Secure the Bridge (the Agreement). Over the following months, it became clear that Mrs McMullon would not obtain a mortgage. From 15 November 2010, she defaulted on payments due under the Agreement.

Mrs McMullon's claim was unsuccessful at first instance, and she appealed. There was no claim that the relationship between Mrs McMullon and Secure the Bridge was unfair because of the terms of the Agreement. The claims were directed at the conduct of Mr Hopkins. The Court of Appeal was invited to consider three issues, two of which may have some general relevance. First, it was argued on behalf of Mrs McMullon that, having found the relationship between the parties to be "inappropriate", the recorder at first instance should not have gone on to find that it was fair. The Court of Appeal noted the recorder's judgment that Mrs McMullon was neither misled nor unduly influenced by Mr Hopkins, and that she knew of his role at Secure the Bridge. It held that the inappropriate nature of the relationship was not such as to render it unfair in all the circumstances.

Second, it was alleged that considerations relating to affordability made the relationship unfair. Those considerations were that the Agreement was profitable to Secure the Bridge (in terms of interest and fees) and Trafalgar Square (as broker), while Mrs McMullon had no way of repaying it unless she obtained a mortgage which had already been refused. The Court of Appeal struggled with this point to some extent, in that it appeared that after the Agreement had been signed, Mr Hopkins falsified information on a mortgage application for Mrs McMullon (which she did not see). This not only reflected badly on Mr Hopkins, but Hildyard J was concerned that it showed him to be aware that Mrs McMullon would not receive a mortgage on the basis of her true financial position. The Court of Appeal ultimately determined, however, that this provided insufficient basis to disturb the recorder's findings.

NRAM plc v. McAdam and another [2015] EWCA Civ 751

The last of the cases under the Act in the second half of 2015 did not relate to the unfair relationship provisions. The issue was whether, where Northern Rock had not distinguished in its documentation between agreements that were regulated and unregulated by the Act, its successor, NRAM, was effectively required to treat all the agreements as regulated when calculating redress.

The Act only regulates credit agreements for amounts lower than a ceiling level. Northern Rock's contractual documents for fixed sum loans sold together with mortgages stated that they were agreements regulated by the Act, even where the sum advanced was in excess of that ceiling level.

The Act provides that from 2008, unless periodic statements are provided to borrowers, they are not required to pay any interest or default sum due during the period of the default. NRAM did not provide the prescribed information to borrowers, and the information it did provide was provided in the same form to borrowers under both regulated and unregulated credit agreements. In 2012, it discovered this mistake, and provided borrowers with regulated agreements with corrected information, and credited them with any interest or other payments wrongly debited from them during the period of its default. It did not provide the same (or any) redress to borrowers whom it had treated in an identical way, but whose credit agreements were unregulated because they were in excess of the ceiling amount. The defendants in this case were borrowers in such a position and, at first instance, they succeeded in persuading the court that they were entitled to the same redress as borrowers with regulated agreements.

The Court of Appeal disagreed. It was required to consider whether:

(a) it was possible to contract in to the Act – the court considered that it was conceptually possible, but that very clear wording would be required, which was absent in this case;

(b) the relevant provisions of the Act were incorporated into the contractual documents – the court held that the relevant contractual provisions indicated that the Act applied on its terms, not because of a contractual intention that it should, and the provisions of the Act were therefore not part of the contract;

(c) NRAM had expressly or impliedly agreed that all borrowers were to have the protection of the Act – the court held that without doing violence to the credit agreements, it was not possible to read the statements that the Act applied as giving rise to an independent contractual agreement to grant the borrowers some or all of the protections that would apply if the agreement was regulated;

(d) an estoppel was created by the wording included in the unregulated contracts that precluded NRAM from treating them as such – the Court of Appeal held that the judge at first instance had relied on the same matters as those that he said gave rise to a contractual agreement that the Act would apply, and that he was wrong for the same reasons. It also found that there was no shared understanding between the parties in this regard; and

(e) there was a representation or warranty that the loan agreement was a regulated agreement when it was not – the court held that there was such a warranty, but the consequences of this were not addressed. It appears likely from the recitation of the facts in other parts of the judgment that NRAM would argue that any claims for breach of warranty were time-barred.

This judgment is interesting in its consideration of earlier cases dealing with mistakes of this kind. The outcome may seem harsh to the borrower but, viewed in another way, any other interpretation would have resulted in a windfall not provided for under the Act.

CoCos – litigation between Lloyds and its noteholders

(1) LBG Capital No. 1 PLC; (2) LBG Capital No. 2 PLC v. BNY Mellon Corporate [2015] EWCA Civ 1257

This period saw the handing down of both first instance and appeal judgments in this case. It also saw the publication by the FCA of the FCA's Policy Statement 15/14 as to which see below (**"Restrictions on the retail distribution of regulatory capital instruments"**).

In 2009, Lloyds Banking Group (LBG), via two special purpose companies, issued the so-called Enhanced Capital Notes (ECNs), which were contingent convertible securities. The ECNs had different maturities, but could be redeemed early if a Capital Disqualification Event (CDE) took place. The dispute between LBG and the holders of the ECNs (represented by the note trustee, BNY Mellon), was as to whether a CDE had taken place.

The judgment of the Court of Appeal considered in some detail the evolution of capital requirements and stress testing during the period from 2008 until the introduction of the EU Fourth Capital Requirements Directive (CRDIV), the PRA's published statements in relation to CRDIV in late December 2013, and the stress test carried out in relation to LBG in December 2014. The court accepted that evolution of such requirements was anticipated in December 2009, when the ECNs were issued. It also accepted that regulatory developments after the ECNs were issued were not relevant to their construction, but were relevant to the issue of whether a CDE had occurred.

At points during this period, LBG sought to increase its capital in order to satisfy the requirements in force at the time. The ECNs were issued in order to do this without diluting existing shareholdings. In general terms, the ECNs would convert into ordinary shares (which would count as part of the highest tier of capital, then termed CT1 capital), if LBG's CT1 capital ratio fell to less than 5%. This trigger point for conversion was selected based on the prevailing capital requirements.

The introduction of CRDIV changed those requirements substantially. The concept of "Core Tier 1" or CT1 capital was replaced by Common Equity Tier 1 (CET1) capital. In addition, contingent convertible securities had to have a trigger point for conversion of at least 5.125%. The PRA also indicated that it believed triggers at this minimum level might not be enough to prevent a firm from failing, and LBG therefore sought to exchange the ECNs for contingent convertible securities with a trigger point for conversion at 7%.

A CDE was defined as including an event whereby, as a result of changes to regulatory capital requirements, the ECNs would cease to be taken into account in whole or in part for the purposes of any stress test applied by the regulator "in respect of the Consolidated Core Tier 1 Ratio". The drafting of the definition did not take account

of the subsequent disappearance of CT1 capital as a concept, and its replacement with CET1 capital. The stress test conducted by the PRA in December 2014 did not include the ECNs. LBG therefore declared a CDE and sought to redeem the ECNs (which carried a high coupon) early. At first instance, the judge held that it was not entitled to do so because, while the December 2014 stress test was relevant for these purposes, the ECNs had not been excluded from it for a reason of principle, but (effectively) because LBG's capital position was sufficiently strong that it did not need to rely on them.

Both LBG and BNY Mellon appealed. LBG said that while the stress test was indeed relevant, the effect of the changes introduced by CRDIV was that the conversion trigger for the ECNs was now far below the relevant minimum ratio. It was therefore the case that the ratio would be breached before the ECNs ever converted, and that they would therefore not be taken into account for the purposes of any stress test conducted by the PRA. BNY Mellon argued that the judge was wrong to take the stress test of December 2014 into account for these purposes, as it was not one conducted in relation to "Consolidated Core Tier 1" capital. BNY Mellon also argued that the judge was correct that the ECNs had not ceased to be taken into account for the purposes of stress testing; they had simply not been taken into account on this occasion.

The Court of Appeal upheld the judge's decision that the December 2014 stress test was relevant to the determination of whether a CDE had occurred. However, it unanimously allowed LBG's appeal, primarily on the basis that the draftsman of the terms of the ECNs had made an obvious error in not providing for a scenario whereby stress testing was carried out not in relation to CT1 capital ratios, but in relation to their then equivalent. The aim and purpose of the CDE definition would be undermined if such an event happened only following a stress test that was carried out by reference to an historic or superseded capital ratio. Accordingly a CDE was deemed to have occurred. Interestingly, the Court of Appeal held that this would also have been obvious to a reasonable addressee of the terms of the ECNs. BNY Mellon noted that many holders of the ECNs were retail investors, who would have assumed the language used to be meticulous. The Court of Appeal held that the fact that investors included retail investors was irrelevant to assessing what the "reasonable addressee" of the terms would have thought, in that the relevant document made it clear that a decision to invest ought only to be taken after informed and detailed consideration of the risks. This aspect of the judgment provides an interesting contrast to the FCA's approach to CoCos (considered below).

Companies litigating with their shareholders – issues relating to privilege

John Michael Sharp (and others) v. Sir Victor Maurice Blank (and others) [2015] EWHC 2681 (Ch)

This judgment also relates to litigation involving LBG and (on this occasion), its shareholders, in relation to its acquisition of HBOS. It considered the extent to which companies are able to withhold their legal advice from shareholders on the basis of privilege.

The claimant shareholders disputed LBG's blanket claim to privilege over correspondence with, and documents containing legal advice from, Linklaters. Such documents were stated to include advice in relation to Lloyds's acquisition of HBOS, its participation in the UK Government's Recapitalisation Scheme, and the form and content of a circular and a prospectus. The argument advanced by the shareholders against the availability of privilege in the circumstances is based upon an old rule applicable to litigation between trustees and beneficiaries, as well as companies and shareholders. The rule is expressed differently by different commentators but, in basic terms, companies cannot usually withhold disclosure of legal advice from their shareholders, even where such advice would be privileged as against a third party.

LBG suggested that the origin of this rule lay in common interest. Companies and shareholders could generally be expected to have a common interest in the subject matter of the legal advice. By logical consequence, once the interests of the shareholders and the company were adverse, the rule should cease to apply, and the company should be able to assert privilege in its advice. The alternative view put forward was that the rule is founded not on common interest but on funding. Where a company pays for legal advice as to its management out of its funds, then effectively its shareholders are paying for that advice and have a right to see it. This was the view preferred by the judge, on the basis that he saw little in the rule to suggest that it was an example of common interest privilege.

This distinction matters, because it has a direct bearing on the availability of what was agreed to be an exception to the rule. The relevant authorities all state that the rule can cease to apply where the company's and the relevant shareholder's interests are adverse.

One possible conclusion of LBG's argument that the rule arises out of common interest might be that a shareholder would be entitled to see legal advice obtained by a company so long as its interests in relation to the subject matter of such advice were not hostile to those of the company. Once they became hostile, as in the context of litigation, the right to see the advice would cease. It is not clear whether LBG put its case in that way, and it appears from at least one case in relation to common interest that it would have had difficulty in doing so[1]. Another possible formulation might be that the rule would not apply unless the interests of the shareholder and the company were held in common when the advice was taken.

By contrast, if the rule is based on who paid for the advice, then the exception to it would not operate in this way. This is, in essence, what the judge found in this case. The outcome of his judgment is that, unless the advice was itself obtained in contemplation of litigation between the company and the shareholder, it will not be privileged, even if the shareholder then sues the company in relation to its subject matter.

The important question therefore becomes whether the company obtained the advice in contemplation of proceedings by shareholders. Companies previously seem to have been given some latitude in this regard, but the judge specifically rejected LBG's assertion that there was a general principle which said that, once a company is committed to a course of action, litigation in relation to it is in contemplation. He stated that: "[i]t is one thing to say the board could reasonably have expected some dissentient shareholders to be unhappy with a decision; it is quite another thing to say that litigation was in the circumstances reasonably contemplated".

While cases involving the application of the rule have arisen periodically, it is interesting to see it applied in a case like the present one. It seems clear that it has various untested boundaries, and it may be time for companies (including banks) to consider it more closely.

Interpretation of the standard form freezing order

JSC BTA Bank v. Ablyazov [2015] UKSC 64

The Supreme Court has recently clarified that the definition of "assets" in the Commercial Court's standard form freezing order can include the proceeds of loan agreements. The freezing order was made in 2009 against Mukhtar Ablyazov, against whom JSC BTA Bank (the Bank) had obtained judgments in excess of US$4 billion, which it had been unable to enforce.

After the freezing order was made, Mr Ablyazov entered into four loan agreements with two BVI companies, pursuant to which he became entitled to borrow some £40 million in total (the Loan Agreements). The Loan Agreements stated that: "[t]he proceeds of the Loan Facility shall be used at [Mr Ablyazov's] sole discretion. [Mr Ablyazov] may direct the Lender to transfer the proceeds of the Loan Facility to any third party". The proceeds of the Loan Agreements were, in fact, used by Mr Ablyazov to fund his own legal expenses, those of co-defendants, and to meet various other expenses.

The issues that the Supreme Court was required to consider were whether: (a) Mr Ablyazov's right to draw down under the Loan Agreements was an asset for the purposes of the Freezing Order; (b) if so, his actions amounted to disposing of, dealing with or diminishing the value of the assets; and (c) the proceeds of the Loan Agreements were assets, on the basis that Mr Ablyazov had power to dispose of or deal with them as if they were his own (relying on a

1. *Commercial Union Assurance Co v. Mander* [1997] CLC 32

so-called extension to the definition of "assets" in the Commercial Court's standard form freezing order).

That extension includes the following: "[the freezing order] applies to all the respondents' assets whether or not they are in their own name … **the respondents' assets include any asset which they have power, directly or indirectly, to dispose of, or deal with as it if were their own. The respondents are to be regarded as having such power if a third party holds or controls the assets in accordance with their direct or indirect instructions"**.

It was clear to both the Court of Appeal and the Supreme Court considering this case that freezing orders are to be strictly construed in favour of the respondent, and that injunctions must be clear and unequivocal. The Supreme Court also held that a flexible approach, in order to thwart attempts to evade freezing orders, did not justify the expansive interpretation of an order already made. It also held that the respondent's own conduct was (unsurprisingly) irrelevant to the actual meaning of the injunction made against him.

The Supreme Court also said: "the context of a freezing order has been of particular importance in determining its true construction in a particular case". "Context" here seems to mean the context of the freezing order jurisdiction itself, its purpose and evolution.

The right to draw down money under a loan agreement is a chose in action. It was the Bank's primary submission that all choses in action are included within the definition of "assets" for the purposes of a freezing order. That submission was rejected at first instance, and on both the Bank's appeals. The reason for which the Bank failed is interesting, particularly in light of Lord Clarke's statement (in relation to the choses in action) that: "[i]n ordinary legal parlance they would I think be regarded as assets".

The reason why they are not to be regarded in this way in the specific parlance of freezing orders seems to be context. The authorities decided on the basis of the original drafting of freezing orders did not support the premise that all choses in action were assets, and the Supreme Court saw no reason to interfere with them.

Based on the new standard wording (in bold above), however, the Supreme Court allowed the Bank's appeal. It held that, on a proper construction of the Loan Agreements, Mr Ablyazov had the power to direct his lenders as to what to do with the money they were contractually obliged to pay under the Loan Agreements. The Supreme Court determined that the underlined words were not directed at assets the respondent owned, but at assets that he, she or it controlled.

This judgment will, of course, have implications for respondents to freezing orders and, now that the meaning of the extended definition of asset has been clarified, there may be cases in which applicants will also have to address the court specifically on whether its inclusion is justified. The implications for third parties are also interesting. Banks are among those most often notified of, and

affected by, freezing orders. While they do not acquire any civil liability to the party which obtained the freezing order, they may be subject to contempt proceedings if they do not comply with its terms. This judgment has a number of possible implications in this context. Credit cards, for example, arguably give a borrower the power to spend the lender's money as though it were his or her own. It is therefore likely that banks and other credit card providers will have to prevent respondents using their credit cards, unless they do so in compliance with the freezing order. This is also likely to be the case in relation to further spending on an overdrawn current account, and banks may generally wish to be cautious about this issue.

Claims for unjust enrichment and unpaid vendor's liens

Bank of Cyprus UK Limited v. Menelaou [2015] UKSC 66

The Supreme Court considered a claim for unjust enrichment made by Bank of Cyprus (the Bank) against Melissa Menelaou (referred to in the judgment as Melissa). Melissa's parents were indebted to the Bank in the amount of £2.2 million, such debt being secured on their family home. In 2008, Mr and Mrs Menelaou decided to sell that property in order to buy a smaller family home and in order to make some capital available. The house they decided to purchase was bought in Melissa's name. The Bank agreed to the transaction, on the condition that the new property purchased was to be charged in its favour, in the amount of £750,000. Melissa was not aware of the existence of the charge, and once she learned of it, when her parents needed to sell the house in 2010, she issued proceedings against the Bank claiming that the charge was void. The Bank counterclaimed for a declaration that it was entitled to be subrogated to an unpaid vendor's lien over the property.

At trial, all parties involved (including the solicitors who had acted for both the Bank and the Menelaous in relation to the transaction) agreed that the charge was void, and the Bank was able to rely on an indemnity from the solicitors. The judge dismissed the Bank's counterclaim, but granted it permission to appeal. The Bank's appeal was successful before the Court of Appeal, and Melissa applied to the Supreme Court.

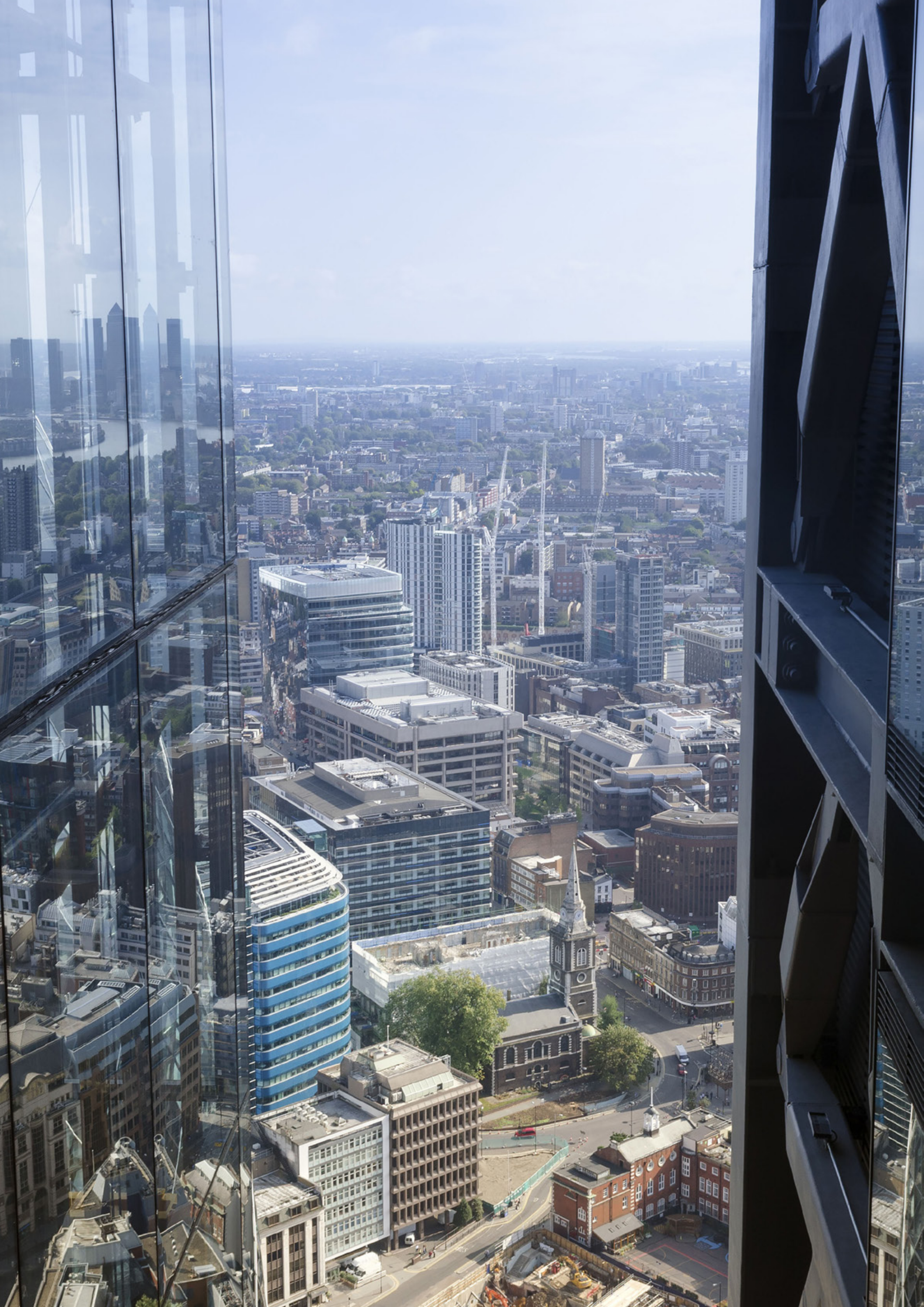
The Supreme Court dismissed Melissa's appeal, holding that the Bank was entitled to be subrogated to an unpaid vendor's lien, but the reasoning of the various judges hearing the appeal differed. The key area of disagreement between them was as to the use of subrogation to an unpaid vendor's lien as a remedy in this case. Specifically, there was some disagreement as to whether, as a proprietary remedy, such subrogation was appropriate where there was no proprietary claim. A lien arises over a property where a vendor has not been paid for it, and the vendor can then refuse to convey the property until the money is paid. A third party who has contributed to the purchase price can be subrogated into that position.

Lord Carnwath was alone in suggesting that the Bank needed to be able to trace its money into the purchase of the property in order to be able to be subrogated to the unpaid vendor's lien. There was some debate as to whether this was possible in the present case, because the purchase price for the property had been deducted by the solicitors from the proceeds of sale of Mr and Mrs Menelaou's previous house, rather than being advanced from the Bank directly. Lord Carnwath held that the circumstances were such that the solicitors held the money on trust for the Bank throughout, and it was therefore able to trace its money into the property. The remedy was therefore appropriate.

Lord Clarke approached the issue somewhat differently. He noted that there were four relevant questions in considering the Bank's unjust enrichment claim: (a) had Melissa been enriched?; (b) was such enrichment at the Bank's expense?; (c) was the enrichment unjust?; and (d) did Melissa have any available defences? He took the view that in taking the property unencumbered by the charge, Melissa had been enriched, and that if such enrichment was at the Bank's expense, it was unjust. Lord Clarke also found that the enrichment was at the Bank's expense, in that had it not agreed to release part of the proceeds of sale of the Menelaous' old property to be used in the purchase of the new property, Melissa could never have acquired the house. There was no need for a direct payment to have been made from the Bank to Melissa in order for its claim to succeed – there had been a transfer of value, which was sufficient. In relation to the available remedy, Lord Clarke said that there was no need to show the existence of a proprietary claim in order for the remedy to be available. He held that a flexible approach could be adopted to the remedy appropriate to each case, and that the result of agreeing to the remedy proposed by the Bank here was simply to reverse an unjust enrichment that would otherwise have taken place.

Lord Neuberger (with whom Lords Kerr and Wilson agreed) largely agreed with Lord Clarke. He also tentatively agreed with Lord Carnwath's conclusion that the Bank had a good proprietary claim that would make the remedy it sought less controversial (Lord Clarke also agreed with Lord Neuberger's tentative views on this point). Lord Neuberger agreed that Melissa had been unjustly enriched at the Bank's expense. Unlike Lord Clarke, he appears to have had some sympathy (although less than Lord Carnwath) with Melissa's argument that she was in no way responsible for what happened, although he came to the conclusion that, as the property was essentially gifted to her, Melissa could be in no better position than her parents. He also agreed that there was no requirement for tracing to be possible in order for the remedy sought by the Bank to be available.

The judgment provides a useful reminder in relation to the way in which the court considers unjust enrichment claims. The majority of the discussion, however, relates to the availability of subrogation to a vendor's lien as a remedy in the circumstances. Such discussion is complex, and there may still be scope for further debate, although the Supreme Court appears to have followed a flexible approach.



Regulatory developments

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

SMR, certification regime and conduct rules

The second half of 2015 has seen the PRA and the FCA finalise many elements of the SMR, certification regime and conduct rules in advance of the start of implementation, on 7 March 2016. Firms still face a significant challenge in being ready for that date, in part because of the scale of the task they need to undertake, but also because some aspects of the new rules are not yet final, and others have only recently been finalised. We set out below a summary of the individual accountability documents published since our last update, including those linked to, but not strictly part of, the SMR.

Strengthening accountability in banking: final rules (including feedback on CP14/31 and CP15/5) and consultation on extending the certification regime to wholesale market activities

FCA CP15/22, July 2015

The FCA appended its final rules in relation to the SMR, certification regime and conduct rules for UK relevant authorised firms to this consultation paper. In addition, the FCA consulted on extending the certification regime. While the title of that consultation related to wholesale activity, the proposed new rules themselves were not limited in that way, and created new certification functions relating to client-dealing and algorithmic trading. The new draft rules also proposed extending the definition of "client" for these purposes.

Strengthening individual accountability in banking: responses to CP14/14, CP28/14 and CP7/15

PRA PS16/15 and **PRA Supervisory Statement 28/15,** July 2015 (Supervisory Statement updated in December 2015)

The PRA used this policy statement in order to set out its remaining final rules in relation to UK relevant authorised firms (many of its rules having been published in the first half of the year). Such rules included transitional provisions, forms, and requirements relating to non-executive directors.

The PRA also appended its Supervisory Statement in relation to the SMR, certification regime and conduct rules. That Supervisory Statement has since been updated to reflect the PRA's guidance in relation to UK branches of non-EEA firms.

Conditions, time limits and variations of approval

PRA Statement of Policy, July 2015

In this publication, the PRA set out its policy in relation to its powers under the SMR to grant conditional approvals in relation to applicants seeking to perform Senior Management Functions (SMFs). It is worth noting that this policy document will need to be amended, as the original SMR did not include a power to vary time-limited approvals, only other conditions placed on them. The Treasury announcement referred to below indicated that this omission in the SMR would be corrected, but the timing for this change is not clear.

Strengthening accountability in banking: UK branches of foreign banks – feedback on FCA CP15/10

FCA FS15/03, August 2015

The FCA used this feedback statement in order to append near-final rules in relation to the UK branches of overseas banks. Its rules were not made final, pending HM Treasury making the necessary order, but the FCA indicated that it did not anticipate them changing substantially. The rules are divided between the UK branches of EEA authorised banks and the UK branches of banks authorised in other jurisdictions. The rules relating to both are complicated. In general terms, there are more requirements applicable to non-EEA banks, but EEA banks will have to negotiate the difficult issues of which matters are, and are not, reserved to their home state regulator. Final rules were produced by the FCA in December 2015 (as to which see below).

Strengthening individual accountability in banking: UK branches of non-EEA banks

PRA PS20/15, August 2015

The PRA's summer publication in relation to UK branches of overseas banks differed from the FCA's in two key respects: one of scope and one of approach. The PRA's rules do not affect the UK branches of EEA banks, which will therefore only need to consider the FCA's rules. In terms of approach, the PRA opted to make a number of its rules as final rules in the summer, leaving as near-final only those that it believed it could not make without the necessary Treasury order. As to the PRA's subsequent revision of its rules, see below.

Strengthening accountability in banking and insurance: regulatory references

FCA CP15/31 and PRA CP36/15, October 2015

In this joint consultation paper, the PRA and the FCA consulted on how best to implement the recommendations of the Fair and Effective Markets Review (as to which see below) on the provision of regulatory references, to prevent "rolling bad apples". The regulators' final rules are still awaited, but the key proposals include requiring firms to request regulatory references going back six years from former employers of candidates applying for SMFs and certification functions, and requiring that disclosures in response to such requests be provided in a standard format by certain firms. References provided over the previous six years would have to be updated were the referee firm to become aware of matters that would cause it to draft the reference differently.

Whistleblowing in deposit-takers, PRA-designated investment firms and insurers

FCA PS15/24 and **PRA PS24/15,** October 2015

The FCA and the PRA have separately published final rules in relation to whistleblowing. Insofar as they relate to deposit-takers, the new rules will only apply to those UK firms that are within the scope of the SMR, and the changes are, in some respects, connected with the SMR. The rules will not apply to the UK branches of overseas banks initially, although the FCA says that it will consult in relation to them. The new rules require that a non-executive director who performs an SMF be allocated the prescribed responsibilities of the "whistleblowers' champion", which are (in essence) to ensure and oversee the integrity, independence and effectiveness of the firm's policies and procedures on whistleblowing, including those intended to protect whistleblowers from being victimised. There are rules in relation to the content of settlement agreements, and rules in relation to the training and information that must be provided to employees. The rules also require certain records to be maintained and information to be provided to regulators.

Senior Managers and Certification Regime: extension to all FSMA authorised persons

HM Treasury paper, October 2015

HM Treasury used this paper to announce the extension of the SMR and certification regime to all firms authorised under FSMA. This change is expected to happen during 2018, but there is clearly a substantial amount of ground that will have to be covered before then.

Of more immediate interest were the changes announced to the rules that banks are in the process of trying to implement. Such changes came within four main categories:

- the presumption of responsibility (whereby senior managers would be presumed to be responsible for breaches within their area of responsibility, unless they could show that they had taken reasonable steps to prevent them) was to be removed, and replaced by a duty of responsibility. This amendment was the subject of an unsuccessful objection by some members of the House of Lords, and it is said that final rules in this area will be made in time for implementation of the SMR;
- there will be rules allowing regulators to make conduct rules applicable to so-called notified non-executive directors;
- the rules requiring all breaches of conduct rules to be notified to regulators will be amended in time for implementation; and
- the drafting lacuna that meant the FCA and the PRA had the power to vary conditions placed on approvals, but not time limits, will be corrected.

Strengthening individual accountability in banking: UK branches of non-EEA banks

PRA PS29/15, October 2015

As set out above, the PRA made most of its rules in relation to the UK branches of overseas banks based outside the EEA in final form. There were some provisions, however, which were not published in final form until December 2015. The only significant change as a result of the finalisation of all the PRA's rules was to the table of functions into which individuals could be grandfathered.

Strengthening accountability in banking: UK branches of foreign banks

FCA PS15/30, December 2015

The FCA appended to this policy statement its final form rules for the UK branches of overseas banks, based both in and outside the EEA. The FCA has flagged only two significant issues following feedback in relation to its near-final rules. First, in relation to non-EEA branches, the FCA accepted that the inclusion within the scope of its certification regime and conduct rules of individuals "dealing with UK clients", as well as individuals

based in the UK, potentially caught a wide range of employees. It has therefore removed that criterion, temporarily, as a basis for inclusion of individuals within those regimes. Second, the FCA has confirmed that the inclusion as relevant authorised persons of EEA firms which accept deposits in the UK on the basis of a services passport, but which have an establishment passport in relation to other activities, is a requirement under FSMA.

Final notices and judgments

Co-op Bank avoided fine but subject to censure

The Co-operative Bank plc - FCA's final notice and **PRA's final notice,** 10 August 2015

The FCA and (more unusually) the PRA issued a public censure of the Co-operative Bank (Co-op Bank) for breaches of Listing Rule 1.3.3R (misleading information not to be published) and Principle 11 (dealing with regulators in an open and co-operative way). Interestingly, they did not impose a financial penalty, notwithstanding that one was merited, as Co-op Bank was engaged in a turnaround plan to ensure it had adequate capital, and a financial penalty would endanger this. Co-op Bank had incorrectly recorded in its published annual accounts that it had adequate capital in the most severe stress scenarios. Co-op Bank also failed to notify intended changes to two senior positions and the reasons behind those changes.

Catalyst

(1) Timothy Alan Roberts; (2) Andrew Wilkins v. FCA [2015] UKUT 408 TCC; **Upper Tribunal's additional reasons,** 18 September 2015

In August 2013, the FCA issued decision notices in relation to Timothy Roberts and Andrew Wilkins. Mr Roberts and Mr Wilkins were directors (and Mr Roberts was CEO) of Catalyst Investment Group Limited (Catalyst). The decision notices contained fines (of £450,000 and £100,000 respectively) and bans preventing Mr Roberts and Mr Wilkins from performing any role in relation to regulated financial services. Both Mr Roberts and Mr Wilkins referred their decision notices to the Upper Tribunal.

The Upper Tribunal largely upheld the FCA's decision in relation to Mr Roberts (although not all elements of it). In relation to Mr Wilkins, however, it disagreed with the FCA that Mr Wilkins was not fit and proper to perform any role in relation to financial services, and accordingly it rejected the FCA's ban. It also reduced the fine imposed to £50,000.

The enforcement action related to Catalyst's role in the distribution of bonds in relation to which Catalyst knew that the issuer considered that it needed, and did not have, a licence. Catalyst nonetheless provided misleading information to investors, collected funds from them, and did not ring-fence those funds.

The aspect of the Upper Tribunal's decision that has attracted attention is its rejection of the FCA's allegations against Mr Wilkins. It rejected the assertion that he acted without integrity, although Mr Wilkins himself accepted that he had lacked due skill and care in certain respects. The Upper Tribunal therefore remitted to the FCA the decision as to whether Mr Wilkins should be banned.

The FCA considered that the Upper Tribunal's decision was not fully reasoned, and it therefore invited the Upper Tribunal to reach the conclusion that, even if Mr Wilkins passed the "fit and proper" test from the point of view of integrity, he nonetheless failed it in terms of competence. The Upper Tribunal therefore produced additional reasons, the following month, clarifying that it considered the FCA to have failed to discharge its burden of proving Mr Wilkins not to be fit and proper, including as to competence.

FCA obtained injunction and penalty for market abuse

FCA v. Da Vinci Invest Ltd. and others [2015] EWHC 2401 (Ch)

The defendants in this case were alleged by the FCA to have engaged in "layering" or "spoofing" in relation to high-volume trading of CFDs relating to shares listed on the London Stock Exchange, in 2010 and 2011. The FCA sought an injunction in relation to the alleged market abuse under section 381 of FSMA and, for the first time, also sought the imposition of a financial penalty by the court under section 129, rather than imposing the penalty itself.

In considering the FCA's claim, the judge stated that he found it obvious based on the wording of FSMA that there was no jurisdiction for the court to impose a financial penalty under section 129 unless it found that the relevant defendant had engaged in market abuse. The judge rejected the argument that it was an abuse of process for the FCA to apply to the court to impose a financial penalty without going through its internal processes in order to impose the penalty itself. He noted, however, an apparent inconsistency in the drafting of FSMA that meant that defences available where the FCA was considering imposing a financial penalty (under section 123 of FSMA) were not expressly stated to be available where the court used its powers under section 129. It was suggested by the FCA, however, that the court should construe section 129 as though it referred to the same defences. The judge also declined to find that the power to impose a penalty was available only where the court actually granted an injunction.

Da Vinci Invest (DVI, the first of six defendants in this case) argued unsuccessfully against the view that market abuse was to be judged objectively, and did not require the person committing it to have a particular state of mind. The judge further rejected the suggestion that a company such as DVI could avoid liability for market abuse where the relevant behaviour was entered into by traders engaged by it as contractors, rather than by employees. The judge was also called on to decide the appropriate standard of proof in a case of this kind. The judge agreed with the FCA that the ordinary civil standard (balance of probabilities) was the appropriate test, but held that the court should take into account (as it would in a case of civil fraud) the inherent improbability of the behaviour alleged taking place, when applying that test.

In determining whether the defendants had engaged in market abuse, the judge decided that it was appropriate for the court, of its own motion, to take into account the matters set out in Article 4 of the Market Abuse Directive (shortly to be replaced). He also rejected the suggestion that the court had to hear evidence from actual market participants that they were misled. In terms of available defences, the judge found that, while DVI did not actively turn a blind eye to the behaviour of traders on its behalf, it was reckless as to that behaviour in the interests of maintaining profit, and as such did not have a defence. In calculating the appropriate penalty, the judge took the view that it was appropriate to use the procedure under DEPP that the FCA would use were it imposing a fine.

Further action by the FCA in relation to Keydata

Craig McNeil, 21 September 2015

The FCA fined Mr McNeil (Keydata's former finance director) £350,000 and prohibited him from performing any significant influence function in relation to regulated activities performed by any authorised person, exempt person or exempt professional firm. It found that Mr McNeil had breached the APER Statements of Principle 4 (appropriate disclosure to the FCA) and 6 (acting with due skill, care and diligence).

The allegations against Mr McNeil related chiefly to the fact that he was aware that Keydata was not receiving payments from the issuer of the bonds in which it had invested its clients' funds. It did not alert either investors or the FCA to this fact, but continued to meet payments to investors from its own corporate funds, thereby masking the issuer's problems. Mr McNeil was also responsible for the preparation of Keydata's board minutes, which the FCA found did not record what Mr McNeil later stated to have been the key points of various board meetings. In addition, Mr McNeil had permitted various payments and transactions, the purpose of which he did not fully understand.

Defects in FCA's enforcement action

Angela Burns v. FCA [2015] UKUT 601 (TCC)

In 2012, the FCA produced a decision notice, fining and banning Angela Burns based on findings that she had misused her position as a non-executive director in order to further her commercial interests, and that she had failed to disclose conflicts of interest. These failings were said to be in breach of APER Statement of Principle 1, in relation to the integrity required of persons performing a controlled function. Ms Burns referred the decision notice to the Upper Tribunal.

The FCA pursued 10 allegations against Ms Burns, of which the Upper Tribunal (in December 2014) upheld four, finding (in May 2015) that Ms Burns was not fit and proper to perform the CF2 function, and that the FCA should impose a fine on her (albeit a significantly reduced one, set at £20,000). Its decision in September was as to Ms Burns's application for the FCA to pay her costs (in the amount of some £1.8 million, including charges for her own time at £565 per hour).

Ms Burns's application was made on a number of grounds, some of which the Upper Tribunal found entirely unconvincing. She was successful in persuading the Upper Tribunal that the FCA had been unreasonable in seeking to enforce its original fine of £154,800, even where the Upper Tribunal had found that six out of the 10 allegations pursued by the FCA failed. The Upper Tribunal found, however, that it would not be appropriate to award Ms Burns her costs of the FCA's unreasonable action in this regard. It did, however, award her costs of £100,000 in relation to the FCA's decision to restore for the purposes of the proceedings before the Upper Tribunal a mistaken allegation that Ms Burns had solicited a bribe. The Upper Tribunal noted that the allegation was a serious one, and that the RDC had suggested that it be removed from the decision notice.

Fine and ban in relation to failings by Aviva Investors

Mothahir Miah, 17 November 2015

The FCA fined Mr Miah £139,000 (taking account of a discount for early settlement) and banned him for five years. The FCA's action related to Mr Miah's role in relation to failings identified by the FCA in relation to Aviva Investors (summarised in our last update), where he was an investment analyst.

Aviva Investors was fined, and paid compensation to clients, in relation to a failure of systems and controls that had allowed cherry-picking by some of its staff, including Mr Miah. Mr Miah had taken advantage of such failures in order to avoid allocating investments he made to particular clients until he could assess their performance during the day. The FCA found that this showed a want of integrity, in breach of Principle 1 of the Statements of Principle for Approved Persons, and imposed the penalties summarised above on the basis that Mr Miah was not fit and proper. It decided, however, to impose a five-year time limit on the ban placed on Mr Miah, in view of his open and contrite attitude.

Failures in relation to prevention of financial crime

Barclays Bank plc, 25 November 2015

The FCA fined Barclays £72,069,400 in respect of failures to manage appropriately the risk of financial crime posed by a single deal in 2011 and 2012. The FCA found that such failures amounted to a breach of Principle 2, which states that a firm must conduct its business with due skill, care and diligence.

Barclays engaged in a large transaction with clients which it had itself identified as susceptible to a greater than usual risk of bribery or corruption, based on the application of various criteria Barclays used in order to identify what it termed "Sensitive PEPs". This would ordinarily have triggered Barclays to follow internal procedures for dealing with clients of this kind. In this case, however, Barclays had entered

into a confidentiality agreement with the clients (the Confidentiality Agreement). The Confidentiality Agreement required that Barclays restrict knowledge of the identity of the clients to a very small number of individuals, including within the bank. If Barclays breached the Confidentiality Agreement, it would be liable to indemnify the clients up to the amount of £37.7 million.

In order to maintain the confidentiality of its clients, Barclays decided to bypass its usual AML procedures. It also decided to keep the clients and the transaction off its IT systems. It was not automatically a problem, in the FCA's view, that Barclays departed from its usual procedures. The difficulty was that it did not put in place an acceptable alternative. There was no indication that actual financial crime had taken place, but the steps Barclays had taken to prevent it were fewer than it would usually undertake in relation to ordinary clients.

The FCA's approach to enforcement was interesting in a number of respects. First, the FCA did not refer to any breach of Principle 3 (requiring a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems), which might seem a more natural basis for enforcement in this case. It is impossible to know why the FCA did not rely on Principle 3, but the most probable reason may be that the Final Notice does not criticise Barclays's risk management systems, as opposed to the fact that they were bypassed in this case. Second, while the requirements of the Money Laundering Regulations are referred to throughout the Final Notice, and the implication is that they were breached, such breaches are not stated as part of the basis for the FCA's enforcement action.

Failure to put in place adequate controls and inaccurate disclosure to regulators

Threadneedle Asset Management,
10 December 2015

Threadneedle Asset Management Limited (TAML), an investment management firm, was fined £6,038,504 by the FCA for breaches of Principle 3 (taking reasonable care to organise and control its affairs responsibly and effectively) and Principle 11 (dealing with regulators in an open and co-operative way). The FCA had asked TAML to report on its risk mitigation, specifically the extent to which fund managers were limited in their ability to book trades. TAML reported that certain members of staff would have oversight of "all aspects of dealing". It later transpired that fund managers remained able to book trades independently of supervision, resulting in a potentially hazardous unauthorised transaction being initiated. The FCA fined TAML both for the failure of control and for misreporting its levels of control. The penalty was reduced by 20 per cent, because TAML agreed to settle at an early stage of the FCA's investigation.

Culture and related issues

Strengthening the alignment of risk and reward: new remuneration rules

FCA PS15/16 and PRA PS12/15,
June 2015

This policy statement followed the joint PRA CP15/14 and FCA CP14/14 published in July 2014, and reflected the feedback received from that consultation. The regulators maintained their position on the length of proposed minimum deferral periods for bonuses, accepting that these exceeded the periods set out in the Capital Requirements Directive (CRD) in places, but justifying their decision. The regulators confirmed their position of introducing a presumption against discretionary payments being justified for management of banks in receipt of government support. The regulators committed to exploring the possibility of buyouts of deferred bonuses to be subject to malus by a previous employer. The regulators confirmed that non-executive directors would be banned from receiving bonuses. The FCA also affirmed its proposed guidance on proportionality, and made small amendments to its proposed guidance on ex-post risk adjustment to bonuses, while the PRA announced its intention to introduce stricter requirements in relation to risk adjustment and performance metrics.

The only significant change announced in this policy statement, in comparison to the consultation paper, relates to which employees come under which minimum deferral periods for bonuses. For PRA regulated firms, certain material risk takers (MRTs) (those who are not in significant risk functions) will only be subject to the CRD mandated minimum deferral period (three to five years), rather than the originally proposed five years. Other MRTs will still come under a deferral period of five years. For non-PRA regulated firms, all MRTs who are not within the SMR will be subject to the CRD minimum in any case. For all firms, employees who fall under the SMR will have a seven-year minimum deferral period.

It is notable in this context that the EBA published its final guidelines on remuneration policies on 21 December 2015, including an opinion on the application of proportionality. This opinion agrees with the European Commission that exemptions or waivers to any of the remuneration principles are not permitted whether on grounds of proportionality or otherwise. Nevertheless the EBA recommends that the CRD should be amended to exclude small and non-complex firms from certain remuneration principles, including deferral, but not the "bonus cap". The EBA has also stated that its guidelines will not apply until 1 January 2017, and the rules will first apply to the 2017 performance year, so firms will not have to adjust existing pay practices yet. A further announcement from the FCA and the PRA is expected in due course.

Risks to customers from performance management at firms – thematic review and guidance for firms

FCA FG15/10, July 2015

The FCA produced guidance following a thematic review of the way in which performance management within firms could pose risks for consumers. Its review was broader in scope than issues connected purely with remuneration, and the finalised guidance refers to formal processes, sales targets and informal communications between sales staff and their managers. The FCA's review was not based on direct assessment, but on information received from whistleblowers and media reports, which was then followed up with firms. The review found instances of poor practice, but no widespread issues.

The FCA's guidance recognises the potential impact on sales staff's behaviour of many strata of management, including pressure applied indirectly from the business needs articulated by senior management. The FCA stated, however, that the right "tone from the top" is not enough, and firms must look not only at their policies in relation to performance management, but at what happens in practice. It recognised that middle management might be under particular pressure to manage conflicts between business needs and avoiding inappropriate selling. The guidance considered the different sources of information available to firms in determining whether undue pressure was being placed on staff to achieve sales targets, as well as identifying some examples of both poor and good practice. In general terms, it is clear that the formal creation of a balanced scorecard, or compliance with remuneration requirements, will not be enough to satisfy the FCA where other aspects of a firm's management of its staff are aimed solely at achieving sales, without proper consideration of the customer's needs.

Decision not to proceed with review of culture within banks

In its Business Plan for 2015/2016, the FCA indicated that it would be carrying out a thematic review of culture in retail and wholesale banks. It was reported at the very end of 2015 that the FCA would not be publishing that review, but the FCA has maintained that it continues to focus on culture as an issue, including at supervisory level with individual banks. The decision, which will have appeared quite reasonable to some in light of the many reforms touching on culture that are still to be fully implemented, has attracted criticism from others, including MPs and consumer groups.

Dealing with customer complaints

Fair treatment for consumers who suffer unauthorised transactions

FCA TR15/10, July 2015

The FCA conducted a thematic review into firms' treatment of customers who suffer unauthorised transactions. The review looked at the application by firms offering current accounts and credit cards of the provisions of the Payment Services Regulations and the Consumer Credit Act 1974. In general, the FCA found that no further thematic work was needed. While requirements were sometimes complex, firms were generally meeting the relevant requirements, and tended to err on the side of the customer in considering claims. The FCA had been concerned that firms might have been holding customers to over-prescriptive security requirements, but it did not find this to be the case. The review contains various examples of good (and indeed some poor) practice. Where the FCA identified concerns, they included: terms and conditions that did not fully inform the customer of his/her rights; lack of clear policies for considering claims; and over-reliance on a small number of staff to consider complaints received.

Improving complaints handling, feedback on CP14/30 and final rules
FCA PS15/19, July 2015

The FCA set out its final position in relation to reforms to the rules around the handling of complaints by FCA-regulated firms, consulted on in CP14/30. These rules apply to all FCA-regulated firms within the scope of the Compulsory Jurisdiction of the Financial Ombudsman Service (FOS): participants in the Voluntary Jurisdiction of FOS are subject to separate rules. Firms are currently permitted not to use a formal response letter to complaints where they respond to complaints before the end of the next business day after receiving the complaint and the complainant accepts their response. The FCA will extend this to the end of the third business day after receiving the complaint. Firms do not currently have to report the number of complaints dealt with in the shorter timeframe. The FCA will make firms report all complaints, whether dealt with in the shorter timeframe or not. In addition, the FCA pledges to amend the twice-yearly "complaints return" that firms currently have to send reporting those complaints. The FCA will also require firms to send a communication to complainants dealt with in the shorter timeframe summarising the response and highlighting their potential recourse to the FOS. These changes will come into force on 30 June 2016. The FCA also said it would require firms to use basic rate phone numbers for customers calling them, rather than premium rate phone numbers, a change which came into force on 26 October 2015.

Changes to DISP
Handbook Notice No. 21, published in April 2015, came into force July 2015

These changes to DISP were made in order to implement the Alternative Dispute Resolution Directive (the Directive) in the UK. Like PS15/19 (referred to above), these amendments were the subject of consultation in CP14/30. The amendments described below apply to the handling of complaints received by firms from 9 July 2015 onwards. Overall, while firms will need to take careful note of the changes introduced in order to implement the Directive, it seems unlikely that they will make any substantial difference to firms' complaints handling in practice.

There are some changes to the information firms must provide to complainants, but the majority of the amendments to DISP relate to referrals to the FOS, by whom they can be made, and when. Where a professional client or eligible counterparty meets the definition of "consumer" adopted by the UK in its implementation of the Directive, he or she will be able to refer a complaint to the FOS. The FOS will now be able to consider a complaint referred to it before a firm has provided its final response to the complaint, or the eight-week period for it to do so has expired, where both complainant and firm agree. Even where this happens, the early reference to the FOS does not absolve the firm of its obligation to deal with complaints within the usual time period.

There are also now only five grounds on which the FOS can refuse a complaint without considering its merits. In particular, the FOS will no longer be able to dismiss a complaint without considering its merits on the grounds that it relates to investment performance.

Rules and guidance on payment protection insurance complaints
FCA CP15/39, November 2015

The FCA consulted on imposing a deadline for complaints relating to PPI. Such deadline is to be preceded by a communications campaign, funded by a new fees rule. Consultation closes on 26 February 2016. The consultation paper records that, to date, firms have paid a total of over £21 billion to 12 million customers in relation to PPI. It also records various issues with complaints received. It was anticipated that the FCA would seek to draw a line under this at some point, and that line is proposed as being two years from the implementation of new rules following the outcome of the consultation.

In some ways more interesting is the second matter dealt with in the consultation paper, which is the approach the FCA says should be adopted in light of the Supreme Court's judgment in *Plevin*, where a claim could be made under the unfair relationship provisions of the Consumer Credit Act 1974. The FCA proposes, in relation to such cases, that firms that would otherwise be minded to reject a PPI complaint should be obliged to undertake a "step 2" assessment. In basic terms, that second step would require firms to consider whether the amount of their commission was disclosed to the customer and, if not, whether such lack of disclosure gave rise to an unfair relationship. In general, they should assume that it did if the commission accounted for 50 per cent or more of the total amount paid by the customer. The FCA also

consults on the appropriate basis for redress in such cases. It does not propose asking firms proactively to review past decisions in relation to complaints that might have been affected by this rule change.

Fair and Effective Markets Review (FEMR)

FEMR's final recommendations

Final report, June 2015

FEMR's final report (into the fixed income, currency and commodities (FICC) markets) recommended various actions, some of which have already led to proposals for implementation, others of which will take longer to put into practice. FEMR itself grouped its recommendations under various headings.

1. Raising standards, professionalism and accountability of individuals – much of this work is expected to be done by the introduction of the SMR, certification regime and conduct rules. FEMR also recommended introducing globally endorsed trading standards for FICC markets, new training requirements, and the extension of criminal sanctions for market abuse, including an increase from seven to 10 years in the maximum sentence. That increased maximum is still less than the sentence imposed on Tom Hayes, who was prosecuted for conspiracy to commit fraud in relation to his role in LIBOR manipulation, and sentenced to 14 years in prison (subsequently reduced to 11). FEMR also recommended the creation of requirements in relation to regulatory references, to prevent "rolling bad apples", and this recommendation is the subject of ongoing consultation.

2. Improving the quality, clarity and market-wide understanding of FICC trading practices – the main recommendation under this heading was the creation of a new FICC Market Standards Board (FMSB) including both firms and end-users of benchmarks, which is to assume a number of responsibilities, including in relation to establishing the minimum training standards referred to above. The FMSB's website contains some details of its membership and how it will work, but there are few indications as to future timing.

3. Strengthening the regulation of FICC markets in the UK – this includes the creation of a new statutory civil and criminal market abuse regime in relation to spot FX. It also included extension of the SMR, certification regime and conduct rules to firms other than banks. The efficacy of these rule changes is, of course, still to be tested, but FEMR has recommended rolling them out to a wider range of authorised firms in some form. Interestingly, it did not advocate extending the presumption of responsibility, which has since been dropped in relation to banks as well. HM Treasury has since announced that the new regime will be applied to all authorised firms, although its precise form remains to be seen.

4. Launching international action to raise standards in global FICC markets – part of this work includes the creation of a single global FX code (the Bank of International Settlements has set up a working group aimed at achieving this), and the adoption of transparency and controls around FX.

Financial benchmarks – thematic review of oversight and controls

FCA TR15/11, July 2015

This review was, as its name implies, a review into firms' oversight and controls in relation to financial benchmarks. What was perhaps less obvious was the FCA's view of what a "benchmark" actually was. Many of the failings it identified appear to have been attributable to firms not treating as benchmarks things that the FCA considered should have been. The FCA considered that firms should adopt a broad interpretation of the IOSCO definition of benchmarks which would potentially include activities that would not immediately be associated with benchmark activity. It also appears that the FCA does not consider it to be of primary relevance whether a firm considers a published price calculation to be a benchmark, if it is capable of being used in that way. It is worth noting in this context that negotiations are ongoing in the EU as to the EU Benchmarks Regulation, and it appears from the documents published in relation to those negotiations that there is potential for a differently drawn definition of "benchmark" to emerge.

The FCA's review considered 12 banks and broking firms, and found that none had fully implemented changes across all benchmark activities. Its review excluded LIBOR and the WM Reuters 4 p.m. fix. The FCA's key messages were that:

(a) firms needed to adopt the broad IOSCO definition of a benchmark;

(b) senior management needed to act quickly in relation to remaining gaps, in that progress to date had not shown sufficient urgency;

(c) firms needed to strengthen governance and oversight, in order to ensure proper management information, monitoring and co-ordination of roles;

(d) firms needed to review how conflicts of interest might arise and take steps to manage them;

(e) firms needed to pay more attention to in-house benchmarks, where conflicts of interest might exist in relation to, for example, their design and their subsequent use;

(f) firms should give proper consideration to the effect of exiting a benchmark, which the FCA considered should take place in an orderly fashion.

Ring-fencing

Disclosures to consumers by non-ring-fenced bodies

FCA CP15/23, July 2015

The Financial Services (Banking Reform) Act 2013 created a category of ring-fenced bodies (RFBs) that would only be permitted to carry out retail, not investment banking. Under a later statutory instrument, the FCA was required to make rules for the disclosure of relevant information to individuals who are, or seek to become, account holders with non-ring-fenced bodies (NRFBs), and this consultation paper set out the FCA's proposals and sought views on them. NRFBs are not the same as bodies which are not RFBs; rather, they are UK deposit takers within the same group as RFBs. The FCA did not propose to extend the disclosure regime to all firms which fall outside the ring-fencing regime. The legislation required NRFBs to provide information on any actions they undertook which RFBs are prohibited from undertaking. The FCA proposed that this information should be high-level and preceded by a scene-setting narrative on ring-fencing; should be provided online; and should only be provided to depositors entitled to hold an account with an NRFB (those with assets of more than £250,000). Information would be provided to eligible depositors who currently have an account at a firm that will become an NRFB before that designation takes effect. Once a bank becomes an NFRB, the information would need to be provided before a depositor opens an account. The FCA also proposed that no further changes were necessary to the FCA Handbook. All of these points were open to consultation.

Guidance on the FCA's approach to the implementation of ring-fencing and ring-fencing transfer schemes

FCA GC15/5, September 2015

The FCA has set out in draft form its guidance regarding its approach to its duties under ring-fencing transfer schemes (RFTSs). RTFSs are schemes by which firms may use the legal procedures under Part VII of FSMA to give effect to any transfers of business needed to adhere to the new ring-fencing regime. The PRA will lead RTFSs, but will be required to consult the FCA at certain points in the process. The FCA set out its criteria for setting out its views on proposed skilled persons to produce reports on the schemes before they go to court for approval, its expectations for the content and form of those reports, its guidance on the notice firms have to give prior to the scheme being heard in court, and the matters it will consider when participating in court proceedings.

The implementation of ring-fencing: prudential requirements, intragroup arrangements and use of financial market infrastructures

PRA CP37/15, October 2015

The PRA set out further details of its proposed policies in relation to ring-fencing. This follows CP19/14, which set out the PRA's proposals on legal structure, governance and continuity of services and facilities, and a subsequent policy statement (PS10/15). The PRA began with proposals to ensure that ring-fenced bodies (RFBs) have adequate financial resources, by requiring that RFBs meet specific prudential requirements on a sub-consolidated basis. The PRA's proposals are intended to ensure that RFBs are insulated within the sub-group they are part of, and that they avoid financial contamination by other group members by heavily restricting the flows of capital in and out of the sub-group. Further to this, the PRA proposed guidance to ensure that RFBs deal with members of their group on arm's length terms, as required by statute, and explained how they would interpret that phrase. The PRA, also as required by statute, sought to define which "exceptional circumstances" would allow an RFB to participate in inter-bank payment systems, and, more generally, the conditions under which RFBs could participate in central securities depositories and central counterparties. The PRA also proposed to ensure RFBs were required to demonstrate their compliance with every ring-fencing obligation and to review their policy towards the exceptions permitted by the PRA. Finally, the PRA set out its preliminary views on additional reporting requirements for RFBs. The Consultation Paper was accompanied by draft rules, a draft supervisory statement and proposed consequential changes to existing PRA publications.

MiFID2

Uncertainty over timing for implementation

There is still uncertainty over whether the implementation of MiFID2 will, indeed, be delayed (in whole or in part), but some reports suggest that this is likely.

FCA's first consultation paper in relation to implementation

FCA CP15/43, December 2015

The FCA published its first consultation paper (open until 8 March 2016) in relation to the implementation of MiFID2 in December 2015, and has said that it anticipates publishing a second consultation in the second quarter of 2016 (it also anticipates that the PRA will consult during 2016). The consultation relates to the FCA's regulation of the secondary trading of financial instruments, and considers: (a) trading venues (Regulated Markets, Multilateral

Trading Facilities and Organised Trading Facilities); (b) Systematic Internalisers; (c) transparency; (d) market data; (e) algorithmic and high-frequency trading requirements; (f) passporting and UK branches of non-EEA firms; (g) proposed extension of the FCA's Principles for Business; and (h) proposed revisions to the FCA's Perimeter Guidance Manual.

Other developments

Smarter Consumer Communications

FCA DP 15/5, June 2015

With this discussion paper, the FCA intended to start a debate around how the regulator and the industry could deliver information to consumers in more effective ways. The FCA commissioned a review of customer literature in the UK and abroad to identify good practice. The discussion paper argued that too often, customer literature is written to conform to regulatory requirements and/or in anticipation of litigation, and this should change to focus on customer understanding. The FCA proposed to review its Handbook to make sure its disclosure requirements assist the customer rather than merely creating red tape for firms. In particular the FCA recommended that firms should highlight important terms and conditions instead of hiding them within large blocks of text, that firms should be more explicit about fees and charges, that firms should alert customers to the existence of the FOS, and that firms should clarify the extent of customers' recourse to the FSCS. The discussion paper ends by inviting firms to share best practice and suggestions as to how best to communicate to customers. The discussion paper is of note because the FCA may decide to amend its Handbook in order to simplify the disclosure requirements and make the required disclosures more customer-friendly.

Restrictions on the retail distribution of regulatory capital instruments – final rules

FCA PS15/14, June 2015

The FCA published final rules regarding the promotion and sale to retail clients of contingent convertible instruments (CoCos), or interests in funds the investment returns of which are "wholly or predominantly linked to, contingent on, highly sensitive to or dependent on, the performance of or changes in the value of" CoCos. The policy statement also includes rules relating to mutual society shares, which are not discussed here.

The rule changes themselves are made in COBS, predominantly COBS 22.3 and came into force on 1 October 2015, following the introduction of temporary rules in October 2014. The FCA has stated that it views CoCos as inappropriate for non-sophisticated retail customers of ordinary means. Interestingly, the feedback received to the FCA's consultation indicated that, while industry respondents were broadly supportive of the FCA's proposals, investors were not. The majority of the investors who responded were, it appears, holders of the CoCos issued by Lloyds Banking Group which were the subject of the judgment summarised above (**"CoCos – litigation between Lloyds and its noteholders"**). In broad terms, the new rules prevent firms from selling CoCos, or communicating/approving inducements to invest in CoCos, to retail clients in the EEA. There are exceptions, including where the client is a sophisticated investor or certified high net worth investor. In the latter case, however, and where the client has self-certified as being sophisticated, the firm must consider the CoCo to be suitable for the individual (within the meaning of COBS 4.12.5G). The restrictions on sale do not apply to MiFID business, although the restrictions on promotion do. The person responsible for compliance oversight, or someone under his or her supervision, must also record the sale/promotion, which exemption applied and why, and such record must be maintained for five years.

The FCA responded to industry concerns by amending the definition of a CoCo, which is drawn by reference to current capital requirements, and which firms will wish to consider when deciding whether the new rules apply. In general, the FCA's view appears to be that, as capital requirements have changed, so too the provisions of CoCos have become more complex, risky and vulnerable to asymmetries of information. This approach is also interesting in the context of the Court of Appeal's approach to the position of retail investors in the LBG CoCos discussed above. More generally, the FCA has indicated that it will keep in mind criticisms that it is applying its product intervention powers inconsistently.

Consumer credit – feedback on CP15/6 and final rules and guidance

FCA PS15/23, September 2015

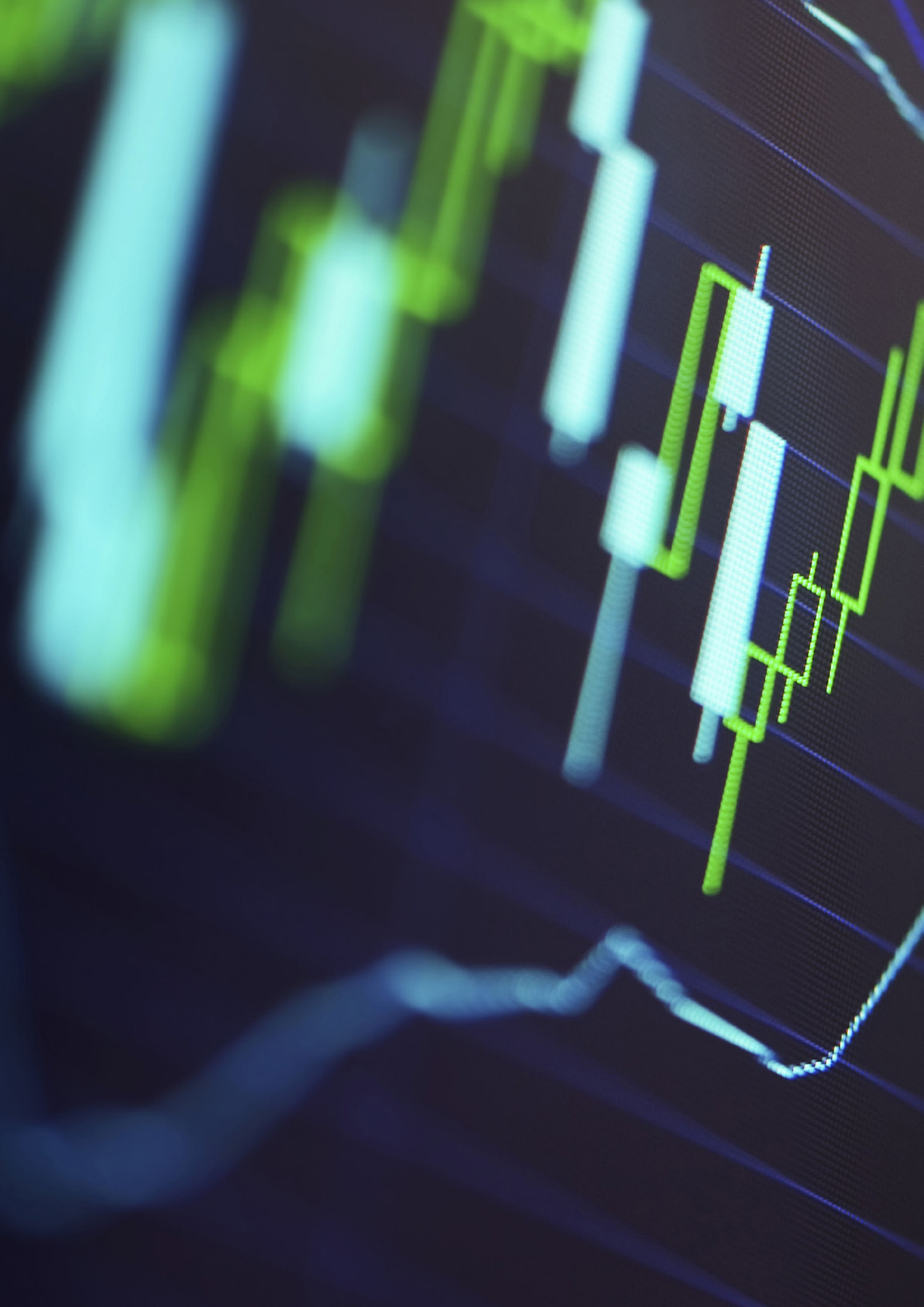
In this policy statement, the FCA presented its final rules on the consumer credit regime, following proposed rules in consultation paper 15/6, published in February 2015. The FCA largely decided to retain the proposed rules outlined in CP15/6 in light of the consultation responses. However, the FCA decided to amend some proposals and delay others. The FCA amended its draft provisions on guarantor lending. It limited their scope to guarantors and borrowers who are "individuals", and lessened the potential impact of obligations on lenders to explain the contract to the guarantor, by allowing for such explanation to be provided as part of independent legal advice received by the guarantor. It allowed lenders to undertake different creditworthiness checks on guarantors as compared with borrowers. The FCA has also weakened lenders' obligations regarding pre-contract explanations and creditworthiness checks on borrowers themselves. In relation to financial promotions, the FCA has clarified that rules relating to APR comparisons in financial promotions relate to credit, rather than to the goods or services financed by the credit. The FCA has also delayed a proposal in PS14/18 to make GABRIEL reporting mandatory. The FCA has also announced consumer-credit related thematic reviews relating to staff remuneration and early arrears management in unsecured lending, and further reviews of the Consumer Credit Act leading up to 1 April 2019.

Flows of confidential and inside information

FCA TR15/13, December 2015

The FCA conducted a thematic review of the way in which the debt capital markets and mergers and acquisitions departments of 16 small to medium-sized investment banks managed confidential and inside information. The FCA considers, however, that its findings ought to be considered by all firms.

In general terms, the FCA emphasised the need for firms to consider circumstances that might pose heightened risk of misuse of information or conflicts of interest, and manage these accordingly. The FCA also said that the role of senior management and lines of reporting were not always sufficiently clear, and that the role of the compliance function was not always appropriately positioned. Not all senior managers the FCA spoke to understood the difference between confidential and inside information, and some seemed to emphasise the role of compliance at the expense of their own part in ensuring good practice. In some firms, compliance was physically distant from the front office, and seen as an administrative function, whereas in others, the over-strong presence of compliance meant that the front office relied on it too much. The FCA also suggested that information was sometimes shared too widely within firms, for example at team meetings. Finally, the FCA found that policies and procedures, and surveillance techniques, were not fit for purpose in all cases. Firms had also not given enough thought to the physical location of individuals whose roles might create a conflict of interest.



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