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PRIVATE BANK BRIEFING

LATHAM & WATKINS

Issues Impacting the Private Bank Sector

Welcome to our quarterly round-up of legal and compliance issues impacting private banks and their clients.

In This Edition

Supervision: FCA Dear CEO Letter to Wealth Managers

On 23 July 2019, the FCA published a Dear CEO letter on its wealth management and stockbroking supervision strategy, which began in April 2019. The strategy includes work to identify, diagnose, and remedy the harm that wealth managers and stockbrokers may cause, and will run for a two-year period. At the end of this period, the FCA will write to firms with its updated view of the key sector risks and its supervisory focus.

The letter sets out the FCA's views of the key risks of harm that wealth management and stockbroking firms pose to their customers or the markets in which they operate. Firms are encouraged to consider whether they present these risks, and what strategies they have in place for mitigating them.

The FCA is concerned about the following areas of focus:

- **Fraud, investment scams, and market abuse:** This remains a priority area for the FCA, which expects firms to ensure suitability and not include high-risk investments inappropriately. The FCA plans to use a range of data to identify the small number of firms that cause issues.
- **Best execution:** The FCA expects firms to have effective day-to-day execution processes, contingent arrangements for periods of market distress, and clear, comprehensive, and effective oversight and monitoring arrangements. Firms must consider their best execution arrangements, particularly if they rely on a single retail service provider (RSP), and make improvements where necessary. The FCA may consider supervisory work in this area. In our view, a private bank's MiFID II implementation framework for best execution should go a long way to addressing the FCA's expectations.
- **Costs and charges disclosures:** The FCA expects firms to review their own costs and charges disclosures to ensure they are satisfying all relevant requirements, including for both ex-ante and ex-post costs and charges disclosures. Firms should be particularly alert to the need to disclose all transaction and incidental costs and charges to customers. The FCA may conduct further work to assess how firms are implementing ex-post costs and charges disclosure requirements. This tallies with the work ESMA is doing (see page 3), so expect a lot more traction in this area.
- **EU withdrawal:** The FCA reminds firms of the need to act in customers' best interests, maintain clear communications, and take steps available to continue to service customers in the EEA in accordance with local law and national regulators' expectations. Firms should be prepared to provide Brexit plans and updates to the FCA, if not already doing so.

The FCA also refers to the Investment Platform Market Study, and states that improving the switching process remains a priority for the regulator, whilst welcoming the progress made to date and encouraging firms not already involved to consider taking part. The FCA will review progress later in 2019, and again in 2020, if needed. It will consider further regulatory action if the efficiency of the switching process does not improve.

SMCR: FCA Confirms Amendments Relating to the Head of Legal and Client Dealing Function

On 26 July 2019, the FCA published a Policy Statement (PS19/20) confirming its changes to the SMCR relating to the Head of Legal and the Client Dealing Function. The FCA confirmed that the Head of Legal does not require approval as a Senior Manager (if not otherwise performing a Senior Management Function), and clarified the scope of the Client Dealing Function under the Certification Regime so that it does not capture purely administrative roles.

Private banks may need to certify not only their Head of Legal, but possibly also one or more individuals who sit above the Head of Legal.

Head of Legal

The FCA is largely confirming the changes as consulted on. It has, however, provided a few additional helpful clarifications in relation to the Head of Legal. The FCA confirms that the individual to whom the Head of Legal reports will need to be certified, if that person is not a Senior Manager. This is because the Certification Regime requires managers of certified persons to also be certified themselves, and the Head of Legal will be a certified person. This creates a chain of accountability up to the Senior Manager level. Therefore, private banks may need to certify not only their Head of Legal, but possibly also one or more individuals who sit above the Head of Legal, but below the relevant Senior Manager.

The FCA explains, however, that as the Head of Legal role will not be a Senior Management Function, the FCA will not seek to hold any other individual to account for the Head of Legal's responsibilities. The FCA also confirms that it does not envisage that other legal roles, apart from the Head of Legal, will fall within the Significant Management Function contained within the Certification Regime. Therefore, other individuals carrying out a legal role will not require certification unless they are a Material Risk Taker, or are otherwise performing any other of the certification functions.

The FCA clarifies that, although the Head of Legal will need to be certified, firms do not need to undertake regulatory referencing or redo fit and proper assessments for this individual, as long as their job does not change. Private banks already subject to the SMCR should note that the deadline for certifying their Head of Legal (and any managers above the Head of Legal but below Senior Manager level) is 9 December 2019.

Client Dealing Function

In relation to the Client Dealing Function, although the FCA reports that respondents requested some further clarifications about what activities would bring an individual within scope (including on the status of sales and product specialists, administrative roles, and those involved in the complaints resolution process), the FCA declines to offer further guidance. Instead, it states that the amended rule has been drafted in a way that provides firms with the flexibility to exercise judgment as to whether a role requires certification. The clear implication is that firms must judge for themselves whether or not particular individuals fall within the scope of this function. Consequently, private banks should ensure that they take a consistent approach across the business, and document thoroughly any determinations as to why particular individuals do or do not require certification.

Tax: DAC6 for Banks — UK Publishes Consultation and Draft Regulations

On 22 July 2019, the UK government published a consultation document and draft Regulations to bring into effect the European Union's rules on reportable cross-border tax arrangements (often referred to as DAC6). These rules will create a significant compliance burden for certain private banks. Under DAC6, intermediaries (which may include banks and law firms) and, in certain cases taxpayers, will be required to report details of certain cross-border arrangements from 1 July 2020. DAC6 will apply retrospectively to arrangements whose first step is implemented between 25 June 2018 and 1 July 2020. HM Revenue & Customs (HMRC) aims to finalise these Regulations so that they are in force by 31 December 2019, regardless of the effect of Brexit.

A number of services provided by banks may mean that banks will be considered as "intermediaries" in relation to certain transactions covered by DAC6.

Generally, the draft UK Regulations are largely consistent with DAC6. Under DAC6, a cross-border arrangement is reportable if it contains one or more of certain hallmarks commonly seen in aggressive tax planning. A reminder of such hallmarks is set out in the table below. Certain hallmarks only apply if one of the main benefits expected from an arrangement is a tax advantage. However, not every hallmark requires the main benefit test (MBT) to be met.

The draft UK Regulations do not include any additional hallmarks, and the information to be supplied to HMRC under the Regulations in relation to reportable cross-border arrangements is as set out in DAC6. The penalty regime set out in the draft UK Regulations draws on concepts from the UK's regime for disclosure of tax avoidance schemes (DOTAS) and is stated as being £600 per day for failure to meet most obligations (such as failing to make reports) and up to £5,000 in certain other cases (such as failing to notify taxpayers and other intermediaries of reference numbers). These penalties are significantly lower than those proposed in certain other Member States. However, the Regulations include a power for the UK courts to impose a penalty of up to £1 million for certain failures if the normal penalties appear "inappropriately low".

A number of services provided by banks may mean that banks will be considered as "intermediaries" in relation to certain transactions covered by DAC6. The definition in DAC6 envisages two distinct types of intermediaries: (i) those who design, market, organise, and make available for implementation or manage the implementation of an arrangement (referred to by HMRC as "promoters"), and (ii) those who provide aid, assistance, or advice in relation to the designing, marketing, organising, or implementing of arrangements (referred to by HMRC as "service providers").

A service provider may have a defence for failure to report when they can argue that they did not and could not reasonably have been expected to know that they were involved in a reportable arrangement. The example provided by HMRC for such a defence is a bank providing finance. A bank may only be involved in a particular part of an arrangement and might not have knowledge of the wider arrangements and, crucially, whether the arrangement triggered any hallmarks. It is helpful that HMRC has stated that it does not expect service providers to do significant extra due diligence to establish whether there is a reportable arrangement.

Many advisers in the UK have adopted a "wait and see" approach in respect of DAC6 and have held off from implementing procedures to identify and collate information on arrangements within scope until further clarity and guidance is obtained. Following the release of the draft Regulations, advisers in the UK will need to consider further how best to manage the EU mandatory disclosure regime process. Notably, HMRC flags that DAC6 is wider than the code of practice on taxation for banks, and so the fact that a bank is compliant with the code will not, in and of itself, mean that a bank has no obligations under DAC6.

Category	Description	MBT
A: Generic hallmarks linked to the MBT	Taxpayer or participant undertakes to comply with a condition of confidentiality	✓
	Remuneration of intermediary related to tax advantage	✓
	Arrangement has standardised documentation and/or structure	✓
B: Specific hallmarks linked to the MBT	Loss buying	✓
	Converting income into capital	✓
	Circular transactions	✓
C: Specific hallmarks related to cross-border transactions	Certain deductible cross-border payments	In certain cases
	Double deductions for depreciation	×
	Relief from double taxation in more than one jurisdiction	×
	Transfer of assets and difference in amount treated as consideration	×
D	Arrangements which undermine tax reporting or obscure beneficial ownership	×
E	Transfer pricing: non-arm's length or hard to value intangibles or base erosive transfers	×

Unfair Terms: Latest From the EU

The European Commission published new guidance and recommendations on unfair contract terms in consumer contracts on 22 July 2019.

The guidance consolidates the numerous decisions of the ECJ on unfair contract terms. The Unfair Contract Terms Directive (UCTD) is sector-neutral, and as a result, the Commission's guidance is not tailored to financial services firms. Therefore, for EU private banks, the guidance and any "blacklist" terms defined by national competent authorities, together with product-specific rules (*e.g.*, consumer credit and mortgage credit), remain the primary source against which client contracts should be assessed.

Third-country firms contracting with EU consumers should note that such contracts will be governed by the law of the consumer's habitual residence, assuming that the service provider actively pursues or directs his business in the country in which the consumer is resident. Therefore, the UCTD applies to such contracts, even if those contracts are governed by the law of the third-country jurisdiction.

Furthermore, in a case involving Amazon, the ECJ held that a contractual term specifying that the contract is governed by the law of the Member State in which the seller is established is unfair if the term does not unambiguously specify that consumers can still rely on the mandatory consumer protection rules of the country of their usual residence. The Commission states that the same logic must apply if the seller is based in a third country. Private banks contracting with EU-based consumers should take the ECJ's approach into account when drafting jurisdiction clauses in their terms. Further, private banks should also consider how this approach impacts global groups.

Notably, the guidance focuses on enabling consumers to properly understand the full extent of their commitment under a contract emanating from the ECJ's decisions. For example:

- Do the terms allow a consumer to estimate the potential cost of any commitment they are making under contractual terms? This includes not only primary commitments, such as the repayment of a loan, but also the functioning of currency conversions, interest, or late payment charges.
- Do consumers know that they bear the risk of depreciation in loans taken out in foreign currencies, and that such depreciation may affect their income?
- Are the contractual sanctions placed on the consumer for failing to comply with their obligations balanced and proportionate? For example, if clauses allow the provider of the services to exercise multiple options in the event of a consumer's breach, private banks should assess the proportionality of the cumulative impact of all options on the consumer, even if such options are unlikely to all be exercised concurrently.

In addition to considering the terms themselves, private banks should be mindful of the extent to which other promotional/summary materials are helping to enhance the consumer's understanding of these issues.

A key takeaway for private banks whose client base spans the EU is that consideration of the rules on unfair terms in one Member State may not be sufficient.

Consideration of unfair terms is a notoriously tricky area; both due to the subjectivity of the analysis and the plethora of rules and guidance. A key takeaway for private banks whose client base spans the EU is that consideration of the rules on unfair terms in one Member State may not be sufficient. Private banks should take note of multiple EU Directives together with local EU Member State implementation. For example: the Unfair Contract Terms Directive, Consumer Rights Directive, Consumer Credit Directive, and the Mortgage Credit Directive. Annex II of the Commission's guidance contains a helpful summary of the EU Member States that have implemented a blacklist of prohibited terms in consumer contracts. The recommendations published by the Commission and endorsed by an expert stakeholder group are useful guidance, focusing on what information firms should provide and how to better present that information. We have included these recommendations as an Annex to this briefing.

MiFID II: ESMA Call for Evidence in Relation to the Impact of the Inducements and the Costs and Charges Disclosure Requirements

On 17 July 2019, ESMA published a call for evidence in relation to the changes that were introduced to the inducements and the costs and charges disclosure requirements under MiFID II. The European Commission is required, prior to 3 March 2020 and after consulting with ESMA, to report to the European Parliament and the Council on the impact of those changes, and has therefore given ESMA the following mandate to feed into the review. ESMA must:

- Assess whether firms comply with the inducements and the costs and charges disclosure rules in practice
- Assess whether application varies across Member States
- Assess the effects of those rules for both professional and retail clients, and give a broader consideration of the extent to which investors have benefited from the new rules so far

In light of this mandate, ESMA launched the call for evidence, which sets out a number of questions for firms and other interested stakeholders in relation to their experience in this area and the issues that have arisen. The responses that ESMA receives will inform its advice to the Commission.

The deadline for comments is 6 September 2019. This call for evidence provides an opportunity for private banks to feed into this review, in particular if they have seen divergent approaches to the rules in different Member States.

Benchmarks: Latest Developments

EU Benchmarks Regulation

1 January 2020 is a key date under the EU Benchmarks Regulation (BMR). In relation to the use of significant and non-significant benchmarks provided by EU administrators, it is the date from which regulated EU users of benchmarks may only use such EU benchmarks if they are provided by EU administrators who are either authorised or registered with their relevant national competent authority, or who have applied for such authorisation or registration.

Key impact:

- ***EU administrators*** must have at least applied for authorisation or registration by 1 January 2020 in order for their benchmarks to continue to be available to use in the EU from 1 January 2020. The market generally is still grappling with a number of scoping issues in order to determine whether certain activities amount to administration, and whether certain figures amount to benchmarks. Given the impending deadline, time is of the essence for any EU administrators who have not yet applied for authorisation or registration.
- ***Supervised users*** must determine which benchmarks they are using, who the administrator is, and what the administrator's BMR compliance plans are. Waiting until 1 January 2020 to see which benchmarks continue to be available will not be sufficient. Users should be proactive by reviewing whether the administrators whose benchmarks they use are authorised or registered — if they are not, users should contact those administrators to ascertain their plans. Users should already have in place fallback plans in case the benchmarks they use cease to be available, along with named alternatives if feasible and appropriate. Users may want to consider test runs of these plans to ensure they are fit for purpose if they need to be engaged.
- ***Third-country benchmarks and critical benchmarks*** will benefit from the extension of the BMR transitional provisions to 31 December 2021 (subject to the formal adoption of the extension, which is expected shortly), whereby third country and critical benchmarks may continue to be used by supervised users until that date without the benchmarks complying with the BMR third country regime (for third country benchmarks) or the relevant administrator being authorised or registered (for critical benchmarks). This extension does not mean that compliance should be put off as tomorrow's problem. We are increasingly seeing users assess whether using a non-EU benchmark that is not BMR compliant (as it does not yet have to be) is appropriate if there is a compliant alternative available, be it in the EU or elsewhere, in order to satisfy themselves that they are acting in their clients' best interests. Additionally, some non-EU administrators will not wish to provide their benchmarks into the EU after 2021, and so will not go down a recognition or endorsement route. Users must anticipate this action and seek to find viable alternatives.
- ***Brexit*** will mean that the UK will become a third country for BMR purposes, and therefore any benchmarks provided by administrators based in the UK will benefit from the extension to the transitional provisions referred to above. Supervised users in the EU may continue to use UK benchmarks regardless of whether they comply with the third-country regime until 31 December 2021.

Transition to Risk-Free Rates

At the end of 2021, the FCA will stop compelling panel banks to contribute data to LIBOR. There is a general expectation that, after this date, some if not all panel banks will cease their contributions — which could lead to the demise of LIBOR. ICE, the LIBOR administrator, has taken steps to change the LIBOR methodology in an attempt to make it less dependent on the contributions from banks, but whether LIBOR would continue in the absence of such contributions is unclear. Whatever the future, the FCA and the SEC (and other regulators) are urging LIBOR users to take steps now to move away from LIBOR. Such users should:

- For legacy agreements
  - Identify all legacy agreements that reference LIBOR
  - Consider whether amendments to legacy agreements are required to reflect appropriate fallback and transition language, and whether amendments can in fact be made (*e.g.*, LIBOR users should evaluate amendment provisions, consent and notice requirements, voting rights, and "sacred rights" provisions that require 100% or other investor consents)
  - Analyse economic consequences and challenges, such as basis risk and margin adjustment
  - Identify liability issues relating to rate changes and/or inability to determine or change rate basis
  - Survey tax considerations
- For new agreements
  - Identify a LIBOR alternative for agreements that will extend beyond 2021 (*e.g.*, SONIA and SOFR)
  - Ensure that appropriate fallback provisions, risk factors, and amendment provisions are included if LIBOR is to be used beyond 2021

These considerations should also be applied to other key benchmarks that may no longer be available or that may change, including, for example, EURIBOR and EONIA. These benchmarks do not currently meet the requirements of the BMR, and given the large volume of financial contracts referencing them, achieving a changeover to new rates will be another huge undertaking. For EONIA-based contracts, the European Money Market Institute (EMMI), the body that administers both EONIA and EURIBOR, has already announced that it will not reform EONIA. Following that announcement, the ECB's Euro Risk Free Rates Working Group announced that it recommends that market participants gradually replace EONIA with the €STR for all products and contracts, making the €STR their standard reference rate. The ECB will first publish the €STR on 2 October 2019, reflecting the trading activity of 1 October 2019. For EURIBOR, the plan is for reform, and EMMI has confirmed that it will change the calculation of EURIBOR to a "hybrid methodology" that relies not just on submissions but also on real transaction data that will meet the BMR requirements and allow EURIBOR to continue to be published.

There has already been movement in the market to transition to the new benchmarks and carry out the scoping exercises suggested above. However, the FCA has put firms on notice that it expects more to be done, faster. The FCA has also placed emphasis on the need for firms to ensure they have sufficient senior management buy-in to the scoping exercises and oversight of the same, which should be proportionate to the nature, scale, and complexity of LIBOR or other relevant benchmark exposure.

AML: European Commission Considers Further Harmonisation of the EU's AML and CTF rules

On 24 July 2019, the European Commission adopted a Communication to the European Parliament and the Council, aimed at improving the implementation of the EU's anti-money laundering (AML) and counter-terrorist financing (CTF) framework, and providing a basis for considering further harmonisation of these rules.

The Commission highlights that, despite the recent enhancements to the legislative framework in this area, challenges remain. For this reason, it has published a series of reports to assess the risks and identify areas for improvement. The findings in the reports are intended to inform the debate about how the AML and CTF framework could be further improved, and to provide a basis for further discussion with relevant stakeholders.

The Commission notes that one option would be the transformation of the Anti-Money Laundering Directive into a Regulation, which would have the potential of setting a harmonised, directly applicable EU regulatory AML framework. The Commission also notes that conferring specific AML supervisory tasks on an EU body could help ensure high-quality and consistent AML supervision of the financial sector. This echoes previous proposals put forward by the Commission to strengthen the AML supervisory powers of the EBA.

This initiative will be relevant to private banks operating across Europe in the context of Brexit, especially in a hard-Brexit scenario, in terms of the ongoing monitoring for potential divergences between the UK and European frameworks. In this context, it already looks likely that the UK will diverge from the EU in terms of the jurisdictions it designates as being high-risk.

SMCR: FCA Feedback Warns on Conduct and Culture

The FCA published its latest piece of feedback on firms' implementation of the SMCR on 5 August 2019.

The FCA observes that firms are taking the regime seriously, and focusing on the spirit of the regime. However, the FCA has found that some firms seem to have been less successful in embedding the regime below Senior Manager level. The FCA considers that there is some room for further progress on the Certification Regime, and that there are potentially more significant weaknesses in the implementation of the Conduct Rules.

The FCA has found that firms are not always tailoring training on the Conduct Rules sufficiently to reflect job roles. The FCA also did not find enough evidence of firms clearly mapping the Conduct Rules to their own values, and many firms were unable to explain what a conduct breach looked like in the context of their business. Firms have also found, through the regulatory references process, that other firms are not always consistent in recording breaches of the Conduct Rules. The FCA warns that, as a result of these findings, it plans to increase its supervisory focus on the Conduct Rules.

Private banks should take this opportunity to evaluate their implementation of the Conduct Rules, particularly their training programmes for Conduct Rules staff who do not fall within the Senior Managers Regime or the Certification Regime. It is crucial to ensure that this training is appropriately tailored to a private bank context, and gives individuals a proper understanding of what "good" and "bad" looks like in the context of their particular roles.

On the Certification Regime, the FCA notes that while firms tend to have robust frameworks in place to oversee their population of certified staff, it has not seen significant changes to performance assessment processes. Most firms could not demonstrate the effectiveness of their assessment approach, use of subjective judgement, or how they ensure consistency across the population. One example the FCA provides is that firms are not necessarily using the Certification Regime to test whether managers of certified staff are competent managers.

Private banks should re-examine their assessment processes and consider whether these promote a robust and effective approach. Private banks should consider in particular how they can ensure a uniform approach to certification, and that assessments really consider the key skills and attributes required for a particular role.

The FCA also comments that it has not necessarily seen firms making a clear link between the SMCR and culture. The FCA considers that the SMCR is primarily enabling firms to improve their controls environment, which they expect to lead to improved behaviours, but the SMCR has not been expressly linked to culture change programmes. The FCA will therefore continue to build on the links between the SMCR and firms' culture.

Private banks should also be aware that the PRA announced in its Business Plan for 2019/20 that it plans to carry out an evaluation of the effectiveness of the SMCR this year, so they can expect further scrutiny of SMCR implementation in the near future.

MiFID II: ESMA Consultation Paper on Guidelines Regarding Aspects of the Compliance Function Requirements

On 15 July 2019, ESMA published a Consultation Paper containing draft guidelines on aspects of the compliance function requirements under MiFID II.

MiFID II introduced expanded compliance function requirements, and the draft guidelines are intended to clarify these requirements and assist in their uniform implementation by firms. The draft guidelines build upon the 2012 guidelines on the same topic, which have been largely confirmed, with some enhancements to take account of the MiFID II requirements. In particular, the draft guidelines are aimed at helping firms to increase the effectiveness of the compliance function, and so are focused on the specific responsibilities of the compliance function.

To the extent that private banks are undertaking any review of MiFID II implementation, regard should be given to these guidelines.

Responses to the consultation should be submitted by 15 October 2019. ESMA will consider the feedback received in Q4 2019/Q1 2020 and expects to publish a final report and the final guidelines by Q2 2020.

Sustainability: UK Sets Out Green Finance Strategy

On 2 July 2019, the UK government published its Green Finance Strategy. The Strategy sets out how the UK government aims to accelerate the growth of green finance, and enable the UK to seize the commercial potential arising from the transition to a sustainable economy. According to HM Treasury, financial services will have a bigger role to play in tackling climate change than any other sector.

The Strategy has two objectives: to align private sector financial flows with clean, environmentally sustainable and resilient growth, and to strengthen the competitiveness of the UK financial sector.
The government plans to use three strategic pillars to achieve these objectives:

- **Greening Finance:** Ensuring current and future financial risks and opportunities from climate and environmental factors are integrated into mainstream financial decision-making, and that markets for green financial products are robust in nature.
- **Financing Green:** Accelerating finance to support the delivery of the UK's carbon targets and clean growth, resilience, and environmental ambitions, as well as international objectives.
- **Capturing the Opportunity:** Ensuring UK financial services capture the domestic and international commercial opportunities, such as climate-related data and analytics, and new green financial products and services.

The Strategy has two objectives: to align private sector financial flows with clean, environmentally sustainable and resilient growth, and to strengthen the competitiveness of the UK financial sector.

The PRA, FCA, Financial Reporting Council, and The Pensions Regulator issued a joint statement in reaction to the Strategy, in which they welcomed the government's action. The regulators urge firms to consider the likely consequence of climate change on their business decisions, in addition to firms meeting their responsibility to consider their impact on the environment. The regulators themselves will also need to ensure that they are paying due attention to climate change. As part of the measures the government is suggesting to support the growth of green finance, the government plans to clarify the need for financial regulators to have regard to climate change when advancing their objectives and discharging their functions.

Policy: Government Launches Financial Services Future Framework Review

On 19 July 2019, HM Treasury published a call for evidence on regulatory coordination. The call for evidence is the first phase of the Treasury's planned interventions to determine the long-term effectiveness of the UK regulatory regime. This first phase will look at the processes for managing the combined impact of regulatory change on financial services firms and their customers, including whether more can be done to better coordinate the work of each regulator.

The call for evidence also introduces the Review more generally, which seeks to address four key challenges:

- **Operating outside the EU:** The UK must decide how to adapt its regulatory arrangements to reflect the UK's new position outside the EU.
- **New relationships:** The UK regulatory framework will need to be open to emerging markets beyond the EU and support the development of new trading relationships, as well as facilitating cooperation on international standards and supervision.
- **Technological change:** The UK's approach to regulation must support the financial services sector in integrating and exploiting innovation, whilst managing risks and protecting consumers.
- **Wider global challenges:** The framework must be agile and must facilitate a creative and far-sighted approach to policy development that will support the financial services sector in helping to solve society's biggest policy challenges (for example, climate change).

The wider Review will take stock of the overall approach to regulation of the UK financial services sector, including how the regulatory framework may need to adapt in the future, particularly when the UK leaves the EU. HM Treasury plans to set out more details of further phases once arrangements for the UK's withdrawal from the EU become clear. These phases could present a key opportunity to influence the future regulatory framework.

The wider Review will take stock of the overall approach to regulation of the UK financial services sector.

The call for evidence specifically requests views on how HM Treasury and the UK regulators work together and with firms to coordinate and manage the overall impact of concurrent regulatory interventions on the financial services industry and consumers. It also requests responses as to how firms and the regulators can work together to make authorisation, supervision, and enforcement more efficient. HM Treasury would like to understand what works well and identify areas in which there may be room for improvement. Comments are requested by 18 October 2019, and private banks should consider how they can feed in to this important work.

Lessons From Enforcement: Court Rules in Favour of Bank Following Closure of Account Due to Money Laundering Concerns

N v. The Royal Bank of Scotland plc (8 July 2019) is the latest in a series of cases in which customers have sought damages from a bank following the freezing or closure of an account due to suspicions of money laundering. The Commercial Court (Mr. Justice Knowles) ruled in favour of the bank, recognising: (a) the stringent requirements imposed on banks by the UK anti-money laundering (AML) regime; (b) the scope for reasonable people to differ about the inferences that may be drawn from a given set of facts and the range of appropriate responses to those facts; and (c) the need to protect banks from liability for decisions that are not capricious. The case underscores the importance of a bank's terms and conditions containing appropriate provisions that enable the bank to close an account.

Facts

In summary:

- N — an authorised payment institution providing foreign exchange and payment services to its customers — held four main accounts and more than 50 client sub-accounts with RBS. The main accounts were very active — with an annual turnover of around £700 million.
- The applicable terms and conditions required RBS to give N 60 days' written notice to close an account, absent "exceptional circumstances". The terms also provided that RBS could delay or refuse to process any payment (and would have no liability for this), if in its reasonable opinion it was prudent to do so in the interests of crime prevention, amongst other things.
- RBS suspected that some of N's clients were involved in boiler room scams and that victims had paid money into N's accounts. Some of the money had been commingled with the main accounts — possibly to try to get around the fact that RBS had frozen several client sub-accounts because of its concerns.
- RBS therefore froze the main accounts and terminated the relationship with N immediately.
- RBS's actions had predictably dramatic consequences for N, given the nature of N's business.
- N sued RBS — alleging, in essence, that RBS had exercised its discretion unreasonably because RBS did not suspect that N itself was involved in money laundering and that freezing the main accounts was excessive when RBS suspected only part of the funds in those accounts was the proceeds of crime.

Judgment

The court dismissed the claim. The judge held that:

- It did not matter that N was not itself suspected of money laundering. Once RBS suspected that N's accounts contained the proceeds of crime, the bank was required to freeze the accounts or risk committing a money laundering offence by making payments from the accounts.
- N's proposed solutions to the commingling issue (ring-fencing the suspect funds; operating the accounts manually, and seeking consent to make payments; seeking an omnibus consent from the National Crime Agency) had been considered by RBS and (rightly) rejected as impractical.
- RBS was not required to turn over every stone to decide if its concerns were well founded.
- RBS had properly considered and taken account of the impact of freezing the accounts and terminating the relationship on N's business. RBS was entitled to weigh those considerations against its own potential exposure.
- The decision to freeze the accounts and terminate the relationship was within the range of reasonable decisions in the circumstances.
- RBS's concerns equated to exceptional circumstances entitling the bank to close the accounts without notice.

The case underscores the importance of a bank's terms and conditions containing appropriate provisions that enable the bank to close an account.

Implications

This is another welcome — and eminently sensible — decision recognising that banks are between a rock and a hard place when balancing their obligations under the UK AML regime and contractual obligations to their customers. RBS did not get everything right — but the court rejected N's ex post facto analysis of what RBS should have done with the benefit of hindsight. That said, the case emphasises the importance of:

- Recording the bank's reasons for deciding to freeze and/or close an account
- Involving more than one person in the decision-making process (a decision taken by a group of people is axiomatically less likely to be capricious than one taken by one person)
- Proper contractual "air cover" (RBS accepted that it would not have been entitled to close the accounts absent the express provision in the relevant terms and conditions)

One issue that the judgment does not address is the extent to which commingling of suspect and "clean" funds in a bank account requires the bank to freeze the whole account rather than try to ring-fence the suspect funds. Although it almost certainly was not Parliament's intention in the Proceeds of Crime Act 2002, the Law Commission's Report on the UK SARs Regime published just a few weeks before the judgment suggests that the vast majority of banks and other financial institutions are freezing the whole account on the basis that the fungible nature of money means banks cannot safely distinguish between one (suspect) pound in an account and another (clean) pound, and are therefore at risk if they make any payment from the account without consent.

The Law Commission recommended that the government clarify the position on ring-fencing, which can result in injustice (for example, to N's customers who were not involved in criminal activity, but whose funds were nonetheless frozen in this case).

FCA Enforcement Annual Performance Report 2018/19

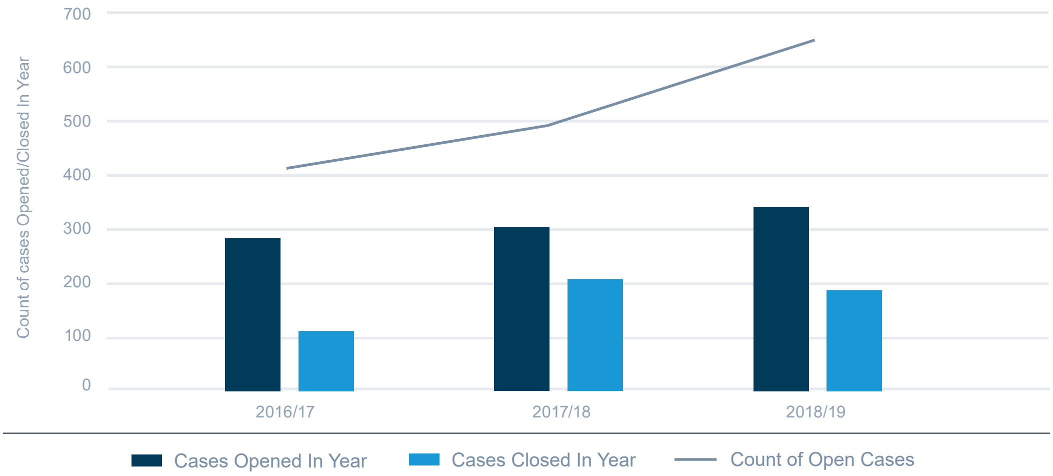
On 9 July 2019, the FCA published its enforcement annual performance report for 2018/19. Below are some of the key figures from the report. These figures show a sharp increase in the level of financial penalties imposed over the last year, and illustrate the impact of the FCA's new enforcement strategy of opening (and often closing) a greater number of enforcement cases.

The value of financial penalties imposed does not reflect one particular area of misconduct, but rather accumulates from a range of different issues — from unfair treatment of customers to transaction reporting failings. The largest fines imposed related to mis-selling, transaction reporting, and financial crime.

Financial penalties imposed

	2016/17	2017/18	2018/19
Number imposed	15	16	16
Total value	£181.0m	£69.9m	£227.3m
Number imposed against firms	6	6	8
Total value imposed against firms	£180.1m	£69.0m	£147.1m
Number imposed against individuals	9	10	8
Total value against individuals	£0.9m	£0.9m	£80.2m

Enforcement case movements



Global Insights — Switzerland

On 30 June 2019, the temporary equivalence decision that the European Commission granted to certain Swiss trading venues for the purposes of the mandatory share trading obligation under MiFID II expired without extension or renewal. As a result, from 1 July 2019, EU investment firms have technically not been able to trade shares that are admitted to trading or traded on a trading venue in the EU on Swiss venues. This technicality is particularly problematic for Swiss shares that are dual-listed in the EU and are therefore subject to the EU share trading obligation, as EU investment firms may be cut off from the main pool of liquidity for these shares, potentially impacting their ability to obtain best execution.

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As discussed in the January edition of this newsletter, the European Commission had already indicated earlier this year that it may take this approach and accordingly, in response, the Swiss government introduced a recognition obligation for foreign trading venues that admit Swiss companies' shares to trading. In response to the non-renewal of equivalence, Switzerland withdrew recognition for EU trading venues under this new measure, meaning that Swiss shares can no longer be traded on EU trading venues. As a result, EU venues have had to suspend or de-list Swiss shares.

Private banks must take these issues into account when considering best execution in this context. Furthermore, these issues are also being reflected in the context of Brexit, in relation to the UK onshoring of the MiFIR share trading obligation and how this will interact with the EU share trading obligation. They also provide an insight as to the likely approach the European Commission may take towards granting equivalence to UK trading venues.

TechTrends: FCA Consults on Prohibiting Sales of Investment Products Referencing Cryptoassets to Retail Clients

On 3 July 2019, the FCA published a Consultation Paper (CP19/22), seeking views on its proposal to ban the sale, marketing, and distribution of derivatives (contracts for difference (CFDs), options, and futures) and exchange traded notes that reference certain types of unregulated, transferable cryptoassets to all retail customers by firms in, or from, the UK. The proposed prohibition only covers unregulated cryptoassets that allow transferability (*i.e.*, those that can be widely exchanged on any cryptoasset platform or other forum).

According to the FCA, growing evidence suggests that such "crypto-derivatives" are causing harm to consumers. The reason is that retail consumers cannot reliably assess the value and risks of such products due to the:

- Nature of the underlying assets, which have no inherent value
- Presence of market abuse and financial crime in the secondary market for cryptoassets
- Extreme volatility in cryptoasset prices
- Inadequate understanding by retail consumers of cryptoassets, and the lack of a clear investment need for the investment products that reference them

In the FCA's view, the inherent risks of these products make it difficult for any retail consumers to make informed investment decisions, regardless of how the products are sold, marketed, or distributed. The FCA believes that the existing regulatory requirements (including product governance, appropriateness, and disclosure requirements) cannot sufficiently address these concerns.

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In the consultation, the FCA notes that CFDs are the main derivative product that reference cryptoassets in the UK market. Although the introduction of ESMA's temporary product intervention measures in relation to CFDs has led to a significant reduction in trading volumes, and the price of cryptoassets has seen a sharp decline, the FCA still believes that crypto-derivatives pose a significant risk of harm to consumers.

The FCA has confirmed that, should the ban be implemented, an appropriate implementation period would follow, and firms would not be required or expected to immediately close clients' positions, as retail customers with existing holdings would be allowed to remain invested. The comment period of the consultation will end on 3 October 2019. The FCA intends to publish a Policy Statement and final Handbook rules in early 2020.

Operational Resilience: FCA Review of Business Continuity Planning

On 11 July 2019, the FCA published the findings from its review of firms' business continuity planning (BCP) in the retail banking sector.

The FCA makes clear that effective BCP is highly relevant to achieving the outcome of operational resilience, which remains a key area of focus for the FCA.

All firms are encouraged to review their business continuity plans in light of the FCA's findings. In particular, the FCA expects firms to proactively identify, test, and revise the relevant capabilities (*e.g.*, people, processes, systems) that mitigate harm in the event of an accident, as part of their ongoing assessment of systems and controls. This is also highlighted in the FCA and PRA's joint Discussion Paper on Operational Resilience. In its recently published findings, the FCA makes clear that effective BCP is highly relevant to achieving the outcome of operational resilience, which remains a key area of focus for the FCA.

Private banks should note the following key areas for enhancement identified by the FCA:

- Adequately considering the link between business continuity and large-scale change projects and the use of management information or other means to proactively identify potential or actual harm, and considering what lessons can be learned from an event
- Implementing relevant and tailored training for all staff
- Defining a broad range of test events covering multiple scenarios and impacts
- Ensuring that BCP is a priority for attention at the highest level of the organisation (*e.g.*, Executive Committee and Board)
- Ensuring that any response to an incident is managed and driven by the appropriate individuals, and considering whether the verification of required solutions should be carried out by an appropriate impartial group or individual (*e.g.*, second line of defence, Risk, Internal Audit, third-party opinion)

Annex: Recommendations for Better Presentation of Information to Consumers

Mandatory Consumer Information
1. Provide all **mandatory consumer information**, which is listed in the "Consumer Journey" in the Annex, as well as any other legally required information under sector-specific EU and national law, where relevant to your business activities.
2. In addition to information requirements for contracts, sector-specific rules can also require traders to 'publish' specific information.[1] **Sector-specific rules** usually take precedence over general consumer rules, such as the CRD, UCPD etc.[2] Although these Recommendations do not address such sector-specific publication requirements, traders concerned may draw inspiration from these Recommendations to meet those requirements in a consumer-friendly way.
3. Provide other **material information**, which is likely to have an impact on the consumer's ability to take an informed transactional decision.
4. Provide information that is most relevant for consumers at **different stages** of the purchase in a **clear and comprehensible** manner. The "Consumer Journey" in the Annex includes a model for providing consumer information at different stages of the transaction. Some information should be permanently visible during the entire ordering process; other information will be relevant only at a specific stage.
5. Adapt the design of information to different means of communication, so that mandatory information is **easy to find and readable irrespective of the device used** (desktop, mobile) for initiating or completing the purchase.
6. **A layered approach** can improve accessibility and understanding of information, especially when the available space is limited, *e.g.* on mobile devices or wearables (*e.g.* smart watch) and any other future technology. Each layer of information should be **more detailed** than the previous one. Further information should be provided via headings with hyperlinks or expanded menus, or features including symbols that, when clicked, reveal information boxes etc.
7. When targeting consumers in other Member States,[3] pay attention that you may be required to provide contractual information, both mandatory consumer information and standard Terms and Conditions, in the **official language** of that Member State.
8. Use a **legible font size** with appropriate **contrast and colour** of the font and the background.
9. **Highlight important terms**, or put them upfront, to attract consumers' attention, for example those imposing obligations, setting deadlines or excluding or limiting rights.
10. Use **simple and plain language**, also when explaining complex issues, without prejudice to maintaining legal accuracy. For example, use short sentences. Avoid using passive voice. Define key or complicated terms or provide hyperlinks to Frequently Asked Questions (FAQ) or other documents that provide meaningful explanations.
11. Use **tables, or similar tools, for listing many information items**, such as breakdown of delivery costs per weight or delivery areas, etc. Use numbers or visuals or other ways to explain procedures concerning deliveries, returns, complaint handling, customer service, and other practicalities.
12. Be creative when providing information, for example use **symbols and visuals** where possible. The "Consumer Journey" in the Annex proposes a set of icons for the categories of mandatory consumer information that companies may use.

[1] *E.g.*, for telecoms operators, inter alia the Universal Service Directive 2002/22/EC includes both specific information requirements regarding contracts (Article 20) and transparency and publication requirements (Article 21).

[2] In line with the "lex specialis" principle. See also Section 1.4.1 of the 2016 EC Guidance on the UCPD.

[3] If the Member State has used the regulatory choice under Article 6(7) of the CRD to set language requirements for the contractual information. Regulatory choices under Article 29 of the Consumer Rights Directive, available at https://ec.europa.eu/info/law/law-topic/consumers/consumer-contract-law/consumer-rights-directive_en.

Standard Terms & Conditions
13. There is no legal obligation to provide standard T&Cs in addition to pre-contractual information nor to repeat in standard T&Cs the mandatory information already provided at the pre-contractual stage. Please consider whether T&Cs are needed at all or whether the mandatory information that you have to provide to the consumer already includes what you say or wanted to say in your T&Cs.
14. Material information, *i.e.* information that consumers need in order to make an informed decision must always be presented before the consumer completes the transaction (pre-contractually) in a clear and comprehensible manner and cannot merely be included in standard T&Cs.
15. If you do consider that standard T&Cs are necessary you must draft them **in plain and intelligible language**[4] allowing the consumer to acquire actual knowledge of all the contract terms. This means two things: a. information is grammatically clear, b. an average consumer is able to foresee the economic consequences resulting from the conclusion of the contract.
16. Make T&Cs available to the consumer before concluding the contract by an **easily understandable link** giving the consumer the possibility to read, to store and to print the T&Cs. Make sure that the link/reference to T&Cs is clear to everyone by avoiding acronyms such as ‘AGB’, ‘T&C’, ‘CGV’, which may not be widely understood by consumers.
17. The clearer the information is and the better it is presented, the easier it will be for the consumer to understand the contract and its consequences. **Unclear contract terms might be null and void**. In case of doubt, courts will give the most favourable interpretation to the consumer. If such terms are essential for the existence and the performance of the contract, the whole contract may be pronounced null and void.
18. Use a **table of contents with hyperlinks** to the major sections of the T&Cs.
19. Use **clear headings for each section of the T&Cs**. When T&Cs contain many sections give a title to each section that will convey the main message – so a quick look is enough for the consumer to understand what the section is about.
20. Keep **T&Cs concise and simple** as much as legally and commercially possible in order to encourage consumers to read them. Where this is not possible, consider other appropriate ways to display the information in a simple way, for example by providing a Frequently Asked Questions (FAQ) document with key information.
21. If you offer products or services to consumers in other EU countries, you are free to choose the law that governs the purchase (**applicable law**), [5] but you must then also inform consumers in a transparent way that they will not lose the standard of protection by their national consumer law and their home courts.[6]
22. Clearly distinguish consumer contractual information from the **personal data protection notice/policy**, for example through a clear title.

[4] As required in Article 5 of the Unfair Contract Terms Directive 93/13/EEC (UCTD).

[5] Specific rules might still apply for certain sectors.

[6] These consumer rights are enshrined in Article 6 of the “Rome I” Regulation (EC) No 593/2008 on the law applicable to contractual obligations and Article 18 of the “Brussels I” Regulation No 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

Changes to Contract Terms
23. Be aware that, under EU law, you **cannot unilaterally change**, without a valid reason, the characteristics of the product or service to be provided or the terms of the contract. If your standard T&Cs contain such clauses, they are likely to be seen as an unfair contract terms – hence, null and void.[7]
24. If you have a valid reason for modifying the contractual terms, **do inform the affected consumers** individually in respect of the existing contracts (*e.g.* subscribers to a social network, app store, newspaper, content streaming service etc.).
25. Use a visually clear way of flagging the changes and when they will come into effect.
26. Use a clear and user-friendly way to inform your consumers as to **their right to accept or refuse the changes to the contract**. Highlight the consequences for the consumers if they do not agree with the proposed changes and how this may impact the enjoyment of their rights and the use of the service.

[7] See in particular letters j) and k) of the Annex, part 1, to the Unfair Contract Terms Directive 93/13/EEC.

What to Look Out for in Q4 2019

- Joint Committee of the ESAs expected to launch a public consultation on amendments to the PRIIPs KID RTS
- UK government expected to announce how it will take forward the Law Commission's recommendations on reforming the SARs regime
- HM Treasury expected to consult on potential changes to the regulatory perimeter in relation to cryptoassets

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