Priorities for International Banks

February 2020

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Introduction

After a turbulent year in British politics, the UK is now clearly charting a momentous course out of the European Union.

Leaving the European Union is likely to have far-reaching implications, particularly for International Banks who have traditionally used London as a gateway for accessing financial services markets in the rest of Europe. What will happen to single market access in the long term remains to be seen.

Aside from the tumult of the Brexit process, one clear outcome from the decision to leave is certainty. Certainty, whether positive or negative, breeds stability and confidence in financial markets. This can only be viewed as a positive development.

Against this background, our Priorities Report offers an invaluable single point of reference for our International Banking clients by setting out key legal and regulatory developments across nine key areas in the coming year. The Report will serve as an indispensable guide for navigating the rapidly changing legal and regulatory landscape in the UK in this transition year and beyond.

The report offers practical tips and guidance in the following areas:

- Financial services regulation
- LIBOR
- Disputes
- Clean energy
- Data, privacy and cyber security
- Business immigration
- Real estate
- Restructuring and insolvency
- Technology, e-commerce and outsourcing

We hope you find this report helpful in planning for the year ahead. If you have any questions about these changes or would like help preparing for them, please do get in touch.

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Financial Services Regulation

The FCA is due to publish its Business Plan for 2020/21 in April 2020. Ahead of this, we have set out the key themes that are driving change across the financial services sector.

Key themes relevant to international banks are:

Operational resilience

Operational resilience, particularly in the context of cyber issues, outsourcing and other technological change, is of increasing interest to the regulators and will remain at the top of the agenda in 2020. The FCA, PRA and Bank of England published a package of consultation papers at the end of 2019 on building operational resilience. Regulators are particularly concerned about banks' outsourcing to the cloud, due in no small part to the sector's dependence on a limited number of providers. International banks can therefore expect further regulation, both directly and indirectly (for example via "Dear CEO" letters) in this area.

Culture and conduct

Poor culture in financial services can lead to harm to consumers and markets, and is a key root cause of major conduct failings within the industry, with recent enforcement decisions highlighting the consequences of unhealthy cultures. Firms' culture and governance will therefore remain a key component of regulatory supervision in 2020, together with greater regulatory focus on non-financial misconduct. This can call into question the fit and proper status of senior managers who fail to ensure known problems in their banks are addressed.

Financial crime

The 5th Money Laundering Directive (MLD5) came into force in the UK on 10 January 2020. Of particular importance to international banks is the expansion of the scope of persons on whom enhance due diligence (EDD) must be conducted. International banks must now apply a newly defined set of EDD measures, and obtain senior management approval, when establishing or continuing business relationships and transactions involving high-risk third countries. Enhanced ongoing monitoring must also be undertaken where there is a connection to high-risk third countries.

What should international banks do to prepare?

Reliance on any third party can impact a firm's operational resilience profile, and international banks who outsource to third parties should be mindful of the regulators' continued focus in this area. When outsourcing, international banks should ensure that their governance structures are fit for purpose and their business continuity plans are comprehensive and considered.

International banks should also be aware of the key drivers of culture that can lead to harm, and how these drivers interact within the organisation. International banks should monitor how they, and particularly their senior managers, deal with misconduct. The FCA has noted that the way in which a firm deals with allegations of non-financial misconduct, such as harassment and bullying, can be as relevant to its assessment of that organisation as the way in which it tackles financial misconduct.

With regard to MLD5, international banks should be well underway with implementing the new requirements. In particular, international banks should conduct a review any relationships which have a connection to a high risk third country and determine if additional EDD measures are required.

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LIBOR

What's changing?

In 2017 the FCA announced that it would cease compelling LIBOR panel firms to submit rates which form the basis of LIBOR calculations. From the end of 2021 at the latest, it is likely that LIBOR will cease to be published entirely, or if it does continue, the number of panel firms submitting data will be insufficient to make LIBOR a reliable, representative rate. In any event, the regulatory expectation in the UK is that firms cease issuing new products linked to LIBOR by the end of Q3 2020 and manage legacy contracts away from LIBOR to ensure a smooth transition. Even the LMA "fallback" provisions are not sufficient to cater for the complete cessation of LIBOR and cannot be used on a long term basis. Banks therefore need to find alternatives to LIBOR and amend their back books as well as their template agreements to enable a switch to another interest rate reference rate (such as base rate or a risk free rate i.e. SONIA (£) or SOFR ($)).

What should international banks do to prepare?

In a letter dated 16 January 2020, the FCA has identified the following four areas for International Banks to focus on in order to deliver the transition:

- **Product development**: which will include:
  a) Conducting a review of your LIBOR exposure. For loan products, this will mean identifying which loans reference it, what currencies they cover and whether the facilities are syndicated or bilateral; and
  b) Deciding which reference rate you will transition to: this is not simply a choice of changing to SONIA or SOFR. Other alternatives are available (for example Bank of England base rate) and the choice will depend upon the size of the loan, sophistication of the customer and the circumstances and expediency of the use of the replacement rate.
- **Reviewing infrastructure, including updating loan system capabilities:** noting that we anticipate it will take any firm a significant period of time to enable (and beta test) their systems to use an alternative rate such as SONIA.
- **Client communications and awareness:** if you have not started writing to customers to notify them of the transition, you should start doing so now. At the same time, decisions will need to be taken on who will pay for the repapering exercise, and how to deal with customers who refuse to engage. You should note that for existing loans which mature beyond 31 December 2021, virtually all English law loan agreements will require borrower consent to amend the basis for charging interest, so you cannot simply say you will apply another reference rate if customers do not respond within a set timescale.
- **Updating documentation:** which will include formulating several forms of template amendment agreement for existing loans (determined by loan type, version number and currency), as well as changing your precedents for new loans.

The FCA has also made it clear that it will be increasing its engagement with all firms about their LIBOR preparation so International Banks should be ready to evidence the progress they have made.

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Disputes

What's changing?

2020 is a year of a great change for the United Kingdom with Brexit finally happening. The financial services sector also faces significant change as it moves away from LIBOR ahead of its cessation at the end of 2021.

The economic impact of LIBOR remains to be seen and firms should continue to monitor its impact for them and their customers.

We commented on the end of LIBOR in our Priorities for International Banks 2019 report, and while firms have been progressing their plans for the transition in the time since, as noted in the earlier page on the LIBOR transition the expectation, in particular from regulators, is that the activity by firms to implement their plans for the transition should now accelerate through 2020.

What should international banks do to prepare?

A primary focus of regulators in monitoring the transition away from LIBOR will be the communications that are sent to individual customers, notifying them of the issue, setting out the options for them and explaining the process. You should therefore be considering and formulating a communication strategy to ensure that adequate explanation is given to customers, thereby minimising the risk of subsequent challenge either from regulators or individually customers.

You should maintain a detailed record of the communications you have with customers so you can evidence the steps that have been taken through the entire process. That includes keeping copies of any correspondence sent to customers, minutes of any meetings and notes of calls.

In anticipation that you will receive enquiries from customers across the business, it is important that all of your customer facing staff are aware of the change and the communications that are being provided so they can talk knowledgably to customers.

We are already seeing a number of solicitors firms that regularly act for claimants in disputes against banks publishing articles noting the potential for issues to arise as individual facilities are transitioned to alternative rates. Those articles highlight the need for firms to ensure that customers are, as far as possible, not prejudiced by the transition. Care should be taken when considering alternative rates, in particular what the impact of the new rate will be on the customer compared to the existing LIBOR based obligations. This is also an area that has been identified by the FCA which has acknowledged the inevitability of a pricing variance between LIBOR and the replacement rate. It has confirmed that Banks are not expected to assume responsibility for that pricing variance, but equally has made it clear that individual customers must be treated fairly when transitioning them to new rates. The most obvious point being, will the new rate cost them more? The issues with pricing variance may be particularly acute if you participate in the syndicated loan market given the potential for differing positions between individual syndicate members.

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Clean Energy

What's on the horizon?

The UK clean energy sector continues to dynamically evolve and respond to the ever changing climate: both in the sense of any ever increasing awareness of the need for a decarbonised economy, but also to the shifting sands of governmental policy. Despite the challenges of the latter the sector continues grow, not just in terms of overall size, but also in its diversity of technologies and corresponding opportunities for funders.

Whilst not in response to any specific legislation or governmental policy the requirement to invest in the infrastructure to support the widely lauded roll out of electric vehicle (EV) charging infrastructure is a significant example of a new and significant opportunity in the clean energy sector.

As part of the global energy transition, the uptake of electric vehicles (EVs) is gathering pace. In the UK alone, sales are going up and 20% of all vehicle sales are expected to be electric by 2025. 'Beyond petroleum', once a famous PR strapline, is now the direction of travel for multiple industries linked to the EV revolution. The trend towards electrification has hugely positive environmental implications. But it also presents a unique opportunity for UK businesses to support and develop the charging infrastructure required to meet the needs of EV drivers.

Decarbonisation is essential, especially in the transport sector, which accounts for 26% of greenhouse gas (GHG) emissions in the UK, with road transport accounting for 91% of these emissions in 2016. According to the Department for Transport, between 2003 and 2015, UK road transport was responsible for 22% of all domestic GHG emissions. EVs and their associated charging infrastructure are now core components of the global energy transition, and central to future energy scenarios mapping the shift to a sustainable energy future.

Continued growth of adjacent clean technologies like solar generation and battery storage will help to ensure that electricity supply keeps pace with demand, as consumers switch to e-mobility. These technologies have their own potential revenue streams – further driving involvement in EV charging infrastructure (EVCI) by businesses and creating a symbiotic relationship between EVCI and the broader clean energy market.

The opportunities for EV infrastructure, battery and clean energy generation projects to support EV chargers are many and varied. They span central and local government, retail, manufacturing, long distance and last mile logistics, the leisure, food and drink industries.

There is a lack of EV charge points in the UK and greater awareness amongst real estate owners is needed. Joint ventures will be particularly attractive ways forward and are likely to trigger further uptake and awareness of EVCI by all businesses over the coming year.

Outside of new technologies such as EV, the UK clean energy sector continues to be a fertile ground for debt solutions for solar, wind, hydro, biomass and other technologies, including new build projects in this increasingly subsidy free environment.

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Data, Privacy and Cyber Security

What's changing?

The draft ePrivacy Regulation (ePR) is currently being negotiated by the European Commission, European Parliament and the Council of the EU. When finalised, the ePR will replace the ePrivacy Directive, which was implemented in the UK by the Privacy and Electronic Communications Regulations 2003 (PECR). Depending on the final version of the ePR, it may introduce changes to rules on electronic direct marketing and the use of cookies. Cookies are already under regulatory scrutiny, with several European regulators (including the Information Commissioner's Office (ICO) in the UK) having recently issued guidance on the use of cookies which confirms that all cookies except those that are strictly necessary for a website to function require explicit, opt-in consent from the user.

International transfers of personal data continue to be a minefield for international organisations. The Advocate General's (AG's) opinion in the "Schrems II" case in the Court of Justice of the European Union (CJEU) has confirmed that SCCs will continue to be a valid mechanism to allow transfer of personal data from the EU to a country outside the EU. However, it imposes a further obligation on transferors of personal data to assess the laws to which the recipient is subject and to cease international transfers if there is found to be anything in those laws which could require the recipient to breach the SCCs. The CJEU's final judgment is due shortly and is expected to follow the AG's opinion.

Brexit continues to complicate international transfers even further; whilst things will be "business as usual" for the transition period, if the European Commission has not deemed the UK to have adequate levels of data protection by the end of the transition period (arguably an ambitious deadline), transfers from other EEA countries to the UK will need to be covered by an appropriate adequacy mechanism, such as SCCs or binding corporate rules.

What should international banks do to prepare?

It will be important for international banks to keep the draft ePR under review and examine their marketing practices in light of the legislation, once it is finalised. A number of European regulators, including the Information Commissioner's Office (ICO) in the UK, have recently released guidance on the use of cookies. In light of this and in preparation for the ePR, international banks may wish to conduct a cookies audit to review the cookies that they currently use across their websites, categorise them and ensure their consent journeys and cookies policies comply with current guidance.

We also recommend that international banks conduct a detailed review of their intra-group and other international transfers of personal data. Where SCCs are relied on, international banks should start carrying out an assessment of the laws of the recipient jurisdiction to ensure that SCCs can continue to be in place without any conflict with those laws. The impact of Brexit will not be fully clear until a deal is reached or a no-deal situation is certain; however, international banks should review any transfers of personal data from Europe to the UK now, so that they are in the best position to act quickly to put in place appropriate adequacy mechanisms, if required, when the Brexit position becomes clear.

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Business Immigration

What's changing?

With the Conservative Party securing a clear majority in the December 2019 election, there is now a degree of certainty as to the UK's future immigration policy – although things are far from crystal clear in a number of areas.

Brexit was naturally a key issue during the election campaign and the UK departed the EU on 31 January 2020. This means that the residence deadline for applications to the EU Settlement Scheme will be 31 December 2020 (with the applications themselves to be submitted by June 2021). Statistics suggest that there has been a trend towards EU migrants returning to their home countries since the Brexit referendum, so it remains to be seen whether this will change during 2020.

The Conservative Party manifesto included a clear commitment to introduce an "Australian-style points based system" in place of the UK's current immigration arrangements. The new system would bring EU migrants (who are not covered by the EU Settlement Scheme rules) and non-EU migrants under the same umbrella, with implementation likely to take place in early 2021 after the EU's free movement rules cease to apply to the UK.

Although described as an Australian-style system, there remains a lack of clarity as to what precise form this will take. It is clear from the Conservative manifesto that the system will actually be quite different to the current Australian system in some respects. For example; a concrete job offer is not always required to secure an Australian visa, but the manifesto notes that a clear job offer will be needed under the proposed new system. Overall; firm details of the proposal remain thin on the ground, but we can expect more specifics once the Migration Advisory Committee provides its report on the issue (which is expected early in 2020).

Given the significant focus placed on immigration matters during the Brexit process and the commitments included in the Conservative manifesto, we would anticipate that any new system will ultimately be designed with a view to reducing overall net migration to the UK. It is, however, clear that access for highly skilled migrants would be prioritised under the proposals.

What should international banks do to prepare?

If banks have not already done so, it would be wise to carry out an audit of staff to establish the extent of reliance on staff working in the UK under current free movement rules. Any audits already carried out should be kept accurate and up to date. Whilst employers should be aware that unregulated immigration advice should not be provided to employees, it would be wise to emphasise the need for Scheme applications to be made to secure ongoing residence in the UK.

For banks who regularly have staff move between EU member states, it will be important to plan ahead and consider whether additional visa permissions will be required when free movement rules cease to apply to the UK.

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Real Estate

What's changing?

The Government has previously introduced the minimum energy efficiency standards which makes it unlawful for owners of property to let buildings which are "sub-standard". Sub-standard buildings are those with a rating below "E" on the relevant energy performance certificate. Prohibitions on continuing to let residential property come into force in 2020 and commercial property in 2023, thereby making it unlawful to have leases in place at such properties, subject to specific exemptions. The Government is now consulting on raising the threshold for sub-standard properties to "C" or even "B" rating.

The implementation of the Overseas Entities Bill is likely in 2021. This means that from 2021, overseas entities wanting to deal in certain UK property will have to register in the overseas entities register. The obligation will be for any such vehicle, whether that is a company, partnership, government or public authority must submit prescribed information with the registrar of companies for England and Wales. If an application is successful, the Registrar will note the overseas entity on the OER and issue it with a unique overseas identity ID number. This ID number will be key to that entity being able to deal with land in the future. In England & Wales, where an overseas entity holds property already, there will be a grace period of 18 months for the overseas entity to register any freehold property, or leasehold interest of more than seven years, of which it became the registered proprietor on or after 1 January 1999. The overseas entity must confirm the information annually and failure to register or keep details up to date will be an offence. Failure to register will prevent any land transactions relating to the relevant entity from being registered.

Various reforms to residential tenancies are continuing to be advanced. From March 2020, all residential tenancies have an implied term that the relevant premises and common parts in their buildings are in repair, that they are free from damp and have adequate natural light, ventilation, water supply and drainage, among other requirements. Separately tenancy deposits will be capped at 5 weeks rent. The government is also planning to legislate to prevent "no-fault" evictions of residential tenants which could impact on the ability for landlords to obtain possession. The trade-off is that other rights for landlord's to gain possession will be enhanced but further detail around this is awaited.

What should international banks do to prepare?

While raising the threshold for sub-standard properties to "C" or "B" ratings wouldn't come into force for a number of years, lenders need to be considering this now as significant capital expenditure may have to be planned and any new regime could impact on the ability to obtain a rental income from affected properties.

Banks should ensure that any foreign borrowers owning real estate make arrangements to complete the necessary arrangements during 2020.

Banks should ensure that they are aware of the requirements for residential tenancies, that properties they are taking as security are kept in good repair and that they keep up to date on future developments around taking possession.

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Restructuring and Insolvency

What's changing?

Certain sectors have come under significant pressure over the past couple of years including retail and casual dining, and there does not appear to be any significant relief in the near term, particularly with Brexit having taken place. There has also been increasing focus from regulators on nonperforming debts as well as additional pressure from within banking organisations themselves to tackle such debts. With increased regulator scrutiny and the negative impact non-performing loans (NPLs) can have on capital ratios, the "do nothing" option is no longer viable.

What should international banks do to prepare?

Banks need to:

- **Be clear on the terms, including jurisdiction and governing law, of the finance documents in preparation for taking enforcement action (if it becomes necessary).** It is easy to underestimate the time it takes to commence enforcement steps and to make assumptions about facility security documentation and how it operates in these circumstances, which (if wrong) can create real problems when not identified and taken into account early.

- **Get the right policies and procedures for NPLs in place quickly.** The Obligors and security may be in many different jurisdictions which requires more thought and planning. There may be opportunities to improve documentation and/or to plug gaps as part of restructuring negotiations but only if identified early enough.

- **Consider all the potential means of recovery and asset protection: enforcement may be time-consuming, uncertain and costly.** There may be other options: assignments of debt and security whether on an individual or portfolio basis. This requires planning and good information on the connection if the value is to be maximised, both in terms of the documentation but also the status of the borrower group and its assets. There may also be means of recovery from professional advisers (and their insurers) who may have provided negligent advice; in circumstances where repayment of the loan may be problematic or non-existent, professional advisers' indemnity insurance may provide an additional source of recovery. Other routes of recovery could also include personal guarantors who may have assets they are keen to protect and which may therefore prompt an earlier settlement.

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Technology, E-commerce and Outsourcing

What's changing?

On 30 September 2019 the European Banking Authority (**EBA**) guidelines on outsourcing (the **Guidelines**) came into force. The Prudential Regulatory Authority (**PRA**) also released its consultation paper on the Guidelines in December 2019 which is set to close on Friday 3 April 2020. The Guidelines are intended to be an update to the existing regulatory regime for banks when outsourcing functions as set out in SYSC8 and MiFID II as well as building on existing guidelines in respect of outsourcing services to the cloud. The Guidelines have been produced as a result of an increasing interest by the European and UK regulators in the way in which banks and financial services institutions consume and rely on particularly IT and digital services in an increasingly complex technology landscape.

The Guidelines set out the expectations on the bank in a number of areas namely:

- **The pre-outsourcing phase:** banks must have clear outsourcing policies to identify what is and isn't outsourcing and critical and important outsourcing and carry out due diligence of suppliers;
- **The contractual phase:** banks must have written agreements with all suppliers which includes specific contractual provisions and protections set out in the Guidelines;
- **The operational phase:** banks must monitor suppliers on an ongoing basis, keep and report to the PRA a register of suppliers as well as be able to exit the arrangement in an orderly way.

The Guidelines state a number of clear exceptions but the view of the PRA is that the majority of arrangements with third parties should be considered outsourcing by default the focus being on what is critical and important so appropriate measures are taken both contractually and operationally. Intra-group outsourcing is permitted but must be objectively justifiable, subject to arm's length contractual conditions and a separate sub-set of requirements particularly where the intra-group outsourcing is to countries outside of the EEA.

What should international banks do to prepare?

International banks should ensure that they have re-evaluated their outsourcing policy in the UK to ensure compliance, update template contracts and documents and consider all of their supplier arrangements entered into with third parties (including intra-group arrangements) by their UK operation to establish whether they fall within the Guidelines and whether the contractual documents need to be updated. Contracts for outsourced services must be updated now for new agreements. For arrangements that were already in place on or before 30 September 2019, firms should make required changes on renewal and at the latest by 31 December 2021.

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