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Dear Sirs

## **Response to CP 08/19 ("Regulating retail banking conduct of business")**

The City of London Law Society is the local Law Society of the City of London and represents City solicitors, who make up 15% of the profession in England & Wales. Members of the Regulatory Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisors, investment managers, custodians, private equity and other specialist fund managers, as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

We are writing to respond to the questions raised in Consultation Paper CP08/19.

### **Executive summary**

The Annex to this letter contains our full responses to the questions in the CP. These are summarised below, by reference to the questions in the CP which we have answered<sup>1</sup>:

- ❑ Q1: The analysis in chapter 3 of the CP is undermined by insufficient consideration of the alternatives to the proposed new framework, in particular whether the BCSB arrangements could be enhanced by (i) substantive improvements to the Codes and (ii) stronger monitoring and enforcement.
- ❑ Q2: We agree with the proposal to apply all the Principles fully for all firms that accept deposits or issue e-money, but would emphasise (i) that doing so would not dictate a need for BCOBS, and (ii) Principle 9 may affect the provision of retail banking services in an investment management context [see paragraph 2.3 of the Annex]<sup>2</sup>.
- ❑ Q3: We have numerous comments on the proposal for BCOBS and on the draft Handbook text, including the following:
  - As suggested above, BCOBS may not be necessary [2.2 and 3.2];
  - There is a need to clarify the boundaries with the PSD and consumer credit regimes through guidance and a clear concordat/MoU between the FSA and the OFT: outstanding PSD scope issues make it very difficult to implement BCOBS without such guidance, and there are some critical issues regarding interaction with the CCA regime (not least in respect of customers in financial difficulty).
  - The "efficient" criterion in BCOBS 5.1 is unnecessary and inappropriate [3.5.1 and 3.5.2];
  - BCOBS 2.3.1 R (3) should be in the form of guidance, rather than a rule [3.8];
  - The relationship to SYSC should be clarified [3.10]; and

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<sup>1</sup> We have not responded to Questions 6, 12 and 13.

<sup>2</sup> References in parenthesis are to paragraph numbers of our response, as set out in the Annex.

- We strongly recommend that section 150 rights of action for damages should be conferred only in respect of rules which specify particular information requirements, contents of communications or operating standards, and not to high-level rules such as BCOBS 2.2.1 R, 5.1.1 R and 5.1.3 R [3.11].
- Q4: There are some practical difficulties in using the proposed definition of "micro-enterprise" where flexibility in BCOBS would be very helpful, and the onus should be on such enterprises and charities and trustees to notify changes in circumstances which affect their categorisation [4.3 and 4.4].
- Q5: We firmly believe that BCOBS should be applied to in-coming firms.
- Q7: Yes, there are many elements of the current Banking Codes which should not be lost, and there is a need for greater clarity and certainty in the way the FSA's Principles for Businesses and proposed high-level rules apply (paragraph 7 of the Annex to this letter suggests a framework for this).
- Q8: We firmly believe that a number of supervisory tools should be exercised before any enforcement action is taken, especially given the short period until the proposed implementation date and the high-level nature of much of the regulation.
- Q9: We would strongly urge the FSA to defer implementation, or to allow firms flexibility as to implementation date.
- Q10: We recommend that there be long transitional periods:
  - for substantive changes to existing specific requirements applicable to bank accounts;
  - for any other rules which require systems changes or training,
  - for areas where the interface with the PSD is unclear, notably, as regards the scope of BCOBS being determined by reference to the currently unclear definition of payment services under the PSD; and
  - for firms to obtain information where necessary to categorise clients (i.e. determine if they are "banking customers"), and there should be a grandfathering regime for this purpose.

The FSA should announce transitional plans as soon as possible.

- Q11: We question the adequacy of the CBA in Annex 2 of the CP, and in particular consider that many organisations will incur significant outlays on professional advice (an expense not mentioned in the CBA).
- Q14: We question in particular the compatibility of the proposals with the Principles of Good Regulation, especially whether they represent an efficient and economic use of FSA resources, and a proportionate response to (i) the problems the FSA has identified in Chapter 2 and Annex 2; and (ii) the benefits that will result from the changes.

Please let us know if you wish us to clarify any of our responses, or suggest more specific proposals.

Yours faithfully

**Margaret Chamberlain**  
**Chair CLLS Regulatory Committee**

Members of the CLLS:

Bridget Barker, Macfarlanes  
 Chris Bates, Clifford Chance  
 Peter Bevan, Linklaters  
 Patrick Buckingham, Herbert Smith  
 John Crosthwait, Slaughter and May  
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James Perry, Ashurst  
Peter Richards-Carpenter, Mayer Brown International  
Richard Stones, Lovells

## ANNEX

### City of London Law Society Regulatory Committee Full Response to FSA CP08/19 "Regulating retail banking conduct of business"

#### 1 Q1: Do you have any comments on our analysis in Chapter 3 and our reasons for proposing a new framework?

- 1.1 We accept there are some arguments to support the FSA regulating the conduct of business of a core activity like accepting deposits (and an increasingly significant activity like e-money issuance). The current arrangements are fragmented, but this would remain the case even if the FSA adopts BCOBS, not least since:
- (a) a different regime will be in place for payment services under the Payment Services Directive ("PSD") / Payment Services Regulations ("PSRs"); and
  - (b) the OFT will continue to deal with consumer credit issues.
- Indeed there will be areas (for example, the provision of statements) where BCOBS, the Payment Services Regulations and the Consumer Credit Act 1974 ("CCA") could overlap.
- 1.2 Chapter 3 of the CP creates the impression the FSA have already decided to end the current approach. Has the FSA considered how it could change the current arrangements to address the FSA's concerns with the Banking Codes and the BCSB (indeed only paragraph 3.11 deals with the issue)? We believe that most, if not all, of the failings could be corrected.
- 1.3 For instance, paragraph 3.9 of the CP criticises the BCSB's lack of powers to impose fines on those found guilty of a material breach of the Codes. However:
- (a) the BCSB arrangements could be changed so the Board gained a fining power; and
  - (b) as the FSA itself recognizes in paragraph 3.9, authorised firms are typically more concerned about negative publicity following a disciplinary finding, than fines – so the BCSB could increase the significance of the adverse publicity (for example, by a public awareness campaign).
- 1.4 The FSA dismisses regulatory and supervisory approaches other than its own. In chapter 3 of the CP, it details those areas in which the FSA sees failings in the current enforcement powers and approach of the BCSB. In paragraph 3.8 of the CP, it states "*the BCSB's regulatory approach ... can tend to focus on detailed rules rather than desirable consumer outcomes or an overarching principle that subscribers must treat customers fairly*". However:
- (a) while the FSA prefers a principles-based approach, and there is widespread acceptance of principles-based regulation, there are many examples of strong yet detailed regulatory regimes that are not designed to be based on principles or to focus on outcomes; and
  - (b) the PSD, to which the CP often refers, and the implementation of which is being relied on so strongly as the reason to introduce BCOBS now, is itself heavy on detailed rules rather than principles-based, and not especially outcome-focused. Legislation and rules imposing the PSD will sit oddly alongside the proposed contents of BCOBS.
- 1.5 Additionally, extending the Principles (specifically Principle 6) is largely superfluous given that (as paragraph 3.4 of the CP highlights):
- (a) banks and other firms engaged in accepting deposits or issuing e-money are already banned from treating customers unfairly (under the Unfair Commercial Practices

Directive ("UCPD") and the Unfair Contract Terms Directive) and the FSA has related enforcement powers under Consumer Protection from Unfair Trading Regulations ("Unfair Trading Regulations") and the Unfair Terms in Consumer Contracts Regulations 1999 ("UTCCRs"); and

- (b) each of the Banking Codes contains a far-reaching fairness commitment (in section 2).

## **2 Q2: Do you agree with our proposal to apply all the Principles fully for all firms that accept deposits or issue e-money (Chapter 4)?**

2.1 We have two comments here, respectively on:

- (a) The possibility of applying the Principles but not introducing BCOBS; and  
(b) The relevance of Principle 9 ("Customers: relationship of trust").

2.2 Applying the Principles alone:

One possible way forward would be to apply the Principles to the conduct of the regulated activities of accepting deposits and issuing e-money (and to amend PRIN 1.1.3 G accordingly) but to state in the guidance that compliance with the Codes, the Unfair Trading Regulations and the UTCCRs would generally be assumed to suggest compliance with the conduct aspects of the Principles – some changes to the substance of the Codes (without them simply repeating the Principles) might be necessary to achieve this.

2.3 Principle 9 can be relevant:

2.3.1 Paragraph 4.9 of the CP states *"we would expect Principle 9 to remain of less relevance to the conduct of deposit-taking activities, given that its concepts of suitable advice and discretionary decisions for customers do not apply in the same way as for other FSA-regulated activities"*.

2.3.2 We recognize the current limitation on the FSA's powers to regulate advice in relation to deposits, but it can regulate suitability in the context of discretionary management activity in those (perhaps less usual) situations where discretionary management arrangements for a retail customer extend to deposit products as well as such instruments as securities, collective investments and derivatives.

2.3.3 Arguably some deposit products deserve a careful assessment of suitability as much as certain securities and derivatives – e.g. products which are index linked to stock market performance, or where the *"interest"* or other return is linked to the performance of other products or structures, as with at least some Sharia-compliant deposits. Although these products have some of the characteristics of CFDs, they are excluded from this classification under Article 85(1) of the Regulated Activities Order by Article 85(2)(b). COBS already recognizes that some of these may require investment-type protections in relation to promotion, see COBS 4.6.7 R and the cross-reference to it in proposed BCOBS rule 2.4.1 G.

2.3.4 However, the proposed information requirements in BCOBS 4 do not deal with these more complex deposit based products and some specific rules in this area may provide greater clarity to product providers than mere reliance on Principle 7.

2.3.5 In addition, although BCOBS 2.4.1G refers to "structured deposits" in relation to the COBS rules applying to past and future performance, it might be clearer for Handbook users if the relevant guidance were repeated in BCOBS 4 in relation to deposits.

### **3 Q3: Do you have any comments on our proposals for a Banking Conduct of Business sourcebook (Chapter 4) and the draft Handbook text in Appendix 1?**

- 3.1 We have a number of specific comments on the draft Handbook text, and these are set out in paragraphs 3.4 through 3.11 below (in addition to comments on Glossary definitions in paragraph 4).
- 3.2 On the question of introducing a Banking Conduct of Business Sourcebook:
- 3.2.1 We consider that this is a separate issue from the question of whether to apply the Principles more broadly, to accepting deposits and issuing e-money – the consultation questions seem to suggest this, although the CP itself does not dwell on the matter.
- 3.2.2 Paragraph 4.11 of the CP describes BCOBS as underpinning the application of the Principles, but the reform would be less costly for firms if the FSA relied, for this purpose, instead on the Banking Codes/BCSB (perhaps strengthened) and existing consumer protection legislation (e.g. the Unfair Trading Regulations and the Unfair Terms in Consumer Contracts Regulations 1999). We have suggested this approach above (see paragraph 2.2 above).
- 3.3 A fundamental issue is the scope of BCOBS and its interaction with other retail banking regulatory regimes, particularly the PSD and the CCA.
- 3.3.1 There is huge uncertainty about the scope of the PSD. Given that the scope of PSD is one of the key concepts defining the scope of BCOBS this is a big problem: banks, building societies and others cannot know the scope of BCOBS and how the requirements of the PSD and BCOBS interact.
- 3.3.2 Paragraph 4.12 of the CP states that BCOBS would apply to "*retail banking service[s]*", covering both accepting deposits and providing services in relation to deposits (as reflected in its proposed definition). BCOBS 1.1.3(R)(1) states that BCOBS does not apply to "*payment service[s]*", defined in terms that mirror the PSD.
- 3.3.3 There are serious concerns about the way in which the FSA is seeking to carve out payment services from the scope of BCOBS without clarifying what this actually means in terms of what is caught by BCOBS.
- (a) While it is all very well in theory to say that what falls within the PSD does not fall within BCOBS, in practice it leads to confusion as to what exactly is caught by what. With such substantial continuing doubt about what is a payment service for the PSD, it is difficult enough for banks to plan for that Directive's implementation, and so banks will not be able to be certain that their plans are effectively capturing the applicable rules;
- (b) The problem is compounded by BCOBS' reference to the PSD: does it mean that the operational aspects of a current account (other than the receipt and repayment of deposits) are carved out from BCOBS (on the basis that they are subject to the PSD) while other aspects are caught? The definition of "retail banking service" (in referring to the provision of "services in relation to that *deposit* including but not limited to repayment to the customer") suggests more than this<sup>3</sup>;
- (c) Does BCOBS apply to payment instruments like cheques which are outside the PSD's scope? There is little in the specific rules to suggest that the FSA proposes regulation of this area in BCOBS;

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<sup>3</sup> Presumably, non-PSD payments to third parties, and the provision of balance and interest information, but scope is unclear.

- (d) The lack of clarity regarding the scope of the PSD has an obvious knock on in relation to determining the scope of BCOBS. It is essential that there be guidance from the FSA on what it considers is a "*retail banking service*" (in the same vein as the anticipated "Approach Document" for the PSD), with practical reference to the various types of current accounts, savings accounts etc and services provided; and
- (e) Once clarity is reached about which accounts fall within the PSD, the industry will have a large job on its hands to ensure that all systems and documentation are amended and updated to reflect the needs, training is undertaken, etc so they would benefit from not having to comply with the extra burden of simultaneously having to implement BCOBS.

#### 3.4 Interaction with credit regulation

3.4.1 Also uncertain is the manner in which the proposed BCOBS would interact with the continued credit responsibilities of the OFT. For instance, regulation of current accounts will continue to be cumbersome in that an account with an overdraft facility will be subject to both OFT and FSA oversight, and to the PSD.

3.4.2 As BCOBS is likely to apply to some banking services which fall under the CCA currently and which will be regulated by the OFT, there is a risk that action in respect of OFT-regulated issues (e.g. the court case on overdraft charges) may overlap with BCOBS.

3.4.3 For example, BCOBS 4.1.2 G(5) requires firms to disclose the costs chargeable to a banking customer and the operation of each retail banking service. There is likely to be a danger that OFT requirements are not clearly reflected in the BCOBS guidance, which has the potential to cause confusion for firms.

3.4.4 The guidance in BCOBS 5.1.2 G, which is presumably intended as elaborating on the fairness requirement in BCOBS 5.1.1 R, raises a host of issues which potentially go beyond conduct of business regulation of retail deposits, for example:

- (a) the bankers' right of set off, which could be critical in the context of managing prudential requirements – the FSA must avoid uncertainty in this area and surely, in the current climate especially but in the longer term too, capital and liquidity must take precedence as essential ingredients of financial stability; and
- (b) banks' treatment of customers in relation to overdrafts and second charge lending<sup>4</sup> which are within the OFT's area of responsibility, and to first mortgages which are generally within the FSA's purview.

3.4.5 Paragraph 1.12 of the CP anticipates a concordat between the FSA and OFT setting out respective responsibilities and how the two bodies will co-operate when addressing issues which cross the boundary between their respective remits.

3.4.6 We recommend that:

- (a) the FSA and OFT clarify a common position on set-off, in consultation with FSA colleagues in prudential regulation and the banking industry; and
- (b) the concordat clearly stipulate the boundaries between the two bodies on a level that is of use to banks, etc.

3.5 In addition to clarification of terms proposed in the Glossary and the interpretation of BCOBS 1 (Application), so firms can appreciate the scope of the new sourcebook, it is important that further guidance about the meaning of certain terms in BCOBS is given, either by the FSA alone or in conjunction with the industry.

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<sup>4</sup> We have not reviewed in this context the OFT's consultation on this subject which was published last Friday, February 13th, other than to note that it does not seem to suggest any limitation on banks' exercise set-off rights.

- 3.5.1 For example, in a post-sale context, what does a "*prompt*" and "*efficient*" service amount to? If the FSA's concern is speed, then the word "efficient" adds little or nothing to the word "*prompt*".
- 3.5.2 To the extent that the FSA now seeks to enhance its supervision in respect of banks' business models, this should be in a prudential context even if conduct of business rule changes may lead banks to change their business models in certain respects.
- 3.5.3 Please see our response to Question 4 for comments on the proposed definition of "*banking customer*", which go beyond the use of the term "*micro enterprise*".
- 3.6 The need in BCOBS 4.1.2 G to include information about the rate of interest does not specify the means of calculating the interest and nor does it deal with any need to make clear when interest will be paid or how it will accrue, or whether there is any need to tell customers about any loss of interest for early withdrawal of money held in notice deposit accounts.
- 3.7 BCOBS 2.3.9 G states that firms should take account of the BBA Code for the Advertising of Interest Bearing Accounts, but does not prescribe any more detail than that about interest rates to be included. Given the variety of ways in which interest rates can be displayed, paid and/or limited to certain sums, it may be useful to have more guidance in this area, as it is often the key factor in a consumer decision to bank with a particular provider and further guidance could encourage greater consistency between providers in the display of interest information. It may not be safer to rely on a principles-based approach on a matter as complex and potentially confusing to consumers as interest rates.
- 3.8 The rule in BCOBS 2.3.1 R (3) requires information in a financial promotion to be "*sufficient for, and presented in a way that is likely to be understood by, the average banking customer to whom it is directed or by whom it is likely to be received*". It would be more fitting to change this from a rule to guidance given the BCOBS 2.2.1 rule that financial promotions be fair, clear and not misleading. What is "*sufficient*" or "*likely to be understood*" by an "*average*" customer does not add much, if anything to the fair, clear and not misleading rule and it may be difficult for firms to have a firm idea of the financial understanding of "*the average banking customer*" to whom the promotion is directed.
- 3.9 Account operation and services
- 3.9.1 BCOBS concerns itself mostly with information needs and closing or moving accounts. It does not deal with some common specific bank account operations which feature in the BBA codes – e.g. cheques, cards and PINS, foreign exchange services, etc. These services could be the cause of complaints from consumers and yet the FSA does not propose rules which could reasonably form a basis of action, and would instead have to rely on Principle 6 or high-level rules such as those in BCOBS 5.1.1 which cannot reasonably be interpreted as providing any substantive regulation of such matters.
- 3.9.2 We suspect that the FSA will not refrain from reliance on Principle 6 for these "*operational*" matters even where no part of BCOBS provides a specific rule in that area. We have seen in some FSA Enforcement cases how Principle 6 can be used against firms in an area where there are no specific FSA Handbook rules (e.g. Hastings Insurance case in 2008 for a firm's decision to cancel policies). Will the FSA seek to enforce Principle 6 against firms for matters which have not been specifically placed in BCOBS but remain in the BBA Codes – such as how specific services are provided by firms?
- 3.9.3 BCOBS should contain guidance about such important issues, even if it is limited to stating that the FSA expects that compliance with the Codes (generally or on specifically identified matters) is likely to meet the standards reflected in FSA Principles in respect of those matters covered in the Codes.
- 3.10 We note that the FSA proposes no changes to SYSC in connection with the introduction of BCOBS. The reference to SYSC in BCOBS 2.2.3 G seems misplaced: is it intended to imply that firms should have similar systems, etc in place in order to comply with promotions

regulated under BCOBS? If so, the guidance is inadequate for this purpose: either it should be omitted, or SYSC rules should be clarified to apply to promotions under BCOBS so that BCOBS 2.2.3 can cross-refer to an applicable SYSC rule.

### 3.11 Section 150 rights of action for damages

3.11.1 On Schedule 5 of BCOBS, we would argue the application of s.150 of FSMA to BCOBS is not a helpful development given the high-level content of many of the rules. Many are close to being at the level of principles, or almost restatements of existing Principles.

3.11.2 We strongly recommend that Schedule 5 focus only on rules which specify particular information requirements, communications contents, and operating standards, so limiting the application of s.150 to these rules rather than high-level rules such as BCOBS 2.2.1 R, 5.1.1 R and 5.1.3 R.

## 4 Q4: Do you have any comments on our proposed use of the definition of micro-enterprise to cover business banking customers (Chapter 4)?

4.1 The idea of a '*micro-enterprise*' features in the PSD itself. The definition there is stated as being that given in Recommendation 2003/361/EC which describes a micro-enterprise as:

*"an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million".*

This is mirrored in the draft text for the PSRs.

4.2 Paragraph 4.14 of the CP suggests that the same definition apply to BCOBS. In principle, it might seem important that the use of the term should not differ as between the PSD and BCOBS, despite this definition being "*wider in scope than the range of business customers covered by the Business Banking Codes*" (paragraph 4.14 of the CP). In practice, by including small trusts in the definition of "*banking customer*", the CP in any event proposes that BCOBS benefit a wider range of clients than does the PSD (or even the PSRs), and there are other difficulties which favour *allowing* firms to differentiate the two regimes.

4.3 The use of a euro (€) denominated amount as one of the determinants of size could lead to difficulties as the value of the euro will fluctuate substantially in relation to sterling yet most relevant accounts will be denominated in sterling. There will also be customers whose number of employees move through the "10 and fewer employees" threshold, perhaps frequently. Firms should have the option:

- (a) to rely on micro enterprises to inform the firm if their status changes (as HM Treasury papers on the PSD and PSRs suggest);
- (b) to rely on a £ sterling threshold (which the FSA should specify) for the purposes of BCOBS.

4.4 As regards other aspects of the definition of "*banking customer*":

4.4.1 We assume that the applicable definition of consumer will be the first of the several that are currently in the Glossary. This would be consistent with the PSRs.

4.4.2 Charities and trustees: to what extent will an authorised firm be obliged to check the status of charities and trustees which state that their income / net assets exceed the relevant threshold (and to monitor for any change, especially in those customers near to the threshold)? We recommend that the FSA issue guidance that permits firms to rely on customer self-certification and (as with micro enterprises) place the onus on the customer (or indeed to require the customer) to notify any change in circumstances (whether upwards or downwards through the threshold).

**5 Q5: Do you have any comments on the proposed application of BCOBS to incoming EEA branches and e-money issuers (Chapter 4)?**

To ensure a level playing field for incoming EEA branches and UK firms and to ensure consistent protection for all consumers, it is essential that BCOBS be applied to incoming firms in the same way as domestic firms.

**6 Q6: Do you have any comments on the proposed application of the requirements in BCOBS to credit unions (Chapter 4)?**

No comments on this question.

**7 Q7: Do you think there are elements of the current Banking Codes and other relevant codes/guidelines that would not appear in the PSD Regulations or BCOBS (as proposed in this CP) but which ought not to be lost?**

- 7.1 Yes, the Banking Codes cover many areas not addressed specifically by BCOBS. The key issue is where and how such matters are best regulated, and the need for greater clarity and certainty to the extent the FSA regards such matters within its remit yet makes no express rules.
- 7.2 A feature that runs through the Banking Codes is a duty on a bank to provide continuing information about a client's account. The proposed BCOBS 4 does not give the same protection to the customer as it concentrates on the information to be provided before a product is taken. For instance, section 4.1 of the Codes requires a subscriber to the Code to provide interest rate information via a helpline, a web site, notice in branches and by asking the staff. Sections 9.4 and 9.5 meanwhile of the Code for individuals promises invaluable on-going information on cheque clearing which is vital to fight fraud.
- 7.3 Reference (in BCOBS 2.3.9) to the BBA/BSA Code of Conduct for the Advertising of Interest Bearing Accounts is helpful. But just as the complexity of interest rate payments and calculations does not lend itself to a high-level principles or guidance based approach, so there are other areas where mere principles or high-level rules are inadequate and leave firms with too much uncertainty.
- 7.4 Greater clarity and certainty could be achieved in various ways:
- 7.4.1 More rules and guidance to focus high-level rules like BCOBS 5.1.1, further supported by references to the Banking Codes (for fuller detail):
- (a) paragraph 4.30 gives examples of matters which might be covered by industry guidance that are "*within [the FSA's] remit*";
  - (b) but the FSA should clarify:
    - (i) whether it considers existing Code standards on such matters to be adequate and a reference point for firms, especially in relation to meeting the standard proposed in BCOBS 5.1.1 in respect of matters not expressly addressed in BCOB, and
    - (ii) whether there are other areas not covered by the Codes but in which its rules imply standards (particularly if the FSA considers existing standards to be inadequate).

- 7.4.2 Formal confirmation of industry guidance, for example in the form of (presumably revised) Banking Codes – but unless and until the industry seeks these, the proposed BCOBS rules remain inadequate.
- 7.4.3 Moving the current Banking Codes' prescriptive rules and guidance to BCOBS would create essentially one central source which firms could use to decide what information they need to provide to customers and what standards of service they need to reach, instead of multi-layered requirements (which may cause confusion, particularly for incoming EEA firms, and potentially conflict).
- 7.5 We suggest the first approach, since it leaves scope for the industry to flesh out more details in guidance, either confirmed by the FSA (second approach) or informal.

## **8 Q8: Do you have any comments on our proposed approach to operationalising the new framework (Chapter 4)?**

- 8.1 Julian Adams of the FSA's Supervision team<sup>5</sup> stated that the FSA accepts that imposing BCOBS at the same time as the PSD would result in a tight timetable. He suggested that some leeway would be given to firms in the immediate period after 1 November 2009 for compliance.
- 8.2 We welcome this approach but consider much more is required, not least because forbearance in FSA enforcement does not preclude FOS proceedings nor the Section 150 claims which the FSA highlights as a benefit of the BCOBS regime.
- 8.3 We suggest that before any enforcement action is taken, the FSA should not only have published the high-level supervisory strategy proposed in paragraph 4.39, but also conduct themed reviews and highlight any failings uncovered by a 'Dear CEO' letter, retail banking newsletter and other supervisory tools.

## **9 Q9: Do you agree that the proposed new framework should come into effect at the same time as the PSD in November 2009 (Chapter 5)?**

- 9.1 No. We think the arguments against greatly outweigh those in favour, and the benefits of implementing at the same time can be achieved either:
- (a) by allowing banks flexibility in implementation, for which there is precedent; or
  - (b) by postponing implementation until the PSD is fully implemented and problems ironed out (perhaps with some enhancement of the Banking Codes in the interim).
- 9.2 An argument can be made that BCOBS should be introduced at the same time as the PSD so any necessary training and changes to systems, processes and terms and conditions can be dealt with at the same time. This could result in lower overall costs than if BCOBS were introduced (and PRIN extended) later.
- 9.3 However, there are areas of crucial importance in the PSD that are still quite unclear. We have highlighted this issue and some of these concerns above (see 3.3). The lack of clarity regarding the scope of the PSD has an obvious knock on in relation to determining the scope of BCOBS: fundamental questions remain unanswered as to the accounts and services covered by the PSD, and consequently the meaning of BCOBS 1.1.3 R. This alone justifies a rethink by the FSA of the proposed implementation timetable for BCOBS.
- 9.4 In the current economic climate, of primary concern to the public is that their money held in banks is safe. To ensure this, considerable work is being carried out on capital adequacy,

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<sup>5</sup> At a BCOBS consultation held at the FSA on 16 December 2008.

liquidity and compensation schemes. It is not a failing in conduct of business matters that has led to the current situation in the banking and finance sector. Accordingly, implementing new and changed conduct of business requirements is not the highest priority when more important changes are on the table and, in contrast to most EU-driven requirements the FSA has discretion in relation to BCOBS.

9.5 Therefore, firms should be given the option of implementing the changes from November 2009 but be under no compulsion to do so.

9.5.1 There is precedent for this, including in the recent past:

(a) firms which were to be subject to the prudential "common platform" requirements were permitted to implement these requirements from 1 January 2007 but had the option of postponing implementation until 1 November 2007; and

(b) likewise firms had a choice of implementation dates for Basel 2.

9.5.2 We believe that this approach would be welcomed by many retail institutions, but two alternatives would be better:

(a) complete postponement of BCOBS implementation until after the final date for PSD authorisation (for firms not deemed authorised), by which time there should be greater clarity on some of the PSD issues that we have mentioned above; or

(b) greater flexibility as to implementation date, allowing institutions to implement in part and/or fully from any date (or any of a number of specified dates) during a period running from this November for, say, two years (i.e. six months beyond the end-date for final PSD authorisation).

9.5.3 Although banks do not benefit from PSD transitional provisions (indeed the conduct requirements apply from November 2009 even to non-authorised firms), we believe that many issues will become clearer after the implementation date whether in the context of dealing with authorisation applications (or potential applications)<sup>6</sup> or from banks and others working through issues with the FSA and the EU Commission.

9.5.4 In a non-prudential context with no complex regulatory reporting requirements, the FSA should be able to accommodate this kind of flexibility, and accordingly we favour the second option (9.5.2(b)).

## **10 Q10: In which areas do you think transitional provisions would be desirable and for how long (Chapter 5)?**

10.1 There are good reasons why BCOBS transitionals should continue beyond well the PSD implementation date, to allow:

(a) time for issues under the PSD to be ironed out before too many systems changes are made to implement BCOBS, where those changes could be affected by PSD interpretation and application; and

(b) banks and other institutions to focus on the higher priority systems and related changes being driven by prudential rule changes and related supervisory enhancement.

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<sup>6</sup> While we hope that the Commission Q&A on the PSD and the FSA's own PSD "Approach Document" will in due course clarify some issues (existing Q&As of the Commission and the FSA leave many issues outstanding), we suspect it will be some considerable time before there is sufficient clarity to determine the perimeter between the PSD and proposed BCOBS regimes.

10.2 The footnote to page 18, and paragraph 5.6 of the CP, state that transitional rules for BCOBS are a possibility and are something that could be consulted on at a later point. In view of the very short period to the proposed BCOBS implementation date, and given the other systems changes banks and others are having to make at present, almost any change presents severe challenges.

10.3 Accordingly we recommend the following:

10.3.1 There should be an extended (18-24 months) transitional period for:

- (a) any rules which make substantive changes to existing specific requirements (or which introduce new specific requirements not hitherto applicable to the activity of accepting deposits);
- (b) any other rules which require systems changes or training;
- (c) the application of BCOBS as a whole in any part of the penumbra of PSD's scope, i.e. where it is not yet clear if the PSD will apply (notably, as regards the scope of BCOBS being determined by reference to the currently unclear definition of payment services under the PSD); and
- (d) firms to clarify which of their clients are within the definition of *"banking customer"*.

10.3.2 In connection with this last point, the FSA should consider introducing grandfathering provisions for certain types of client.

10.3.3 Because of the short time until the implementation date proposed in CP 08/19 we strongly urge the FSA to announce its plans about transitional provisions very shortly.

**11 Q11: Will a change to the proposed new framework generate any further costs that have not been identified in Annex 2?**

11.1 It seems unlikely that a change seen as so significant by the FSA, involving introduction of a new source book, can be achieved across such a large sector for so little. We question whether the survey carried out quickly and during September, when the credit crisis was approaching its peak, can be representative especially given the low response rate among the non-credit union deposit takers (other than the largest).

11.2 For example, we would expect one-off outlay on professional advice by many organisations, beyond their needs for PSD and UCPD advice, yet the CBA makes no mention of this.

**12 Q12: Will a change to the proposed new framework generate any further benefits that have not been identified in Annex 2?**

No comments on this question.

**13 Q13: Do you have any other comments on our CBA (Annex 2)?**

No comments on this question.

**14 Q14: Do you agree with the compatibility statement in Annex 3?**

14.1 We find the arguments in this Annex unconvincing, like those in Chapter 2 of the CP and in the CBA (Annex 2), especially those concerning the Principles of Good Regulation.

- 14.2 In particular we have significant doubts as to the statement in paragraph 8 of Annex 3, and the synergies with payment services supervision implied by paragraph 13.
- 14.3 The CP presents inadequate evidence and arguments that the BCOBS changes are a good use of the FSA's resources and proportionate either (1) to the problems identified in the current self-regulatory arguments or (2) to the resulting benefits – particularly given the alternative of enhancing BCSB arrangements (see paragraphs 1.2, 1.3, and 1.5(b) above).

**Macfarlanes**  
**Clifford Chance**  
**Linklaters**  
**Herbert Smith**  
**Slaughter and May**  
**Denton Wilde Sapte**  
**Slaughter and May**  
**Norton Rose**  
**Freshfields Bruckhaus Deringer**  
**S J Berwin**  
**CMS Cameron McKenna**  
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