

# **THE NOVEMBER 2009 'BANKING AND PAYMENT SERVICES REGIME'**

**Raymond Cox QC**

1. The rules relating to the conduct of business by banks and similar institutions are all set to change from 1 November 2009. From that date:
  - the Payment Services Regulations 2009 will come into force, covering the conduct of business in relation to electronic transfers, and be supervised by the FSA.
  - Banks will become subject to regulation by the FSA in relation to conduct of business outside electronic transfers. The FSA's general principles of business will be applied for the first time, and there will be a new section of the FSA Handbook, BCOBS, covering conduct of business by banks and near banks.
  - The Banking Codes will be no more, at least in their current comprehensive guise, though some form of industry guidance will continue to exist.

## **The existing regime**

2. In one sense, the conduct of business by banks has been at the centre of attention since the beginning of the credit crisis in the autumn of 2008. The growth of huge imbalances in the current accounts of different countries, leading to enormous investment in Western countries and a ferocious search for yield by investors; the wave of financial innovation which met that demand, including an explosion in securitised instruments from mid 1990s; the failure of banks and financial institutions to originate and distribute securities so as to divest themselves of risk, and in some cases their appetite for acquiring and arbitraging securities without regard to the risk; and over reliance in some cases on short-term market funding instead of long-term deposits, played a leading role in the creation of the global credit crisis (see for

example the *Turner Review “A Regulatory Response to The Global Banking Crisis”*, commissioned by the Government, of March 2009).

3. Such conduct of business is now the focus of intense scrutiny; the question being what if anything should be done to prevent any such crisis recurring.
4. The UK Government considers that the current tripartite system for bank regulation in the UK (split between the Bank of England responsible for the stability of the economy as a whole, the FSA responsible for the regulation of individual firms, and the Treasury) should be maintained, though reformed to some extent, notably by the creation of a new Council for Financial Stability (that is the Treasury, the Bank of England and the FSA) charged with overseeing the stability of the financial system as a whole.
5. On the other hand, the Opposition has indicated that it would abolish the FSA, hand all banking supervision to the Bank of England (with insurance to boot), and create a new Consumer Protection Agency to take over and the rest of the functions of the FSA.
6. This article is not concerned with the causes of the credit crisis, as such, or what should be done to banking regulation as a result. My focus is on changes to the regulation of the day-to-day conduct or business by banks and other institutions in making payments for customers, and lending. However, it may be that the credit crisis encouraged the FSA to take over the provision of the day-to-day conduct of business outside of the scope of the payment services regulation, and may yet lead to specific regulation of loan to value in relation to mortgages, and the sale of securitised products on the wholesale market (raised in *Turner*, chapter 3).

### **The significance of the new rules**

7. Until now, the banking industry in the UK has largely been self-regulated. The conduct of business of banks was governed by the Banking Codes for personal customers and for businesses. First introduced in 1992, the Banking Codes applied to current and deposit accounts, payment services, plastic money, loans and overdrafts. Subscription to the Codes was voluntary, but in practice universal. The Banking Codes covered the provision of information relating to interest rates, charges, other terms and conditions; making changes to an account, advertising, statements of account, the terms on which payment would be cleared, the use of plastic cards, confidentiality, unauthorised

transactions and the liability for them, lending, and complaints. The creators of the Banking Codes had become progressively more independent from the banking industry after the creation of the Banking Code Standards Board (BCSB), on which eventually industry participants were in the minority.

8. The roles of outside regulators were limited. The OFT continued to deal with the regulation of credit. The Financial Ombudsman Service (FOS) dealt with certain complaints in relation to banking business. For its part, the FSA dealt with the authorisation of banks (prudential regulation) but otherwise left regulation to the BCSB and the OFT.
9. In deciding in April 2009 to do away with self-regulation from November 2009, the FSA was quite frank in conceding that self-regulation had not, largely, failed (although there were problems with the quality of information given to customers, and regulation of for instance credit card and bank default charges), but the FSA preferred to bring the conduct of banking within the scope of its general principles of business, to implement an overarching obligation to treat customers fairly, and to bring under one roof both the supervision of the stability of individual banks and the day-to-day conduct of business of those banks. The FSA therefore took the opportunity when the regulation of conduct of business in relation to electronic payments was handed to the FSA from November 2009, to take over supervision of all other conduct of business in relation to banking (although not in the provision of credit which continues to be regulated by the OFT) (*FSA Consultation Paper, "Regulating Retail Banking Conduct Of Business"*, November 2008).

### **The challenges and dangers of the new regime for banks**

10. The new area of regulation has been called ‘the Banking and Payment Services Regime’ by the FSA, but it is undeniably a patchwork of different rules, which will to some extent be more complex than before.
11. First there is the Payment Services Regulation 2008 SI 2009/209, bringing into effect the EU Payment Services Directive, which broadly, implement rules relating to electronic methods of payment such as funds transfers. This regulation applies to banks and other institutions which provide electronic payment services; it does not apply to other methods of payment such as cash or cheques, but it does apply whether or not the institution is a bank. The directive and regulation sets out some sensible rules relating to registration of payment service providers, information required to be provided in relation to

the payment service and, in particular the time of payment, the time when an instruction can be revoked, and liability for unauthorised payments.

12. One measure worthy of note is that charges for payment services can only be levied if "such charges reasonably correspond to the payment services provider's actual costs" (regulation 54(1)). It was, of course, a regulation controlling the fairness of provisions for charges in the Unfair Terms In Consumer Contracts Regulation 1999 SI 1999/2083 which was applied by the OFT to set a limit for default charges levied by credit card companies, and has been relied upon in the continuing dispute between the OFT and banks in relation to default charges.
13. There is an obvious question as to whether or not regulation 54 of the Payment Services Regulation will be used against banks in the future in relation to charges for electronic transfers.
14. The second element of the Banking and Payment Services Regime is BCOBS, which is a new section of the FSA Handbook. BCOBS covers payments by cash or cheque, and other methods not covered by the payment services regulation. Again, BCOBS provides sensible rules relating to the provision of information. There is a general requirement that any communication is "fair, clear and not misleading". There is also a general comment that the firm must provide a service in relation to retail banking service which is "prompt efficient and fair".
15. One particular provision of the BCOBS again stands out. It is required that a firm "should deal fairly with the banking customer whom it has reason to believe in financial difficulty" (5.1.5).
16. The way in which a bank deals with a customer (outside the Consumer Credit Act) in financial difficulty will therefore be subject to a requirement of fairness, breach of which may give rise to a claim by the customer against the bank for compensation under s.150, Financial Services And Markets Act 2000. This requirement links up with the requirement from April 2008 that the OFT have regard to whether or not an applicant is involved in "irresponsible lending" in deciding whether or not to grant a credit licence. However the latter provision does not provide a customer with a claim in damages, unlike BCOBS 5.1.5.
17. Obvious questions may arise as to, for example, the time within which payment is required, the amounts required to be paid in instalments, the selection of the time at which to enforcing security, and the manner in which

the security is enforced. The fairness obligation in BCOBS 5.1.5 will apply to the bank's conduct in relation to such matters. If the bank has a policy in relation to our such matters, it may be that a great many cases may be involved, over a period of time.

### **The problems which have arisen in the past**

18. The reason that alarm bells should ring in relation to the requirements that charges reasonably correspond to actual costs, and that a bank should deal fairly with a customer in financial difficulty, in particular, is that experience has shown the pitfalls for banks of requirements such as these.
19. The OFT investigation of default charges levied by credit card companies resulted in a significant reduction in charges, but at least the reduction applied prospectively. There was no requirement that historic charges be repaid. Since the credit card companies had been levying charges in excess of the flat fee allowed by the OFT for years, this was a significant concession. In relation to charges levied by banks for unauthorised overdrafts, or bounced cheques, there is no room for any such concession. Many individual customers have brought proceedings against banks seeking recovery of charges because they were said to be unfair or penal. The test litigation between the OFT and eight of the banks has some way to go; stage one (application of the Unfair Terms in Consumer Contracts Regulation) is awaiting determination by the House of Lords.
20. What is clear is that there was in relation to such charges a significant failure of the system of regulation of the conduct of business by banks over a number of years. The Banking Codes were not concerned with the price of services which was regarded as a competitive issue between to subscriber banks. The OFT did not, it appears, monitor prices against the regulation. The FSA was not involved. As a result, the application of the regulation was not tested, and the banks levied charges many years which they are now being asked to repay.

### **The way forward**

21. The question which arises is how to avoid a similar debacle in relation to the areas of the new banking and payment services regime referred to above which impose requirements which may lead to claims by customers many years down the line.

22. This is not, as such, an issue which is being addressed by the FSA in its publications in relation to the new banking in payment services regime. It is however a significant issue for the banks.
23. The danger would arise if the banks were to levy charges in respect of electronic transfers, or implement policies in relation to customers in financial difficulty, for many customers, and over a period of time, after which the charges or policies were to be challenged. It would be better for the banks, and customers, if potential issues were, so far as possible, anticipated and resolved with the approval of the FSA. Fortunately, the FSA has already made clear that there is a role for the approval of industry guidance in relation to regulated activity (*FSA Confirmation Of Industry Guidance*, September 2007).
24. If industry guide is given in relation to charges in respect of electronic transfers, or policies in relation to customers and financial services, and approved by the FSA, there would be an argument that the resultant policy was best practice. In relation to the charges levied in respect of electronic transfers, the industry practice may relate to the elements to be taken into account in assessing the costs of the transfer. In relation to customers in financial difficulty, the industry practice may relate to time periods and steps to be taken. The chances of a customer being treated unfairly and successfully complaining that steps taken by a bank in accordance with the industry guidance approved by the FSA had been in breach of the recurrence and caused loss would be minimised. The new banking payment services regime holds threats but offers opportunities to banks to manage their risks in relation to the conduct of business.

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3<sup>rd</sup> August 2009.