

Client note

Can you credit it? – The Consumer Credit Bill

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This note is written as a general guide only. It should not be relied upon as a substitute for legal advice.

The consumer credit industry has experienced much pain in implementing changes to consumer credit advertisements, agreements and early settlement rules over the past year and the Consumer Credit Bill (“CCB” or the “Bill”) introduces a number of further significant changes. In particular it will enhance the powers of the Office of Fair Trading (“OFT”) under the Consumer Credit Act 1974 (“CCA” or the “Act”) and will introduce sweeping new powers for the Court in dealing with “unfair relationships”. The scope of the new provisions is extremely wide, both in terms of the nature of agreements and activities covered and the powers of the court.

This article briefly recounts the development of the Bill, summarises the changes that will be faced by the industry, and then focuses on the new unfair relationships provisions.

1. DEVELOPMENT OF THE BILL

The Consumer Credit Bill in its current form is part of the Government’s ongoing review of consumer credit law. Published on 8 December 2003, the white paper, “Fair, Clear and Competitive – The Consumer Credit Market in the 21st Century” paved the way for a raft of changes to the consumer credit regime in the United Kingdom. The changes have so far been implemented by a series of statutory instruments,¹ covering advertising, form and content of agreements, disclosure and early settlement rules. Primary legislation is also

needed to amend the CCA itself, as opposed to the instruments made under the CCA. This led to the publishing of the Consumer Credit Bill, which is currently passing through the House of Lords. On the current timescale, the Bill is expected to receive royal assent around the end of this year.

2. THE CONSUMER CREDIT BILL – KEY CHANGES

The new “unfair relationships” provisions are considered in detail below. In summary, the changes to be introduced are as follows:

Clauses in the Bill

1-5	Scope of CCA	<p>Removal of Financial Limits</p> <p>The Bill proposes removing the £25,000 limit on consumer credit and hire agreements entered into after the Consumer Credit Act 2005 comes into force. Exemptions will be available for ‘high net worth’ debtors and hirers,² and for businesses.³</p> <p>Partnerships</p> <p>Partnerships of more than three persons will not be included within the definition of “individual” for the purposes of the Act.</p>
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¹ Consumer Credit (Advertisements) Regulations 2004 SI 2004/1484.
 Consumer Credit (Agreements) (Amendment) Regulations 2004 SI 2004/1482.
 Consumer Credit (Disclosure of Information) Regulations 2004 SI 2004/1481.
 Consumer Credit (Early Settlement) Regulations 2004 SI 2004/1483.
 Consumer Credit (Miscellaneous Amendments) Regulations 2004 SI 2004/2619.
 The Consumer Credit Act 1974 (Electronic Communications) Order 2004 SI 2004/3236.
 The Consumer Credit (Enforcement, Default and Termination Notices) (Amendment) Regulations 2004 SI 2004/3237.

² The scope of this exemption will be defined by an order made under the Act.

³ An agreement for credit exceeding £25,000 will not be regulated if the agreement is entered into ‘wholly or predominantly’ for business purposes, which will be presumed if a declaration in specified form is made by the debtor or hirer. However, knowledge or reasonable cause for suspicion on the part of the creditor that this is not the case will rebut that presumption.

Clauses in the Bill

6-7	Fixed-Sum and Running-Account Credit	<p>Creditors will be required to supply annual statements in relation to fixed-sum credit. No charge may be made for this service. Where this requirement is not complied with, then for the period of non-compliance the agreement will be unenforceable, no interest may be charged, and no default charges may be applied for any breach which occurs during the period of non-enforceability, even if the breach continues after the end of that period.</p> <p>Further regulations may be made requiring statements in relation to running-account credit to include additional information about consequences of failure to make required payments or of only making “prescribed payments in prescribed circumstances”.</p> <p>These rules will apply in relation to agreements whenever made.</p>
8-18	New Default Rules	<p>There will be various new rules for notices by the creditor to the debtor in the event of default. For example, notice will be required:</p> <ul style="list-style-type: none"> • for fixed-sum credit, when a debtor is in arrears by more than the sum of his last two payments, or for running-account credit, when a debtor misses two consecutive payments and, in either case, certain other conditions are satisfied • if any default sum becomes payable • if the creditor intends to charge interest on judgment debts. <p>Failure to provide these notices will lead to similar remedies in each case, being the inability during the period of non-compliance:</p> <ul style="list-style-type: none"> • to charge interest on relevant sums due • to charge default sums • where not yet enforced, to enforce the agreement. <p>In the case of failure to give notice of default sums being payable, interest cannot be charged on those default sums during the period of non-compliance and for the period up to the twenty-ninth day after notice is given.</p> <p>These rules will apply in relation to agreements whenever made, but only to defaults arising, and default sums becoming payable, after the relevant provisions come into force.</p> <p>No compounding of interest on default sums</p> <p>Only simple interest will be payable on default sums. This will apply in relation to agreements whenever made, but only to default sums becoming payable after the provision comes into effect.</p>
15	Enforcement orders	<p>Subsections 127(3) to 127(5) of the Act shall cease to have effect. This means that agreements which would under the current section 127 be wholly unenforceable, due to a technical defect or the failure to provide the correct cancellation notice, will be enforceable by a court order. This will not however affect agreements entered into before the new provision comes into force.</p>

Clauses in the Bill

19–22	Unfair relationships	<p>The court will have wide powers to make an order against the creditor if it deems the relationship between creditor and debtor to be “unfair” to the debtor due to the terms of the agreement, the manner in which the creditor has exercised or enforced his rights under the agreement or any other thing done by or on behalf of the creditor.</p> <p>These rules will cover an agreement already in existence when these provisions come into force, provided that the agreement is still in existence at the end of a further transitional period of one year.</p> <p>This will replace the current extortionate credit bargain regime under sections 137-140 of the Act, which will cease to have effect.</p>
23–54	Licensing	<p>The OFT will be given far broader powers in relation to the CCA. This will include powers to charge different licensing fees to different licensees towards the costs in carrying out its CCA functions, to issue limited licences, to issue licences for limited or unlimited periods, to impose requirements on licensees, to require provision of information and to levy fines.</p> <p>Licences will be required for debt administration and credit information services, in addition to the current categories.</p> <p>The definition of “consumer credit business” and “consumer hire business” will be enlarged to cover, respectively, being a creditor, as well as providing credit and being an owner, as well as bailing/hiring goods.</p>
38–43	Power of OFT to impose requirements on licensees	<p>The OFT is to be provided with a new intermediate power to impose requirements:</p> <ul style="list-style-type: none"> • on licensees in relation to a business carried on (or proposed to be carried on) under the licence where it is dissatisfied with the business or conduct of the licensee or an associate or former associate of his • on the responsible person in relation to a group licence where the OFT is dissatisfied with the manner in which that person is regulating or otherwise supervising licensees, or proposes to do so. <p>This power will not be affected by whether the matters giving rise to the OFT’s concern arose before or after the relevant provisions come into force.</p> <p>The OFT will have to notify its intention to impose requirements on, or to fine licensees and must then allow representations to be made to it. It must also publish guidance and statements of policy as to how it intends to exercise its powers.</p>
47–48	Power of OFT to require access to premises and enter premises under warrant	<p>The OFT will have the power to require access to licensees’ premises at reasonable times and on reasonable notice in order to carry out its functions under the Consumer Credit Act.</p> <p>Where the OFT has reasonable grounds to believe that there is on the premises information in relation to which it could impose a requirement of access, and that such requirement would not be complied with or the information would be tampered with, it may obtain a warrant to enter and search the premises and to seize that information.</p>

Clauses in the Bill

52–54	OFT Power to Fine	Where a licensee fails to comply with a requirement under the intermediate power or a requirement to notify changes in their circumstances, the OFT may impose a civil penalty of up to £50,000 for each breach.
55–58	Consumer Credit Appeals Tribunal	Appeals will be allowed to a new body, the Consumer Credit Appeals Tribunal, in place of the current right of appeal to the Secretary of State. Appeals will then be allowed to the Court of Appeal on points of law, and then, with leave, to the House of Lords.
59–61	Financial Ombudsman Scheme (FOS)	The jurisdiction of the FOS is extended to hear complaints involving licensed persons under the 1974 Act not already covered by the FOS. Fees will be imposed on licensees to meet the costs of establishing and running the Consumer Credit jurisdiction of the FOS.

THE NEW UNFAIR RELATIONSHIP PROVISIONS

We will now look at the unfair relationship provisions of the Bill in more detail.

3 BACKGROUND

3.1 The unfair relationship provisions will replace sections 137 to 140 of the CCA, which allow a court to reopen a credit agreement if it finds that it is an “extortionate credit bargain”.

A credit bargain is extortionate if it:

“(a) requires the debtor or a relative of his to make payments (whether unconditionally or on certain contingencies) which are grossly exorbitant

(b) otherwise grossly contravenes ordinary principles of fair dealing”.

3.2 When deciding whether a bargain is extortionate the court can take a number of factors into account. These are:

- (a) interest rates prevailing when the agreement was made
- (b) age, experience, business capacity and health of the debtor
- (c) whether the debtor was under financial pressure when the agreement was made
- (d) the creditor’s risk relative to the value of any security

(e) the relationship between the debtor and creditor.

3.3 These provisions have not proved effective as a means of consumer protection. In over 30 years, it is thought that only 30 extortionate credit cases have been heard in court in which an extortionate credit bargain was claimed and the bargain held to be extortionate only in around 10 of these cases. The provision is ineffective for two main reasons:

- (a) The threshold is too high. Courts have been reluctant to find that a bargain was “grossly exorbitant” or otherwise “grossly” contravened ordinary principles of fair dealing in cases where the borrower represented a significant credit risk to the lender.
- (b) The test is applied only at the time the agreement is entered into. It does not allow the court to consider circumstances affecting the cost of credit (such as default charges) at any later stage.

3.4 Replacement provisions were considered in various DTI consultation papers prior to the publication of the Bill. These initially stated that new protections would apply to “unjust credit transactions”. Significantly, the DTI’s White Paper stated:

- “Any assessment [of unfairness] must be flexible enough to accommodate all

circumstances affecting the use of credit, *while giving certainty to all interested parties about what is acceptable and what is not.*”

- “Legislative factors and guidance from the OFT will give a clear message to businesses, the courts and, if appropriate, ADR adjudicators in determining the fairness of credit transactions.”
- “We will consult informally on developing our definition of an unfair credit transaction through our stakeholder group.... We intend that the OFT will have initial draft guidance available by the time these legislative proposals are considered by Parliament.

As we will now see, none of these aspirations has been fulfilled.

4. THE UNFAIR RELATIONSHIPS PROVISIONS

4.1 The provisions set out in clauses 19 to 22 go considerably further than contemplated by the DTI even in the White Paper. Clause 19 introduces a new section 140A as follows:

- (1) *The court may make an order... in connection with a credit agreement if it determines that the relationship between the creditor and the debtor arising out of the agreement (or the agreement taken with any related agreement) is unfair to the debtor because of one or more of the following:*
- (a) *any of the terms of the agreement or of any related agreement*
 - (b) *the way in which the creditor has exercised or enforced any of his rights under the agreement or any related agreement*
 - (c) *any other thing done (or not done) by, or on behalf of, the creditor (either before or after the making of the agreement or any related agreement).”*

These provisions have given rise to a number of concerns.

5. THE MAIN CONCERNS

5.1 Scope

The scope of the new provisions is extremely wide.

- (a) Section 140A(5) excludes regulated mortgage contracts *but not mortgages entered into before 31 October 2004*. It therefore covers most current mortgages, both securitised and non-securitised.
- (b) “Credit agreement” is defined as any agreement between an individual (the ‘debtor’) and any other person (the ‘creditor’) by which the creditor provides the debtor with credit of any amount (section 140C(1)).⁴
- (c) The relationship extends to “related agreements”. These are agreements consolidated by the main agreement, “linked agreements” (transactions financed by the credit agreement) and any security provided in relation to the above.⁵
- (d) The court has the power to review not just the credit transaction but the “relationship” between the debtor and the creditor arising out of the credit agreement and any related agreement as well.

5.2 The powers and obligations of the court

The court’s powers will arise on an application by the debtor or a surety, at the instance of the debtor or a surety in enforcement proceedings or at the instance of the debtor or a surety in any other proceedings where the amount paid or payable under the agreement is relevant.

- (a) The relevant powers and obligations (contained in sections 140A (2) to (4)) are as follows:
 - (i) The court may have regard to all matters it thinks relevant...
 - (ii) The court shall treat anything done (or not done by), or behalf of, or in

⁴ The extortionate credit bargain provisions also apply to unregulated consumer credit agreements.

⁵ A “credit bargain” includes agreements that have an impact on the APR of a credit agreement but do not include other agreements which would fall within the definition of ‘related agreement’.

relation to an associate⁶ or former associate of the creditor as if done (or not done) by, or behalf of, or in relation to, the creditor.

- (iii) The court may make a determination in relation to relationship, notwithstanding that the relationship may have ended.
- (b) If the court decides to make an order its powers are similar, but wider, than those contained in section 139 CCA. Section 140A(1) provides that an order... may do one or more of the following:
 - (i) require the creditor (or any associate etcetera) to repay any sum paid by the debtor or surety...
 - (ii) require the creditor (or any associate etcetera) to do or not to do (or cease doing) anything specified in the order...
 - (iii) reduce or discharge any sum payable by the debtor or any surety...
 - (iv) direct the return to the surety of any property...
 - (v) otherwise set aside (in whole or part) any duty imposed on the debtor or an surety...
 - (vi) alter the terms of the agreement or any related agreement
 - (vii) direct accounts to be taken... between any persons.

5.3 The reversal of the burden of proof

Section 140A(11) provides:

“If in any proceedings, the debtor or a surety alleges that the relationship between the creditor and the debtor is unfair to the debtor, it is for the creditor to prove to the contrary.”

Other than to assert unfairness, it seems that borrowers need to make little effort to bring a claim.

5.4 Retrospective application

- (a) The unfair relationship test will apply to all credit agreements made following the commencement of the new section 140B, including any which become completed before the end of the transitional period.
- (b) The test will apply to any agreement made before the commencement of section 140B which has not become a completed agreement by the end of the transitional period, that is those under which a sum is or may still be payable following the end of the transitional period.
- (c) The test will not apply to an agreement made before the commencement of section 140B which:
 - (i) is completed before the commencement of that section
 - (ii) becomes completed during the transitional period.
- (d) The court may continue to use sections 137-140 to reopen agreements which were made before the repeal of those sections and which:
 - (i) are completed before that repeal
 - (ii) become completed during the transitional period.
- (e) Applications under section 139 may continue to be made during the transitional period in respect of agreements made before the repeal of that section and which have not been completed. Provided application is made before the end of the transitional period, the court may use sections 137–140 to reopen the agreement which is the subject of that application even where the hearing continues beyond the transitional period.
- (f) An agreement is a completed agreement if:
 - (i) there is no sum payable under the agreement
 - (ii) there is no sum which will or may become so payable.
- (g) The transitional period is one year from the commencement of section 140B,

⁶ “Associate” is broadly defined in section 184 of the CCA to include relatives of an individual and in relation to a company, companies under the same ownership or control.

except in relation to related agreements. By section 68 of the Bill the Secretary of State may extend or further extend the transitional period.

- (h) Where a related agreement was made before the commencement of the new section 140C, no remedies under section 140B may be made in relation to that agreement if it was a completed agreement immediately before the earlier of:
 - (i) the date of the order under section 140B in relation to the main agreement
 - (ii) the end of the transitional period.Transitional period means one year from the commencement of new section 140C.

5.5 The meaning of ‘unfair’

Great uncertainty is caused by the lack of a definition of an “unfair relationship” in the Bill.

- (a) The Government Minister responsible for the Bill (Gerry Sutcliffe) has repeatedly refused to provide any definition of “unfair” in Parliamentary debates because he does not wish courts to have regard to Hansard reports as an aid to interpretation:⁷

“The new test will allow the courts to tackle unfair relationships, whatever form they take, and it is not constrained by artificial definitions, factors or illustrative lists of practices....”

“It is... important that the test does not constrain or impede the courts’ ability to do justice in every case. That is why I will not try to define an unfair relationship. It is for the courts to determine such things according to the relevant facts of each case. Unfairness is not a new concept for the industry, and fair lenders have nothing to fear from its introduction.”

⁷ Following the 1993 House of Lords decision in *Pepper v Hart* [1993] 1 All ER 42, it is open to the court, in certain circumstances, to have reference to the edition of Hansard covering the parliamentary debate surrounding a piece of legislation for interpretation of that legislation.

- (b) By avoiding debate of the meaning of “unfair”, there was no need to persuade the Houses of the requirements for rules in any particular area. Instead, the industry faces sweeping provisions which apply extremely broadly. By way of example, a “responsible lending” requirement, which might be required under the proposed new Consumer Credit Directive, is missing from the CCB. Parliament has not, therefore, formally considered issues raised by having such an obligation, which could well be imported by the unfair relationships provisions. Parliament, it seems, did not turn its collective mind to these considerations when passing these provisions through.

5.6 Fairness as a legal concept

It is for the court to determine what an “unfair relationship” is. In looking forward to how a court might approach this, we can draw helpful conclusions from the approach to fairness under other legislation, such as the Unfair Contract Terms Act 1977 and the Unfair Terms in Consumer Contracts Regulations 1999 and the rules made by the Financial Services Authority (“the FSA”) under the FSMA.

(a) Unfair Contract Terms Act 1977

The Unfair Contract Terms Act 1977, Schedule 2, refers to, “the strength of the bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer’s requirements could have been met”, when deciding the **reasonableness** of terms in certain contracts.

Section 11 sets out the “reasonableness test” for the Act, for both contract terms (subsection 1) and notices (subsection 2). In either case, the requirement of reasonableness is that... [the term or notice]... shall have been **fair and reasonable**” to be included, or relied on, as appropriate.

(b) **Unfair Terms in Consumer Contracts Regulations 1999**

The House of Lords in *Director General of Fair Trading v First National Bank* [2002] 1 AC 481 was concerned with the provisions of the Unfair Terms in Consumer Contracts Regulations 1994.

- (i) The court was referred to Regulation 4, which states, “unfair term’ means any term which contrary to the requirement of **good faith** causes a significant imbalance in the parties’ rights and obligations under the contract to the detriment of the consumer”, and to Schedule 2, which echoes the provisions of UCTA Schedule 2, then adds, “In making an assessment of good faith, particular attention shall be had to... (d) the extent to which the seller or supplier has dealt **fairly** and equitably with the consumer”.⁸
- (ii) Lord Bingham, giving the leading judgment, said that “a term falling within the scope of the Regulations is unfair if it causes a significant imbalance in the parties’ rights and obligations under the contract to the detriment of the consumer in a manner or to an extent which is contrary to the requirement of good faith. The requirement of significant imbalance is met if a term is so weighted in favour of the supplier as to tilt the parties’ rights and obligations under the contract significantly in his favour.”
- (iii) Usefully, Lord Bingham added that “the requirement of good faith in this context is one of fair and open dealing. Openness requires that the

terms should be expressed fully, clearly and legibly, containing no concealed pitfalls or traps.

Appropriate prominence should be given to terms which might operate disadvantageously to the customer. Fair dealing requires that a supplier should not, whether deliberately or unconsciously, take advantage of the consumer’s necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, [or] weak bargaining position.... Good faith... looks to good standards of commercial morality and practice.”

(c) **Financial Services and Markets Act 2000**

One of the regulatory objectives under section 5 of the Act is the protection of consumers.

- (i) Several of the FSA’s eleven Principles for Businesses directly support this regulatory objective of protecting consumers. Fairness is core to these Principles, for example:

Principle 6 – A firm must pay due regard to the interests of its customers and treat them **fairly**.

Principle 7 – A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, **fair** and not misleading.

Principle 8 – A firm must manage conflicts of interest **fairly**, both between itself and its customers and between customers and another client.

- (ii) In a 2001 paper⁹ the FSA attempted to explain (rather than define) fairness, but concluded that fairness is a flexible concept that could not and should not be defined.

- (iii) The FSA acknowledges that “fairness” correlates in some ways to better-known English law concepts such as “natural justice” and “equity” but is not quite the same. European

⁸ This case dealt with the 1994 Regulations, which were revoked and replaced in 1999. The 1999 Regulations removed the 1994 Regulations’ Schedule 2 because the 1999 Regulations followed more faithfully the substantive provisions of the 1993 EC Directive. As Schedule 2 to the 1994 Regulations repeated Recital 16 to the EC Directive, however, very little has been lost by the removal of the schedule in the 1999 Regulations: the good faith test will be interpreted by the courts in the light of the Directive and Recital 16.

⁹ Treating Customers Fairly After the Point of Sale – 2001.

jurisdictions use the term “good faith” in the context of financial services, and this is the test used in the Unfair Terms in Consumer Contracts Regulations 1999.

(iv) The FSA says that ultimately, fairness is flexible, contextual and not necessarily one-sided (customers must continue to take responsibility for their own decisions).

(v) The FSA has now identified the following broad themes for fair treatment:

Give the customer what they have paid for – ensure the customer fully understands the reality of the product sold.

Do not take advantage of the customer – avoid pushy sales tactics; do not sell inappropriate products to customers; do not allow the priorities of the provider to unduly influence the sale of a particular product.

Offer the customer the best product you can – both initially and in the ongoing relationship.

Do your best to resolve mistakes as quickly as possible – the provider should be prepared to acknowledge mistakes and make recompense where appropriate.

Show flexibility, empathy and consideration in dealing with customers – use discretion where customers have made honest mistakes; judge each case separately; the provider should err on the side of generosity.

Exhibit clarity in all customer dealings – terms and conditions should be as clear and as easy to understand as possible; changes or new features should be explained; messages should be consistent; avoid misleading language.

(vi) The FSA has stated that it aims to reduce the volume of specific rules to address particular fairness issues as its Treating Customers Fairly (“TCF”) principles-based approach takes effect.¹⁰ The FSA hopes that TCF will better achieve its regulatory aims, flexing to deal with different contexts and situations. The move is from a set of specific rules designed to achieve fair treatment of customers, to a principles-based approach under which fair treatment **becomes the rule.**

(vii) Indeed, the issues firms authorised under the FSMA are facing in trying to understand what they need to do to treat customers fairly, sets the scene for the problems awaiting the lending industry in coming to terms with the principles-based unfair relationships provisions of the Bill. Following investigation, research and consideration so far spanning four years, the closest the FSA has come to a definition of fairness is a list of “broad themes”.

(viii) In a situation in which the burden is on the lender to prove that the relationship was not unfair, lenders will not find this very comforting.

It took six years for a case to reach the House of Lords under the Unfair Terms in Consumer Contracts Regulations 1994. It might well be the case that authoritative guidance as to what to do to avoid an unfair relationship will not be available for at least a few years following implementation of the new provisions.

6. Conclusion

6.1 The Consumer Credit Bill, together with the changes made by secondary legislation over the course of the past year, brings major changes to the consumer credit regime. The consumer credit industry has not faced such an upheaval for 30 years.

¹⁰ Treating Customers Fairly. Building on Progress July 2005 pp. 40–41 (paragraphs 6.14 and 6.15).

6.2 Lenders have been able to assess the impact of most of the new provisions, affecting advertising, form and content of agreements, disclosure, early settlement and default rules. The impact of two aspects is however very difficult to assess:

- The OFT have in the past been accused of being a toothless regulator in enforcing consumer credit rules. The new Bill certainly gives the OFT teeth and the approach the OFT will take in relation to their new powers is unclear at the moment.
- The new unfair relationships provisions are extremely broad in scope and the key test of what is unfair is not defined. Lenders will also potentially become liable to actions under a range of agreements entered into at a time when the relevant terms did not infringe any applicable regulations. This gives rise to great uncertainty as to the scope of lenders' exposure to claims and will impede financial and operational planning and the assessment of what capital lenders will require.¹¹

This article was written by Roger Tym, of counsel in Lovells' financial institutions group. The article was first published in Butterworth's Journal of International Banking and Financial Law (November 2005)

¹¹ Under the capital adequacy requirement provisions of Basel II, one of the key aspects is the provision of capital for potential liability under claims and this includes regulatory compensation claims.

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