

**LESSONS LEARNED REVIEW**

**COMMISSIONED BY**

**THE NON-EXECUTIVE DIRECTORS OF**

**THE FINANCIAL CONDUCT AUTHORITY INTO**

**THE SUPERVISORY INTERVENTION ON INTEREST RATE HEDGING**

**PRODUCTS (IRHPs)**

**REPORT OF THE INDEPENDENT REVIEWER**

**JOHN SWIFT QC**

**26 NOVEMBER 2021**

**(amended on 7 February 2022\*)**

© John Swift QC copyright 2021

## **Legal Disclaimer**

This report (the "Report") has been prepared by John Swift QC as the Independent Reviewer commissioned by the Non-Executive Directors of the Financial Conduct Authority (the "FCA") to conduct a Lessons Learned Review (the "Review") into the supervisory intervention on Interest Rate Hedging Products ("IRHPs"), in accordance with the Protocol and the ToR set out in Appendix 2 and 3, respectively.

As described in more detail in Appendix 10 of this Report, John Swift QC has been assisted by a Support Team in the conduct of the Review, including in the preparation of this Report.

The views, findings, conclusions and recommendations in this Report are entirely those of John Swift QC and are not attributable to any member of his Support Team. The contents of this Report, including the views, findings, conclusions and recommendations expressed within it, are based upon John Swift QC's assessment of information provided to him and the Support Team by the FCA, Her Majesty's Treasury, and others, including by way of meetings with relevant individuals and witness evidence provided by the current and former employees of the Financial Services Authority ("FSA") and the FCA. The conclusions in this Report are therefore reliant upon the accuracy of the information provided to John Swift QC and his Support Team during the course of the Review, and the representations process referred to in the Preface. John Swift QC has not conducted an independent audit of the information made available to him. Public information and industry and statistical data are from sources identified, where appropriate, in the Report and have not been independently verified.

No representation or warranty is given as to the accuracy or completeness of any information or document relied upon in making findings and forming the views, conclusions and recommendations set out in this Report. Other people considering the same documents, information and materials might reach different conclusions from those reached by John Swift QC. To the extent permissible by law, John Swift QC and his Support Team accept no liability or responsibility and exclude any such liability or responsibility, whether in contract, in tort (including negligence), under statute or otherwise, in respect of any loss or damage (whether direct or indirect) suffered by any party: (i) as a result of, or in connection with the content of, or any omissions from, the

Report; and/or (ii) as a result of any actions taken or decisions made by any person as a consequence of the views, findings and lessons learned set forth in the Report. This disclaimer and exclusion of liability extends but is not limited to any references to or comments upon legal or regulatory requirements, standards, or guidance which reflect the views of John Swift QC. No responsibility is taken for changes in market conditions, laws or regulations and no obligation is assumed to revise this Report to reflect changes, events or conditions which occur subsequent to the date of publication of this Report.

If, and to the extent that, this Report includes any legally privileged material, such inclusion is made on the basis that privilege is not thereby waived or, alternatively, is only waived for the limited purposes of the Review, and is not intended to be any wider or a general waiver of privilege in that material. Any legally privileged material provided to John Swift QC and his Support Team has been provided for the specific purpose of carrying out the Review.

The Report's contents should not be relied upon by any parties other than the FCA for any purpose. No liability is accepted for any actions taken or not taken in relation to the Report's contents.

## CONTENTS

	<b>Page</b>
Glossary .....	6
Preface.....	14
Chapter 1 Executive Summary .....	21
Chapter 2 Legal and Regulatory Context.....	39
Chapter 3 Events leading to the introduction of the Initial Scheme (March to June 2012)....	81
Chapter 4 Main Scheme (July 2012 to January 2013).....	135
Chapter 5 Implementation of the Scheme.....	203
Chapter 6 Results of the Scheme .....	282
Chapter 7 Terms of Reference: Questions 1 to 4.....	295
<b>ToR 1</b> .....	296
<b>ToR 2</b> .....	316
<b>ToR 3</b> .....	337
<b>ToR 4</b> .....	368
Chapter 8 Lessons Learned/Recommendations .....	371
Appendix 1 – Chronology.....	393
Appendix 2 - Protocol.....	417
Appendix 3 – Terms of Reference .....	423
Appendix 4 – Draft Initial Agreement shared with banks on 25 June 2012.....	427
Appendix 5 – Initial Agreement .....	434
Appendix 6 – Supplemental Agreement.....	451
Appendix 7 - Letter from Clive Adamson to the banks dated 17 January 2013.....	458
Appendix 8 – Letter from Clive Adamson to the banks dated 29 January 2013 .....	472
Appendix 9 – Sales Standards.....	487
Appendix 10 – Biographies .....	489

## Glossary

Term	Definition
AIB	Allied Irish Banks p.l.c.
APPG	All-Party Parliamentary Group on Interest Rate Swap Mis-selling. A cross-party group founded in 2012 by Guto Bebb MP, which subsequently expanded its remit to become the All-Party Parliamentary Group on Fair Business Banking
Authorisations	An FSA/FCA division responsible for authorising firms and individuals operating in the financial market
bank or banks	Any one or more of the nine banks involved in the Scheme: AIB, Bank of Ireland, Barclays, Clydesdale, Co-op Bank, HSBC, Lloyds, RBS and Santander  (For the purposes of the Report, we have referred to the banks as those institutions were named as at 30 June 2012)
Bank of England	The central bank of the United Kingdom
Bank of Ireland	Bank of Ireland Group plc
Barclays	Barclays Bank PLC
BBA	British Bankers' Association
BLP	Berwin Leighton Paisner LLP
BIS	Department for Business, Innovation and Skills. A ministerial department of the UK Government from 2009 to 2016
The Board	The respective Boards of the FSA and the FCA. Where the Report refers to the Board, this is a reference to the Board's composition at the relevant point in time.
Bully-Banks	Campaign group set up in November 2011 to seek redress on behalf of SMEs impacted by the sale of IRHPs
Category A	As defined in the Initial Agreement (Appendix 5)
Category B	As defined in the Initial Agreement (Appendix 5)
Category C	As defined in the Initial Agreement (Appendix 5)
CBU	The Conduct Business Unit. An FSA/FCA executive committee which, during the Review Period, reported to its executive chairman and was responsible for overseeing the

	direction and activity of the operational platform of the FSA/FCA
CEDW Team	Complex Events Driven Work Team, sometimes referred to in FCA documents as the "Central" or "Complex Events" team.
Chancellor	The Government's chief financial minister with overall responsibility for the work of HMT
Clydesdale/NAGE	Clydesdale Bank PLC (part of National Australia Group Europe)
COB	The FSA's Conduct of Business sourcebook in force until 31 October 2007 (as defined in Section 1 of Chapter 2)
COBS	The FSA's Conduct of Business Sourcebook in force from 1 November 2007 (as defined in Section 1 of Chapter 2)
Complex Events Team	A team within the FCA's Event Supervision Department, which handles cases of complex event-driven work, including the Scheme
Companies Act	Companies Act 2006
Co-op Bank	The Co-operative Bank plc
CSRC	The Conduct Business Unit Supervision and Risk Committee. FSA/FCA committee which, during the Review Period, reported to ESRC and was responsible for taking or ratifying supervisory decisions about firm specific issues
Deloitte	Deloitte LLP
DSRC	The Divisional Supervisory Risk Committee. An FSA/FCA committee which, during the Review Period, reported to ERIC and was responsible for exercising oversight over the supervisory processes, supervisory decision making and risk portfolio within the FCA's supervision division
Enforcement	FSA/FCA division responsible for exercising the FSA/FCA's criminal, civil and regulatory investigation and enforcement powers
ERIC	The Executive Regulatory Issues Committee. An FSA/FCA committee which, during the Review Period, reported to ExCo and was responsible for taking decisions on regulatory issues escalated to it from across the FCA's divisions

ESRC	The Executive Supervision and Risk Committee. An FSA/FCA committee which, during the Review Period, reported to ExCo and was responsible for making supervisory decisions about firm specific issues that were referred to it
Event Supervision Department	A department within FSA/FCA's Supervision department
the Exchange of Letters	Letter from the FSA to each of the first-tier banks dated 29 January 2013, and subsequently to the second-tier banks, setting out further detail on the FSA's final position in relation to the Scheme Terms, including the detailed Annexes enclosed and the various responses from the banks
ExCo	The Executive Committee, one of the FCA's two most senior executive decision-making bodies. It oversees the FCA's general strategy, direction and activity.  Where the Report refers to ExCo, this is a reference to ExCo's composition at the relevant point in time.
Executive	The FSA/FCA's CEO, ExCo and sub-committees to whom responsibility was delegated.  Four people held the role of CEO during the Review Period; Hector Sants (July 2007 - June 2012), Martin Wheatley (Chief-Executive-designate, February 2011 – April 2013; CEO, April 2013 – September 2015), Tracy McDermott (Acting Chief Executive Officer, September 2015 - July 2016) and Andrew Bailey (July 2016 – March 2020).
EY	Ernst & Young LLP
FAQs	Frequently Asked Questions compiled by the FSA and provided to the Skilled Persons during the Pilot Review
FCA	The Financial Conduct Authority (as it became known on 1 April 2013)
FS Act 2012	Financial Services Act 2012
first-tier banks	HSBC, Lloyds, RBS and Barclays  Cumulatively these four banks sold 90 per cent of IRHPs during the Relevant Period
FOIA	Freedom of Information Act 2000
FOS	Financial Ombudsman Service



FSA	The Financial Services Authority. The predecessor of the FCA, which ceased to exist as such on 1 April 2013
FSA/FCA	A term used in the Report where the conduct described involves action by both the FSA and FCA, as applicable
FSB	Federation of Small Businesses
FSMA	Financial Services and Markets Act 2000, including relevant amendments
GCD	The General Counsel Division. An FSA/FCA department providing legal advice to other departments within the FSA/FCA
Grant Thornton	Grant Thornton UK LLP
HMT	Her Majesty's Treasury
HSBC	HSBC Bank PLC
Initial Agreement (See Appendix 5)	Agreement dated June or July 2012 between the FSA and each of the nine banks comprising: <ul style="list-style-type: none"> <li>• the Initial Settlement Agreement;</li> <li>• the Initial Written Undertaking; and</li> <li>• the Initial Appendix</li> </ul>
Initial Appendix	Appendix attached to the Initial Written Undertaking setting out the terms of the proactive redress exercise and PBR. One component part of the Initial Agreement
Independent Reviewer	John Swift QC
Initial Scheme	The FSA's scheme into the mis-sale of IRHPs to be conducted in accordance with the Initial Agreement (prior to its amendment by the Supplemental Agreement and the Exchange of Letters)
Initial Settlement Agreement	Substantive agreement between the FSA and each of the banks containing the Recitals and key terms of the Initial Agreement. One component part of the Initial Agreement
Initial Sophisticated Customer Criteria	The Sophisticated Customer Criteria in the Initial Agreement
Initial Written Undertaking	Undertaking provided to the FSA as a component part of the Initial Agreement pursuant to which the banks undertook to carry out a PBR

Intermediate Customer	As defined in paragraph 52 of Chapter 2										
IRHPs	Interest rate hedging products, as defined in Section 2 of Chapter 2										
	<table border="1"> <thead> <tr> <th>Type of IRHP</th> <th>Definition</th> </tr> </thead> <tbody> <tr> <td>Cap</td> <td>Defined in paragraphs 27-28 of Chapter 2</td> </tr> <tr> <td>Floor</td> <td>Defined in paragraphs 29-30 of Chapter 2</td> </tr> <tr> <td>Structured Collar</td> <td>Defined in paragraph 32 of Chapter 2</td> </tr> <tr> <td>Swap</td> <td>Defined in paragraph 25 of Chapter 2</td> </tr> </tbody> </table>	Type of IRHP	Definition	Cap	Defined in paragraphs 27-28 of Chapter 2	Floor	Defined in paragraphs 29-30 of Chapter 2	Structured Collar	Defined in paragraph 32 of Chapter 2	Swap	Defined in paragraph 25 of Chapter 2
	Type of IRHP	Definition									
	Cap	Defined in paragraphs 27-28 of Chapter 2									
	Floor	Defined in paragraphs 29-30 of Chapter 2									
Structured Collar	Defined in paragraph 32 of Chapter 2										
Swap	Defined in paragraph 25 of Chapter 2										
IRHP Review Central Team	FCA support team that reported Scheme-related issues to the IRS Steering Group										
IRS Steering Committee	The Interest Rate Swaps Steering Committee. An FCA team responsible for providing strategic direction to the Scheme										
IRS Steering Group	The Interest Rate Swaps Steering Group. An FSA/FCA team responsible for the delivery of the Scheme										
IRS Technical Group	The Interest Rate Swaps Technical Group. An FSA/FCA team created to discuss technical issues arising in relation to the delivery of the Scheme										
KPMG	KPMG LLP										
KWM	King & Wood Mallesons LLP										
Lloyds	Lloyds Banking Group plc										
Limitation Act	Limitation Act 1980										
Macfarlanes	Macfarlanes LLP										
Main Scheme	The FCA's scheme by way of supervisory intervention into the mis-sale of IRHPs to be conducted in accordance with the Scheme Terms										
Maxwellisation	The legal practice that allows persons who are to be criticised in an official report to respond prior to publication, based on details of the criticism received in advance										
MiFID	Markets in Financial Instruments Directive 2004/39/EC, its full title being Directive 2004/39/EC of the European										

	Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC
MTM	"Mark to market": a method of measuring the fair value of financial instruments that can fluctuate over time, by reference to current market conditions
OIVOP	Own Initiative Variation of Permission. A supervisory power available to the FSA under section 45 FSMA to vary a firm's permission without its consent. The equivalent power is available to the FCA under section 55J FSMA
Osborne Clarke	Osborne Clarke LLP
PBR	Past Business Review
Pilot Findings Paper	An FSA paper entitled " <i>Interest Rate Hedging Products – Pilot Findings</i> " published in January 2013 and amended in March 2013
Pilot Review	A limited customer file review undertaken by the banks and Skilled Persons between August 2012 and the end of January 2013, proposing redress outcomes for the FSA's consideration
Pilot Stage	The period between 1 July 2012 and 31 January 2013, during which the FSA undertook the Pilot Review
PPI	Payment protection insurance
PRA	Prudential Regulation Authority
Principles	The FSA/FCA's Principles for Businesses (PRIN)
Private Customer	As defined in paragraph 52 of Chapter 2
Professional Client	As defined in paragraphs 58-60 of Chapter 2
Promontory	Promontory Financial Group (UK) Limited
Protocol	The Protocol provided to John Swift QC in relation to the Review
RAO	The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/544
RBS	The Royal Bank of Scotland plc
RDC	The FSA/FCA's Regulatory Decisions Committee

Regulatory Requirements	Regulatory Requirements as defined in the Initial Agreement, meaning the Principles, rules and guidance contained in the FSA's Handbook
Relevant Period	The period from and including 1 December 2001 until 29 June 2012 (or such later date as any of the banks entered into the Initial Agreement)
Remuneration Code	As set out in the FCA Handbook
Requirement Notices	Notices written in accordance with section 166 FSMA. The FSA/FCA issued a number of Requirement Notices to the banks throughout the Scheme
Retail Banking	FSA/FCA division with oversight of the retail banking sector
Retail Client	As defined in paragraph 58 of Chapter 2
the Review	John Swift QC's Lessons Learned Review in respect of the FSA/FCA's supervisory intervention on IRHPs commissioned by the Non-Executive Directors of the FCA
Review Period	The period between 1 March 2012 and 31 December 2018 covered by the Review under the ToR
Sales Standards	Nine standards set out in the Initial Agreement against which the banks' sales of IRHPs were to be assessed as part of the PBR (See Appendix 9)
Santander	Santander UK plc
the Scheme	The FSA/FCA's supervisory intervention into the mis-sale of IRHPs comprising the Initial Agreement as amended by the Supplemental Agreement and the Exchange of Letters
Scheme Terms	The terms of the Initial Agreement, as amended and supplemented by the Supplemental Agreement and the Exchange of Letters
second-tier banks	AIB, Bank of Ireland, Clydesdale, Co-op Bank and Santander
SJ Berwin	SJ Berwin LLP
Skilled Person and Skilled Persons	Any one or more of those independent reviewers appointed by the banks pursuant to section 166 FSMA to oversee the PBR
SMEs	Small and medium-sized enterprises
SMCR	The FCA's Senior Managers and Certification Regime

Sophisticated Customer Criteria	Sophisticated Customer Criteria in the Supplemental Agreement
SPV	Special Purpose Vehicle. A subsidiary created by a parent company to isolate financial risk
Supervision	FSA/FCA division comprising of various committees and dedicated teams that supervise firms acting in different sectors
Supplemental Agreement	Agreement reached with each of the banks and the FSA during early 2013, which varied the terms of the Initial Agreement
Support Team	Legal advisers and a communications director appointed to assist the Independent Reviewer with the Review
TBLs	Tailored Business Loans (as described in paragraph 33 of Chapter 2)
TSC	Treasury Select Committee. A select committee of the House of Commons
ToR	Terms of Reference provided to John Swift QC in respect of the Review
VVOP	Voluntarily varying a firm's permission. The means by which a firm could apply to the FSA to vary its permission under section 44 FSMA. The equivalent power is available to the FCA under section 55H FSMA
7.5% Rule	The rebuttable presumption that a customer would not have purchased a product with break costs greater than 7.5% of the notional value of the IRHP in a pessimistic but plausible interest rate scenario

## Preface

### A. The context of this Review

1. In 2019, the Non-Executive Directors of the FCA commissioned an independent "lessons learned review" into the FSA's (and subsequently the FCA's) supervisory intervention on IRHPs, including the design, implementation, and oversight of the IRHP redress scheme. The FCA committed to such a review of its supervisory intervention on IRHPs in 2015, but this was deferred pending the conclusion of legal action relating to the Scheme.<sup>1</sup> I was appointed, following an interview process, in June 2019 as the Independent Reviewer for this Review.<sup>2</sup>
2. The FCA invited interested stakeholders to comment on the draft ToR for the Review. The ToR, which set out the scope of this Review, and the key questions to be addressed, were published by the FCA on 20 June 2019.<sup>3</sup> The Protocol, which sets out the procedures in accordance with which the Review is to be carried out, was published in August 2019.<sup>4</sup>
3. In September 2019, the FCA announced that my Support Team had been established<sup>5</sup> and informed interested parties of my contact details for the purposes of this Review.<sup>6</sup> The same press notice drew attention to an important limitation of the scope of the Review, namely that it *"is not intended to be a route by which the redress scheme or*

---

<sup>1</sup> The Financial Conduct Authority, "*Independent review of Interest rate hedging products*", 14 August 2019, accessible at <https://www.fca.org.uk/transparency/independent-review-interest-rate-hedging-products> (ARTICLE 017).

<sup>2</sup> The Financial Conduct Authority, "*Independent reviews of Interest Rate Hedging Products and the Connaught Income Fund Series I*", 20 June 2019, accessible at <https://www.fca.org.uk/news/press-releases/independent-reviews-interest-rate-hedging-products-and-connaught-income-fund-series-1> (ARTICLE 018).

<sup>3</sup> See Appendix 3.

<sup>4</sup> The Financial Conduct Authority, "*Independent review of Interest rate hedging products*", 14 August 2019, accessible at <https://www.fca.org.uk/transparency/independent-review-interest-rate-hedging-products> (ARTICLE 017). The Terms of Reference and Protocol are appended to this Report at Appendix 2 and 3.

<sup>5</sup> Biographies of the Support Team are at Appendix 10.

<sup>6</sup> The Financial Conduct Authority, "*Further details of Independent Investigation of Interest Rate Hedging Products announced*", 16 September 2019, accessible at <https://www.fca.org.uk/news/press-releases/further-details-independent-investigation-interest-rate-hedging-products-announced> (ARTICLE 015).

*individual cases can be reopened; nor is it intended to assess the appropriateness and reasonableness of individual offers."*<sup>7</sup>

4. My Support Team comprises a team of legal advisers with experience of banking, financial regulation and investigations from Ashurst LLP, as well as Nikolaus Grubeck and Kristina Lukacova, both of Monckton Chambers. The FCA also recommended that I should engage the services of a person or firm experienced in media and communications, and so Kenny Kemp joined my Support Team as communications director.

**B. The process for collecting evidence**

5. In late 2019, my Support Team and I began the process of collecting evidence for this Review, primarily by: (i) reviewing representations from members of the public and other interested parties, which were sent to a dedicated, independent electronic mailbox, (ii) interviewing witnesses with knowledge and experience of the Scheme (including current and former FSA/FCA employees, representatives from the banks and Skilled Persons involved in the Scheme, and IRHP customers and their representatives), and (iii) reviewing documents both in the public domain and disclosed to this Review by the FCA.

*i) Representations made to the Review mailbox*

6. While the primary focus of the ToR was the conduct of the FSA/FCA, and the lessons to be learned from the FSA/FCA's design and implementation of the Scheme, it was important for me to hear from a wide range of stakeholders. Shortly after the publication of the details of the Review mailbox (which was accessible only by my Support Team and me), I began to receive written submissions from a range of stakeholders. On 18 December 2019, the Review issued a press release inviting anyone affected by or involved with the FSA/FCA's IRHP Redress Scheme to send their views in writing to the Review mailbox. Though the press release asked for views to be shared by 31 January 2020, I continued to receive and review submissions sent after that date. In total, I

---

<sup>7</sup> The Financial Conduct Authority, "*Further details of Independent Investigation of Interest Rate Hedging Products announced*", 16 September 2019, accessible at <https://www.fca.org.uk/news/press-releases/further-details-independent-investigation-interest-rate-hedging-products-announced> (ARTICLE 015). I comment at ToR 3 below on the relevance of that limitation on the way on which I conducted the Review.

received written representations from over 35 individuals/institutions, often expressed in great detail and supported by extensive documentation. My Support Team and I are grateful to all those who took the time to share their experiences and reflections on the Scheme, and their suggestions as to the lessons to be learned by the FCA.

*ii) Witness evidence*

7. Between December 2019 and October 2020, my Support Team and I conducted 34 interviews with stakeholders, including former and current FSA/FCA employees, IRHP customers and their representatives, members of the APPG, representatives from banks, Skilled Persons, and HMT. Again, my Support Team and I are grateful for the time taken by all those who met with us in these meetings, which we found to be invaluable. Despite several attempts to contact him via the FCA, and through the addresses provided by the FCA and other information in the public domain, my Support Team and I were unable to secure the cooperation of Martin Wheatley, who was the CEO of the FSA/FCA during much of the Review Period.<sup>8</sup> We were otherwise able to speak with many of the key decision-makers at the FSA/FCA.
8. All of the interviews were recorded and transcribed. This Report refers to some of these interview transcripts which, save as quoted, remain confidential as between my Support Team and me, and the individuals and/or institutions in question (and their legal advisers, where applicable), in order to encourage the exchange of full and frank views for this Review and lessons learned exercise.
9. In accordance with the Protocol for this Review, all current or former FSA/FCA employees named in the Report who were below the level of Director during the Review Period have been anonymised. During the preparation of the Report, one former FCA

---

<sup>8</sup> The Review prepared letters addressed to Martin Wheatley which the FCA sent on 27 November 2019, 13 January and 30 April 2020. Additionally, the Review sought to contact Martin Wheatley through social media and by email on 4 March, 8 March, 11 March and 17 March 2020. On 23 July 2021, a further email was sent to Martin Wheatley. This email was sent to the same email address to which an earlier interview invitation had been sent. The purpose of the email was to inform Martin Wheatley that, subject to agreeing to a confidentiality undertaking, the Review would share with him extracts of the Report that may be regarded as potential criticisms of him and in relation to which he may wish to make representations. Martin Wheatley responded to this correspondence and provided the requested confidentiality undertaking. He was then provided with the relevant extracts of the Report; no comments on these were received.



employee below Director level, who provided significant evidence to the Review, requested that their anonymity be waived. Whilst the Review was content to agree to this request, the FCA took the view that this would constitute a departure from the Protocol and was not appropriate. The FCA expressed concerns that naming this individual could lead to other individuals becoming identifiable, or give rise to adverse inferences in relation to others not named. While not accepting that these concerns have been made out, the Review has nonetheless not named the individual so as to comply with the Protocol. Instead, it has, with that individual's agreement, designated the individual throughout the Report with the initial 'I'.

*iii) Documentary evidence disclosed by the FCA*

10. Given the length of time covered by this Review (1 March 2012 to 31 December 2018), and the number of FSA/FCA individuals and teams that worked on the Scheme at various points, it is unsurprising that the FCA holds a significant volume of documents pertaining to the Scheme.
11. In total, the Review received around one million documents. Initially the FCA disclosed three tranches of documents at the commencement of this Review (between 9 September and 1 October 2019), comprising nearly 900 documents (a significant proportion of which were in the public domain), which it considered likely to be relevant. These documents were the "tip of the iceberg", and my Support Team and I continued to receive documents in tranches over the coming months, with the bulk of the documents (around 770,000) being disclosed to us between 4 June and 15 July 2020. A further 142,000 documents were received between 15 July and 31 August 2020, and an additional 36,315 documents were disclosed in September 2020.
12. On 5 February 2021, the FCA disclosed to the Review the updates to the Skilled Person reports that it had received during 2020 and 2021.
13. On 30 March 2021, this Review received an extensive number of representations from the FCA in relation to a draft of the Report provided to the FCA on 8 February 2021. These representations cited a number of documents in support of the FCA's position,

some of which had not previously been provided to this Review.<sup>9</sup> Among these unseen documents was an email and attachment sent by an FCA employee to the FCA's CEO in early 2015. The attachment was of sufficient seriousness that this Review deemed it necessary to obtain further evidence from an FCA employee in that regard.

14. Finally, this Review identified some questions regarding the data reported by the FCA in its *"Progress of sales through stages of the review as at 30 September 2016"* chart; the FCA provided its response on 30 March and 12 May 2021.
15. Following standard document review processes commonly used in litigation and investigations involving large document volumes (such as the application of search and exclusion terms), my Support Team and I refined around one million documents received from the FCA into a more focused review population by identifying those documents most likely to be relevant. Such relevant documents included, amongst others, internal FCA emails, meeting notes and agendas, and correspondence with banks, Skilled Persons, customers and their Parliamentary and professional representatives that relate to the design and implementation of the Scheme. While the majority of these documents remain confidential to the FCA and other parties, I have on many occasions relied upon them in forming my opinions as to the questions in the ToR, as the best available contemporaneous record of the decisions made by the FSA/FCA during the Review Period.
16. In addition to the documents disclosed by the FCA by way of general disclosure, I also received: (i) documents responding to 57 supplemental document or information requests made by the Review, and (ii) FCA "work packages", a series of six sets of written submissions sent to me by the FCA in response to specific questions I asked, in order to help me to understand particular aspects or features of the FSA/FCA's organisation or systems.

### **C. Timing and preparation of this Report**

17. The sheer volume of documents disclosed by the FCA as being potentially relevant to the Review, and therefore requiring at least some degree of consideration, as well as the

---

<sup>9</sup> The FCA has confirmed that the late disclosure was unintentional and a result of an error.

timing of their disclosure posed a significant challenge to my ability to complete this Review within 15 months of my appointment (in other words, September 2020), as originally envisaged in the Protocol. In March 2020, given the impact of the COVID-19 pandemic, with its attendant restrictions on travel and changes to working practices, combined with the fact that my Support Team and I had not yet received the majority of the documents expected from the FCA, I requested an extension to the 15-month deadline outlined in the Protocol, which was accepted.<sup>10</sup> On 27 September 2021, the FCA indicated that the Report would be published by the end of 2021.

18. Having considered the evidence, this Review sets out conclusions on the questions posed by the ToR, as well as a detailed factual summary of the key events during the Review Period on which I have based my conclusions. At certain points, for necessary context, I have also commented on events that precede or post-date the Review Period.
19. In accordance with the principles of Maxwellisation,<sup>11</sup> and the Protocol for this Review, individuals and/or institutions (including the FCA itself)<sup>12</sup> potentially criticised in this Report have been given a reasonable opportunity to respond to any such criticisms prior to publication. The FCA has also undertaken a notification process by which any individual or institution named or identifiable in the Report is made aware of that fact prior to publication.
20. The Review has received extensive representations from the FCA and others. All these representations have been carefully considered and, where appropriate, have been expressly referred to in this Report. The Report does not expressly refer to, or deal with,

---

<sup>10</sup> The Financial Conduct Authority, "*FSA/FCA Interest Rate Hedging Products Lessons Learned Review deadline extended until early 2021*", 20 March 2020, accessible at <https://www.fca.org.uk/news/news-stories/fca-interest-rate-hedging-products-lessons-learned-review-deadline-extended-early-2021> (ARTICLE 014).

<sup>11</sup> The Treasury Committee, "*A Review of 'Maxwellisation'*", November 2016, accessible at <https://publications.parliament.uk/pa/cm201617/cmselect/cmtreasy/maxwellisation/a-review-of-maxwellisation-24-11-16.pdf> (ARTICLE 042).

<sup>12</sup> This Review provided the FCA with draft versions of the Report on 8 February 2021 and 2 June 2021. In addition, the FCA was provided with a copy of the Review's Lessons Learned/Recommendations on 21 April 2021 and the Executive Summary on 21 July 2021. On 30 March, 2 July, and 11 August 2021, this Review received representations on the Report from the FCA.

every representation which has been made. All representations have, however, been taken into consideration.

21. I finalised this Report and provided it to the Board of the FCA on 4 November 2021. On 19 November 2021, the FCA confirmed that it did not propose to make any further representations in addition to the representations it made previously. It proposed a small number of minor edits, which I have considered and adopted as appropriate. None of these edits affect the substance or conclusions of the Report. I delivered this Report to the FCA on 25 November 2021.
22. In accordance with the ToR and Protocol of this Review, publication of this Report is a matter for the Board of the FCA.

John Swift QC

26 November 2021

## Chapter 1

### Executive Summary

1. In 2013 the FSA entered into agreements with nine banks, which resulted in over £2.2 billion in compensation being paid by those banks to thousands of customers who had been mis-sold Interest Rate Hedging Products, or IRHPs, over the period from 2001-2011. This voluntary customer redress scheme, which was overseen by Skilled Persons approved by the FSA/FCA, was implemented from 2013 and was largely completed by 2016. It led to just over 20,000 IRHP sales to customers being examined and around 14,000 offers of basic redress and interest being accepted. The FSA's intervention that led to the creation of the Scheme, and the FSA/FCA's role throughout the period of its implementation were subject to intense scrutiny and criticism. This included legal actions and a report from the Treasury Select Committee, as well as a Parliamentary debate in the House of Commons on 4 December 2014 on the FCA's intervention on the mis-selling of IRHPs, both of which ultimately led to the appointment of the Independent Reviewer in 2019. Pursuant to the Independent Reviewer's duty to report to the Non-Executive Directors of the Board of the FCA, this Report considers the FSA/FCA's supervisory intervention over the period 2012-2018, in accordance with the ToR, and specifically the establishment and operation of the Scheme agreed between the FSA and the banks. It sets out the factual background and then makes findings in respect of the quality and effectiveness of the regulatory response. Section 1 of the Executive Summary summarises the factual chapters of the Report. Section 2 summarises the principal conclusions on the questions posed in the ToR, which are addressed in Chapter 7.

#### **Section 1 - Overview of the factual chapters**

2. **Chapter 2** sets out the relevant legal and regulatory context. First, it gives an outline of the FSA/FCA's status, role, and responsibilities. It then describes IRHPs (as well as TBLs<sup>13</sup>) and their regulatory status and sets out the relevant Principles and rules applicable to the sale of IRHPs as well as the related powers of the FSA/FCA. Finally,

---

<sup>13</sup> For the purposes of this Review, an IRHP is a financial instrument separate from any lending arrangements between a customer and a bank, as distinct from a TBL, a loan agreement with embedded swap/hedging terms. TBLs are addressed in Chapter 2, Section 2.

Chapter 2 considers the wider legal context in the form of claims in the civil courts concerning the alleged mis-sale of IRHPs.

3. In the simplest terms, an IRHP is a financial instrument which enables customers to manage, or 'hedge', their exposure to fluctuating interest rates. It is a contract for differences, the purpose of which is to secure a profit or avoid a loss by reference to fluctuations in interest rates. For example, an interest rate swap involves two parties agreeing to exchange one stream of future interest payments for another, based on a specified principal amount. In most cases, interest rate swaps include the exchange of a fixed interest rate for a floating rate. Changes in the variable rate of interest will determine which party is 'in the money' and which is 'out of the money' at any particular point in time over the duration of the IRHP.
4. Throughout the period considered by this Report, stand-alone IRHPs fell within the jurisdiction of the FSA/FCA. Their sale was subject to various regulatory rules, including the Conduct of Business Rules (known as COB before 1 November 2007 and COBS thereafter). The FSA/FCA had – and has – a range of relevant statutory powers at its disposal, such as the power to vary a firm's regulatory permissions, to establish a consumer redress scheme under section 404 FSMA, or to obtain restitution under sections 382 or 384 FSMA.
5. Outside the regulatory context, customers who claimed to have been mis-sold IRHPs were often unsuccessful in the civil courts and/or ineligible under the FOS.
6. **Chapter 3** describes the origins of the Scheme, following the sequence of events from March 2012 to the end of June 2012. By the end of this period, the FSA had taken two of the most important decisions regarding IRHPs, namely to: (i) enter into voluntary agreements with the first-tier banks, rather than exercising its statutory powers; and (ii) confine the scope of the entire Scheme to a subset of Private Customers/Retail Clients designated as 'non-sophisticated'. Chapter 3 sets out the process by which those decisions were made.

7. The FSA had become aware of concerns regarding the alleged mis-selling of IRHPs by March 2010 but had not, in its own words, "*joined the dots*"<sup>14</sup> until 2012. By March 2012, it was facing increasing public and political pressure to intervene. At this point, the FSA's understanding of the issue was still limited – it assumed, for example, that the mis-selling rate was only around five per cent, although it subsequently turned out to be over 90 per cent.<sup>15</sup>
8. By the end of April 2012, following an initial information-gathering exercise, the FSA reached the view that there was sufficient *prima facie* evidence of poor practices and poor consumer outcomes to pursue the matter. Further investigations revealed that about 30,000 sales of IRHPs to Private Customers/Retail Clients had been made between 2001 and 2011, with a surge in sales in 2005-2008.<sup>16</sup> In 2008, interest rates plummeted and thousands of customers found the mark-to-market value of their IRHPs materially changed, leaving them with significant losses if those IRHPs terminated early. Alternatively, customers were tied in under the IRHP contracts to pay far higher interest rates than the prevailing market rate for years to come; in some cases the IRHP contract terms extended well beyond the period of the underlying loan.
9. In May 2012, having considered the options available to it in considerable detail, the FSA decided against an immediate exercise of statutory powers to obtain redress, given the limited evidence available at the time. That left the FSA with two choices. The first option was to commission Skilled Person reports on IRHP sales to Private Customers/Retail Clients under section 166 FSMA, to inform any subsequent further response. The second option was to negotiate redress by way of voluntary agreements with the banks. In evaluating these choices, the FSA was under considerable time pressure, having committed to report to the public by the end of June 2012.
10. The FSA decided to commence negotiations with the banks with a view to securing customer redress by way of a voluntary agreement. Discussions with the first-tier banks began in mid-June 2012. By that point, the FSA had identified structured collars – a

---

<sup>14</sup> FCA Records, FSA CBU, *Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 3.

<sup>15</sup> See Chapter 3, Section 5, para. 78.

<sup>16</sup> See Chapter 3, Section 3, para. 32, Figure 1.

particularly complex IRHP – as a product that should never have been sold to Private Customers/Retail Clients, unless they "*truly understood*" the risks involved.<sup>17</sup> The FSA was therefore looking to the first-tier banks to provide proactive redress to the relatively small number of such customers who were deemed 'non-sophisticated' and who had purchased structured collars. In respect of the other types of IRHPs, the FSA expected the banks to carry out a PBR of sales to all Private Customers/Retail Clients and to provide fair and reasonable redress where there had been a breach of the Regulatory Requirements, including specified Sales Standards. That was the basis of the agreement initially proposed to the first-tier banks.

11. However, the FSA subsequently changed its mind. Following representations by some of the first-tier banks, the FSA agreed that the scope of the entire Scheme should be limited to 'non-sophisticated' customers, defined in accordance with the Initial Sophisticated Customer Criteria. Under these criteria, customers would be classed as sophisticated if they had at least two of: (i) a turnover of more than £6,500,000, (ii) a balance sheet total of more than £3,260,000, or (iii) more than 50 employees. In addition, customers (even if they fell below the quantitative criteria) would also have been classed as sophisticated if the relevant bank was able to demonstrate that, at the time of the sale, they had the necessary experience and knowledge to understand the service provided and the type of the product, including their complexity and the risks involved.
12. This Review examined the contemporary documents and heard evidence from FCA employees engaged in those discussions and decisions as the time. It has found no explanation why that change was agreed by the FSA. It was a very simple change – a stroke of the pen to change the defined expression "*Customers*" to exclude those who met the "*Sophisticated Customer Criteria*" – but one that ultimately resulted in the exclusion of about a third of all relevant IRHP sales from the scope of the Scheme. The conclusions regarding this far-reaching change are discussed further in Section 2 below and in ToR 2. There was no consultation with customers or their representatives before the FSA agreed with the first-tier banks to the limitation of the scope of the Scheme.

---

<sup>17</sup> See Chapter 3, Section 5, para. 56(a).



13. The agreements with the first-tier banks were publicly announced on 29 June 2012. Chapter 3 finishes with a description of that Initial Agreement,<sup>18</sup> which contained many of the component parts of the Scheme. However, much was left to be resolved before implementation of the Scheme could commence.
14. **Chapter 4** deals with the events following the announcement of the Initial Scheme up to the introduction of the Main Scheme, covering the period between 1 July 2012 and 31 January 2013.
15. Within a fortnight of entering into the Initial Agreement with the first-tier banks, the FSA entered into the Initial Agreement with the five second-tier banks. Skilled Persons had to be appointed. The banks preferred that candidates were vetted by the FSA with regard to their competence, capacity and independence. In parallel, the FSA also asked each bank to develop a methodology setting out the policies, processes and procedures it proposed to adopt during a "*Pilot Review*". It then reviewed the various methodologies, which would typically go through several iterations as a result of the FSA's requests for amendments.
16. By early October 2012, the FSA had given its approval for all of the first-tier banks to begin the Pilot Review. Each bank conducted a Pilot Review of between 10 to 50 cases. In the process, the principal components of the Scheme – Sales Standards, eligibility requirements and redress – were tested. Three key issues arose out of the preliminary findings of the Pilot Review: (i) the parameters of the Initial Sophisticated Customer Criteria, (ii) disclosure of break costs, and (iii) consistency of redress. Each of these issues is discussed in detail in Chapter 4.
17. As to eligibility, Chapter 4 describes how the original quantitative test set out in the Initial Agreement – based solely on the three criteria of turnover, assets and employees of the contracting customer – evolved into a far more complex set of criteria. One of the key changes was the introduction of a £10 million notional hedge threshold: a customer with an IRHP (or aggregated IRHPs) in excess of £10 million was deemed sophisticated. Further, where a customer was a member of a Companies Act Group, or a BIPRU Group, the £10 million notional hedge threshold applied to the aggregate hedges of the whole

---

<sup>18</sup> Included in full at Appendix 5.

group, regardless of the size of the individual customer's IRHP exposure. Again, there was insufficient stakeholder consultation before these changes became part of the Supplemental Agreement.

18. As to disclosure of break costs, Sales Standard 2<sup>19</sup> stipulated that the banks were required to have provided customers, in good time before the conclusion of a contract, with "*an appropriate, comprehensible and fair, clear and not misleading disclosure of any potential break costs.*" The FSA subsequently made clear that Sales Standard 2 could be satisfied in a number of ways, including by an explanation of what a break cost is and how any might apply to the customer, or an indication of the potential size (or scale) of any applicable break costs.<sup>20</sup> It indicated that the latter could be achieved "*by providing an indicative figure relevant to the product sold - or an explanation of how many applicable break costs could be calculated*".<sup>21</sup> The FSA came under significant pressure to water down that requirement, but it stood its ground.
19. To similar effect, on redress, what had started off as a broad test of what was fair and reasonable evolved into a complex set of rules. These included a hypothetical question, or counterfactual, as to what the customer would have done had the bank not been in breach. These issues are discussed further in ToR 3.
20. Chapter 4 ends with the publication of the FSA's report on the Pilot Review. One of the key findings was that over 90 per cent of the sampled cases involved breaches of the regulatory requirements. The sample proved to be remarkably accurate.
21. **Chapter 5** covers the implementation of the Scheme from February 2013 until the end of 2018, with a particular focus on the respective roles and responsibilities of the FSA, and later the FCA, the banks and the Skilled Persons.
22. It starts with the early stages of the implementation of the Scheme. In particular, between February and April 2013, there were several outstanding issues left to be addressed before the banks and Skilled Persons could commence their review. For example, Skilled

---

<sup>19</sup> As set out in the Appendix to the Initial Agreement.

<sup>20</sup> FCA Records, *FAQs for Skilled Persons*, 18 September 2012, 347285. See also Chapter 4, Section 2, para. 48.

<sup>21</sup> FCA Records, *FAQs for Skilled Persons*, 18 September 2012, 347285. See also Chapter 4, Section 2, para. 48.

Persons had to be appointed and each bank and its respective Skilled Person(s) needed to agree a revised methodology. Unlike at Pilot Stage, the FSA decided not to review the revised methodologies, but left this to the Skilled Persons.

23. Chapter 5 also looks more closely at the FCA's role in the implementation of the Scheme. Once the FCA assigned the responsibility of determining the outcome in individual cases to the banks and the Skilled Persons, the expectation was that its role would be one of only oversight. Yet, a range of issues emerged on which the FCA was required to provide guidance and direction regarding the interpretation and application of the Scheme Terms. This need for more substantive involvement by the FCA continued as the implementation of the Scheme progressed. While the FCA engaged on these points, its interventions were often on an *ad hoc* basis, with limited strategic consideration of what the nature and scale of the FCA's oversight should be.
24. Other matters discussed in Chapter 5 include the FCA's decision not to publish the Initial Agreement, the Supplemental Agreement and the Exchange of Letters, various significant issues which emerged during the implementation of the Scheme (such as interest payments and consequential loss), and the FCA's use of resources in the exercise of its supervisory jurisdiction. As to the latter, the FCA's oversight role was curtailed by the significant reduction in the amount of resource dedicated to the implementation of the Scheme compared to its establishment.
25. **Chapter 6** sets out some of the key statistics on the outcomes of the Scheme. Out of the 30,784 IRHP sales reviewed under the Scheme, 10,577 sales were excluded on the basis that they were assessed as sales to 'sophisticated' customers, while 20,207 sales were assessed as sales to 'non-sophisticated' customers. In respect of the latter, IRHP contracts were, in the great majority of cases, either cancelled, with a refund of all historical cash flows plus interest (colloquially referred to as "full tear-up"),<sup>22</sup> or replaced with caps. In a minority of cases, the IRHP contracts were replaced by other IRHPs, or no redress was offered. In an even smaller minority of cases, customers appear to have rejected (or failed to respond to) redress offers.

---

<sup>22</sup> See Chapter 4, Section 3, para. 105.

26. The data set out in Chapter 6 goes beyond the limited data previously published by the FCA, and beyond the disclosure provided by the FCA to the Review. Through access to the final reports of the Skilled Persons, the Review has been able to disaggregate much of the data bank-by-bank.<sup>23</sup> This data is relevant for any assessment of whether the Scheme produced consistent outcomes, which is further addressed in ToR 3.

## **Section 2 – Overview of the Review's conclusions**

27. ToR 1-4, which are set out in full at the end of this Executive Summary, raise over 20 sometimes overlapping issues. ToR 1 and 2 are concerned primarily with the FSA/FCA's approach to securing appropriate redress, whereas ToR 3 and 4 address mainly the outcomes of the Scheme. Chapter 7 deals with each of the issues, and sub-issues, following their sequence. The Executive Summary does not repeat every conclusion but focuses on only a number of principal findings.
28. As discussed in more detail in Chapter 7, the standard of review adopted by the Review is what was objectively reasonable, appropriate, and proportionate in all the circumstances. On that basis, FSA/FCA's conduct is assessed by the standard of an experienced, skilled and efficient regulator acting in accordance with its statutory duties and taking full account of the evidence available to it at the time of the decisions. The findings in the Report avoid the benefit of hindsight.

### **A. ToR 1: The FSA's approach to the intervention**

29. ToR 1 asks whether the FSA's approach to the intervention was a reasonable response to its concern about the mis-selling of IRHPs, including by reference to seven particular aspects of the FSA's approach. One of the key questions is whether, given the armoury of statutory powers available to it, the FSA acted reasonably in choosing the route of a voluntary agreement. Another is whether the FSA acted reasonably as regards the transparency of the Scheme.

---

<sup>23</sup> See Chapter 6, Section 1, para. 6, Figures 5 and 6.

*i) The use of a voluntary agreement*

30. This Review has found that a voluntary agreement was an appropriate way for the FSA to address its concerns about the sale of IRHPs to those eligible under the Scheme Terms. By 'locking' the banks into a review by reference to an agreed and rigorous set of Sales Standards, the voluntary redress scheme was a 'bird in the hand'. It meant that eligible customers gained an advantage compared to the use of statutory powers with less certain and likely slower outcomes. The use of a voluntary agreement also allowed the FSA greater scope in ensuring redress on the basis of its Principles for Businesses as well as the COB/COBS rules, which may otherwise have entailed lengthy and uncertain legal disputes with the banks. Finally, the use of a voluntary agreement allowed the FSA to obtain redress in relation to sales going back as far as 2001, avoiding potential limitation issues.
31. However, about 10,000 sales of IRHPs to customers designated by the FSA/FCA's rules as Private Customers/Retail Clients were excluded from the Scheme. That was about one third of the total, leaving customers with no relief other than through the courts, the FOS (only if they were an individual or a micro-business), or through the banks' existing complaints procedures. The Review has found that the voluntary Scheme was an inadequate regulatory response as regards those customers. Their exclusion is discussed further in ToR 2.
32. This Review has also found that the FSA/FCA should have put more focus on potential enforcement action in parallel with the Scheme. Each time this came up for consideration, the decision was taken not to institute enforcement proceedings against any of the banks or individuals. At best, only limited progress was made in preparing any potential enforcement action. This appears to have been partially driven by concerns about perceived risks to the implementation of the Scheme. However, it left the FSA without a viable fallback option and thus arguably in a significantly weaker bargaining position in establishing the Scheme. It also meant that elements of possible misconduct (other than those appropriate to be dealt with by way of a redress scheme) avoided any regulatory action – for example, potential issues such as inappropriate sales incentives and shortcomings in systems and controls were not addressed by the Scheme.

33. I have found that the FSA/FCA should have carried out a more intensive investigation of the root causes of the mis-selling before concluding not to pursue enforcement action. Nothing in the Scheme prevented that and it could have been done in parallel to the creation and implementation of the Scheme. With the benefit of such further investigatory work, the FSA/FCA would have been in a much better position to assess whether to pursue enforcement action in addition to the Scheme and, if so, to ensure accountability where appropriate.

*ii) Transparency*

34. This Review has found that in the period covered by the creation of the Scheme, the FSA fell below the appropriate standard of transparency. The FSA's principal failing on transparency consisted of the lack of consultation on: (i) the nature, terms and scope of the Scheme before it entered into the Initial Agreement, and (ii) the changes subsequently made to the Scheme following the Pilot Review.

35. As to the former, the FSA never disclosed to the public that the Initial Agreement deviated significantly from the proposals it had first put to the banks. The subsequent exclusion of 'sophisticated' customers, without adequate consultation with stakeholders, fell below the requisite standard of transparency.

36. As to the latter, so many changes were made to the initial 'sophistication' test – and thus to the criteria determining inclusion or exclusion from the Scheme – that this required a completely new document, the Supplemental Agreement. The FSA knew that these changes meant many customers who expected to be eligible based on the June 2012 announcement would cease to be so. Yet the changes were negotiated in last-minute confidential discussions with the banks. HMT – then the main shareholder of two of the first-tier banks – was the only other stakeholder closely involved in that process. It was not until the publication of the FSA's paper on the Pilot Review findings in January 2013 that customers realised the full extent of the changes. Again, I have found that the FSA's conduct fell short of the level of transparency that would have been appropriate.

37. I accept that there were regular communications with certain external stakeholders, including customers' representatives such as Bully-Banks, but key decisions were generally presented to these interlocutors as *fait accompli*. While adequate consultation,

in this context, does not necessarily have to be a formal consultation exercise, it does require providing a meaningful opportunity for all stakeholders to make representations on the planned course of action *before* decisions are taken. This was not done.

38. Moreover, I have found that during the period of the implementation of the Scheme, the FSA/FCA's communications to stakeholders, and the public generally, did not provide a level playing field between the banks (who were privy to all the information regarding the Scheme Terms) and the potential beneficiaries of the Scheme (who were not). The FSA/FCA provided information only in a piecemeal fashion across multiple, disparate website publications. One low point was the FCA's insistence, two years after the beginning of the implementation of the Scheme, that it could not provide details of the Scheme to Parliament; another that third parties were unable to access the Supplemental Agreement and the Exchange of Letters until 2015.
39. This Review has found that, in all the circumstances, the FSA/FCA did not strike the appropriate balance between the two public interest principles of transparency and the protection of confidential information. The FSA/FCA would have been able to comply with the principle of transparency without acting in breach of the law. Parliament has expressly provided for a number of disclosure exceptions, or 'gateways'. These allow relevant regulators to disclose confidential information in various circumstances, including for the purposes of enabling or assisting the FSA/FCA to discharge its public functions. Disclosure of the kind referred to in ToR 1 would arguably have fallen within one or more of these exceptions. Yet, I have seen no evidence that the FSA/FCA properly considered this and carried out the kind of balancing exercise that would have been appropriate. Further, to the extent that the FSA tied its hands by including a confidentiality clause in the Initial Agreement, it never should have agreed to a clause in those terms.

**B. ToR 2: The scope of the Scheme and the customer eligibility criteria**

40. ToR 2 concerns whether the scope of the Scheme was appropriate. The various sub-issues include the key questions whether customer eligibility requirements were appropriate, and whether it was right to exclude TBLs.

i) *Customer eligibility*

41. My main conclusion on the scope of the Scheme is that the FSA was wrong to confine it to a subset of Private Customers/Retail Clients designated as 'non-sophisticated'. I have found that this avoided, without adequate objective justification, the FSA's wider responsibilities vis-à-vis all Private Customers/Retail Clients who had been mis-sold IRHPs over the Relevant Period and to whom the banks owed the same regulatory obligations owed to 'non-sophisticated' customers.
42. Simply put, customers who fall within the same category have rights which the regulator has the corresponding duty to protect. This does not mean that there is no regulatory discretion, and that intervention for one must mean the same kind of intervention for all. However, if any subset of customers is to benefit from more advantageous treatment from the regulator, there should be an objective, well-evidenced justification for that treatment. That justification needs to be tested through a proper consultation process. That was not the case here.
43. Instead, when the FSA was asked to restrict the scope of the whole Scheme to 'non-sophisticated' customers, it did so after only the briefest consideration, and without sufficient involvement by the Board. There was no clear evidence as to how the eligibility test was identified as appropriate, nor of any impact analysis being conducted. The criteria were adopted with no adequate (formal or informal) consultation with stakeholders. Likewise, I have seen no evidence of any proper analysis or impact assessment regarding the subsequent changes to eligibility in the Supplemental Agreement discussed above.
44. Neither the 'old' eligibility test under the Initial Agreement, nor the 'new' test under the Supplemental Agreement, allowed a customer deemed 'sophisticated' to provide evidence that they did not in fact possess the "*expertise and skills needed to understand the risks*". Contrast that with the alternative subjective test available to the banks, which allowed them to establish, on a case-by-case basis, that a customer did have the relevant expertise or skills and should be excluded.
45. Moreover, a customer's knowledge and experience at the time of the contract does not relieve a bank from its obligations under the regulatory rules. It may be a relevant



consideration in determining whether the bank was in breach of regulatory requirements in any given case. However, the status of a customer, assessed by some measure of knowledge or experience or both, cannot give the bank an automatic regulatory 'free pass', to avoid the consequences of its own breaches. This applies especially in respect of IRHP sales where knowledge and experience would have been irrelevant (such as where the bank unreasonably insisted on a duration longer than the term of the loan, or unfairly and unnecessarily tied the purchase of an IRHP to the loan, each of which would be considered as a breach of the Regulatory Requirements). The subjective criterion, therefore, was also not appropriate.

46. In the event, in respect of some 10,000 excluded sales to customers, the banks were relieved of any responsibility under the Scheme to provide redress. Moreover, the FSA/FCA decided not to exercise its statutory powers beyond the Scheme. The failure to take any steps to consider whether sales of IRHPs to those customers had been in breach of the rules, and to consider the root causes and wider consequences of such conduct, is not consistent with the standard of an experienced, skilled and efficient regulator acting in accordance with its statutory duties.

*ii) The four corners of the jurisdiction: inclusion of IRHPs vs. exclusion of TBLs*

47. Unlike stand-alone IRHPs, TBLs were never within the scope of the FSA/FCA's jurisdiction. The FSA/FCA had no practicable, appropriate or legal basis upon which to mount the equivalent of an industry-wide scheme in relation to TBLs. In the circumstances, this Review has concluded that the FSA acted appropriately in confining the scope of the Scheme to stand-alone IRHPs.

**C. ToR 3: Did the Scheme deliver fair and consistent outcomes?**

48. ToR 3 asks whether, overall, the Scheme delivered fair and consistent outcomes for SMEs within the scope of the Scheme. Sub-issues (a) to (c) concern a number of discrete and important matters, including break costs, contingent liability, the approach to consequential loss, and the treatment of SMEs in financial difficulty or insolvency. Sub-issues (d) to (h) concern various checks and balances within the Scheme, such as the role of the Skilled Persons and the FCA's own oversight function. A detailed answer to each

of the sub-issues can be found in Chapter 7. However, this Executive Summary focuses on two overarching themes: regulatory accountability and consistency of outcomes.

*i) Regulatory accountability*

49. In each of the 30,000 or so cases considered under the Scheme, the FSA/FCA left it to the Skilled Persons to form a view on whether the banks were complying with the Scheme Terms. The banks would make a provisional decision, which the Skilled Persons would approve or reject. The credibility of the Scheme's implementation therefore fell largely on the shoulders of the Skilled Persons.
50. The terms of appointment of Skilled Persons provided some assurance that the banks would be monitored in a way that ensured they acted fairly in discharging their obligations. However, the FSA should have provided for an independent appeal mechanism. When it decided against that, while restricting its own role to that of (limited) supervision, it created a lacuna in the system of accountability. Skilled Persons had generally only limited engagement with customers and were not amenable to judicial review<sup>24</sup> (nor liable to them in either tort or contract),<sup>25</sup> leaving Scheme participants with only very limited scope to challenge any perceived or actual unfairness in how they were dealt with. Much of the dissatisfaction expressed to this Review as to the way the Scheme worked in individual cases could have been avoided, or at least mitigated, through the simple process of providing for a right of appeal to an independent tribunal or other body.
51. As to the FCA's oversight of the Scheme during the implementation period, its effectiveness was limited by the narrow functions it had reserved to itself under the Scheme, as well as by a lack of dedicated resource. This Review has also concluded that there was scope for more engagement by the Board in providing guidance and oversight before major strategic decisions were taken.
52. Whereas the FSA had committed substantial resources to the establishment of the Scheme during 2012 and the early part of 2013, subsequently the FSA/FCA left the

---

<sup>24</sup> As held by the Court of Appeal in R. (on the application of Holmcroft Properties Ltd) v KPMG LLP [2018] EWCA Civ 2093.

<sup>25</sup> No contract existed between customers and Skilled Persons and the Initial Agreement expressly excluded third party rights.

monitoring role to a very small unit with no legacy knowledge of the events leading to the creation of the Scheme.

53. In the event, the implementation process took around three years, with the FCA personnel assigned to overseeing this process extremely stretched in dealing with the problems that emerged. It was impressive what certain (relatively junior) FCA personnel were able to contribute towards the objective of achieving fair and consistent outcomes throughout the implementation of the Scheme. However, it is difficult to avoid the conclusion that had greater resources been made available, and clearer objectives been set beyond a general reactive and advisory function, the FSA/FCA's oversight role could have been significantly more effective.

*ii) Outcomes: fair and consistent overall?*

54. The ToR caution that "*the Review is not intended to be a route by which the redress scheme or individual cases can be re-opened; nor is it intended to assess the appropriateness and reasonableness of individual offers.*" This Review is thus in no position to assess individual redress decisions made in respect of each of the customers who participated in the Scheme.
55. Subject to that, and the other qualifications set out in Chapter 7, the evidence justifies the finding that, overall, the Scheme delivered fair outcomes for those customers within its scope. It led to just over 20,000 IRHP sales to customers being examined over a period of several years and around 14,000 offers of basic redress and interest being accepted, with £2.2 billion paid in compensation for losses (including a generous rate of interest at 8 per cent). The great majority of IRHP contracts examined were torn up or replaced with simple caps. Most eligible customers therefore obtained redress that met the objective of the Scheme and in all likelihood was 'better' from their perspective than any outcome they could have achieved outside the Scheme.
56. For those customers, despite the reservations expressed by this Review about various elements of the Scheme, the FSA/FCA's intervention was thus of significant direct benefit. Moreover, by holding the banks to the agreement that their conduct should be assessed by reference to exacting regulatory requirements including specified Sales Standards, the Scheme route to redress avoided many of the problems that might

otherwise have been encountered by such customers. In that respect, the FSA/FCA deserves considerable credit.

57. As for consistency, it is neither within the scope of the ToR nor practicable for this Review to comment in any detail on the inferences that might be drawn from the disaggregated figures. Suffice to say that, they appear to show some disparity between the banks as to the distribution of the outcomes. While this Review cannot go behind the assurances given by each of the Skilled Persons to the FCA in their Final Reports that their banks complied with their obligations under the Scheme (aimed at fair and consistent outcomes for customers of each bank), the quantitative evidence available does not enable this Review to conclude that there has been consistency of outcomes as between the customers of different banks.

**D. ToR 4: Was the redress exercise delivered in an effective and timely way?**

58. The FSA (and later the FCA) were unduly optimistic about the time it would take to deliver the Scheme. For example, in January 2013,<sup>26</sup> the FSA stated that it expected the banks to complete the review within six months or, for banks with larger review populations, within 12 months – yet, those expectations of the FSA on timing were more like exhortations to the banks and were not realistic. The evidence shows that nothing was 'ready to go' until April 2013. It was not until the autumn of 2015 that redress offers had been largely completed, with several cases taking significantly longer to resolve.<sup>27</sup>
59. The time and effort required to implement a Scheme of this magnitude must not be underestimated. The Scheme was regarded by one of the Skilled Persons as the most complex they had ever come across and the very high cost of the exercise was commensurate with its scale, covering over 20,000 cases.<sup>28</sup> There are, however, several lessons to be learned as to how such matters might be addressed in the future. These are considered in the Recommendations section, in Chapter 8 of the Report.

---

<sup>26</sup> See Chapter 5, Section 1, para. 28.

<sup>27</sup> See Chapter 5, Section 1, para. 18.

<sup>28</sup> See Chapter 5, Introduction, para. 3.

**E. ToR questions that the Review has been asked to address**

60. The questions set out in paragraph 5 of the ToR are listed below.

**Question 1:**

Whether the FSA's approach to the intervention, including the potential benefits over alternative options and parameters for the scheme, was a reasonable response to the FSA's concern about the mis-selling of IRHPs, including:

- a) The extent of the FSA's jurisdiction over sales of IRHPs
- b) The work undertaken to collate and analyse information and assess the extent of IRHP sales
- c) The use of a pilot scheme and development of the full scheme, including implementation of any learnings
- d) The voluntary nature of the scheme and whether, in light of [the] scope of the FSA's jurisdiction, it was an appropriate way to address concerns about the sale of IRHPs
- e) The appropriateness of the communication of the substance and operation of the scheme, including the issuing of guidance, to persons potentially affected by it
- f) The transparency of the scheme, including the confidentiality of the agreements with the firms
- g) The work to identify and maintain relationships with key internal and external stakeholders and the extent, nature and frequency of any communications.

**Question 2:**

Whether the criteria for eligibility to benefit from the scheme were appropriate, including:

- a) The scope of the scheme in light of the FSA's jurisdiction, including the definitions of SMEs who might benefit from it, the products covered and whether it was right to exclude commercial loans with mark-to-market break costs
- b) The different approach to remediation based on the complexity of the products.

**Question 3:**

Whether overall, the scheme delivered fair and consistent outcomes for SMEs within the scope of the scheme in a proportionate and transparent way, including:

- a) The approach to technical issues, such as but not limited to break cost, contingent liability, application of the sophistication criteria and alternative products as redress (swaps for swaps)
- b) The approach to consequential losses including the appropriateness of guidance given by the FSA, both formal and informal
- c) The treatment of SMEs in financial difficulty or insolvency
- d) Whether the involvement of the skilled persons appointed under s166 FSMA provided adequate assurance that the banks acted fairly in discharging their obligations under the IRHP agreements to achieve consistent outcomes
- e) The extent and effectiveness of the FSA's and later the FCA's oversight of the scheme, including the level of reliance on skilled persons and approach to ensuring consistency across firms and skilled persons
- f) Whether the agreements provided adequate mechanisms to allow SMEs within the scope of the scheme to challenge proposed redress offers
- g) The impact of SMEs' ability to refer their case to the Financial Ombudsman Service before their case has been resolved via the redress scheme
- h) The approach to monitoring firms' progress and the work of the skilled persons, including the production of management information.

**Question 4:**

Whether the redress exercise was delivered in an effective and timely way, including [...] the effectiveness of the FSA's and later the FCA's oversight of the timeliness of redress, and communications about timescale.

## **Chapter 2**

### **Legal and Regulatory Context**

**This Chapter considers the relevant legal and regulatory context during the Review Period by reference to the following four topics:**

- A. Section 1 considers the FSA/FCA's status, duties, objectives, rules and powers, including: (i) the statutory basis for its powers; (ii) where it fits in the wider constitutional structure (i.e. its interaction with and accountability to HMT and Parliament); (iii) its general objectives; and (iv) its general powers;**
- B. Section 2 describes IRHPs that are the subject of this Review. The Section also deals with TBLs;**
- C. Section 3 describes: (i) the regulatory status of both IRHPs and TBLs; (ii) the application of the FSA/FCA's Principles and its Conduct of Business rules both generally and specifically in respect of the sales of IRHPs; and (iii) the FSA/FCA's powers to investigate and deal with any breaches flowing from such sales; and**
- D. Section 4 considers the feasibility of commencing legal proceedings in the civil courts as a means of redress for those who claimed to have been mis-sold IRHPs.**

#### **Section 1 – The FSA/FCA's status, duties, objectives, rules and powers**

##### **A. Constitutional Position**

- 1. From 1 December 2001 until 31 March 2013, the FSA was an independent non-governmental body given statutory powers by FSMA in relation to the regulation of the financial services industry in the United Kingdom.
- 2. Following the Government's announcement in June 2010 that it intended to restructure the UK's financial regulatory framework, the FSA became the FCA from 1 April 2013 pursuant to the FS Act 2012. The FCA, like the FSA, derives its powers and duties from FSMA.
- 3. At the same time, the PRA took over prudential regulatory responsibilities for banks and large investment firms, along with building societies, credit unions and insurers.

4. While the FSA was operationally independent of the Government, it was nonetheless accountable to HMT Ministers and Parliament. Its powers were derived from FSMA, as amended from time to time, and as supplemented by delegated legislation and by the FSA's Handbook.<sup>29</sup>
5. The FCA is similarly an independent financial regulator whose statutory powers are derived from FSMA and delegated legislation. It too is accountable to HMT Ministers and Parliament. For instance, every year the FCA reports to HMT on its progress, including the extent to which it has advanced its objectives, through its annual report, which HMT is required to lay before Parliament. Additionally, the FCA appears before Parliament's TSC twice a year, in a general accountability hearing to scrutinise the FCA's work. The FCA is funded by the industry it regulates through statutory fee-raising powers and operates independently of the Government.
6. The FSA was governed by a Board, including a Chair, all of whom were appointed by HMT. The FCA continues to be governed by a Board with members comprising: a Chair and a Chief Executive appointed by HMT; the Bank of England Deputy Governor for prudential regulation; two non-executive members appointed jointly by the Secretary of State for BEIS (formerly BIS) and HMT; and at least one other member appointed by HMT. As with the FSA, the FCA's Board manages its senior executives and helps set the FCA's strategic direction as an organisation.<sup>30</sup> It also ensures that it has the necessary financial and human resources in place to meet its statutory objectives. The Board retains all decision-making powers except those which it has delegated to either a committee or an individual.
7. The ExCo is one of the highest-ranking executive decision-making bodies of the FCA. ExCo oversees the general strategy, direction and activities of the FCA, including

---

<sup>29</sup> The current version of the FCA's Handbook can be accessed online (see: <https://www.handbook.fca.org.uk/handbook>). This replaced the previous version of the Handbook, which can be accessed in the version made available on 30 August 2006 (<https://www.handbook.fca.org.uk/handbook/COB/?date=2006-08-30>).

<sup>30</sup> See Chapter 5, Section 2, paras. 65-72.



delivery of the annual business plan. It is responsible for monitoring the direction and performance of the organisation within the strategic framework set by the Board.<sup>31</sup>

## **B. Statutory Objectives and Duties under FSMA**

8. Set out below are the FSA's, and subsequently the FCA's, objectives pursuant to FSMA and relevant amendments.

### *i) The FSA objectives*

9. FSMA came fully into force on 30 November 2001.

10. In discharging its general functions, the FSA was required, so far as reasonably possible, to act in a way which was compatible with its five "regulatory" objectives:<sup>32</sup>

- a. market confidence: maintaining confidence in the financial system;
- b. financial stability: contributing to the protection and enhancement of the stability of the UK financial system;
- c. public awareness: promoting public understanding of the financial system;
- d. the protection of consumers (as to which see further below); and
- e. reduction of financial crime.<sup>33</sup>

11. As part of advancing those "regulatory" objectives, the FSA was also required to have regard to (so far as relevant):<sup>34</sup>

- a. *"the need to use its resources in the most efficient and economic way;*
- b. *the responsibilities of those who manage the affairs of authorised persons;*
- c. *the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in*

---

<sup>31</sup> See The Financial Conduct Authority, "Executive Committees", 8 July 2021, accessible at <https://www.fca.org.uk/about/executive-committees>

<sup>32</sup> Section 2(1) FSMA, as amended by section 1(2) of the Financial Services Act 2010.

<sup>33</sup> Section 2(2) FSMA, as amended by section 1(2) of the Financial Services Act 2010.

<sup>34</sup> The full list of relevant considerations were set out in section 2(3) FSMA, as amended by section 2(2) of the Financial Services Act 2010.

*general terms, which are expected to result from the imposition of that burden or restriction (...)"*.

12. In relation to the protection of consumers objective, section 5 FSMA provided:

*"(1) The protection of consumers objective is: securing the appropriate degree of protection for consumers.*

*(2) In considering what degree of protection may be appropriate, the Authority must have regard to—*

*a) the differing degrees of risk involved in different kinds of investment or other transaction;*

*b) the differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity;*

*c) the needs that consumers may have for advice and accurate information; and*

*d) the general principle that consumers should take responsibility for their decisions".<sup>35</sup>*

*ii) The FCA objectives*

13. Following the establishment of the FCA on 1 April 2013, it was given a new "strategic" objective of ensuring that the relevant markets function well. It had to exercise its general functions in a way which, so far as was reasonably possible, was both compatible with its strategic objective and advanced one or more of its "operational" objectives.

14. Those "operational" objectives are as follows:

a. the consumer protection objective: securing an appropriate degree of protection for consumers;

b. the integrity objective: protecting and enhancing the integrity of the UK's financial system; and

---

<sup>35</sup> Section 5 FSMA in its original terms.

- c. the competition objective: promoting effective competition in the interests of consumers in the markets for regulated financial services.<sup>36</sup>
15. In determining what degree of protection for consumers may be appropriate, the FCA is also required to have regard to, amongst other matters:
- a) *"the differing degrees of risk involved in different kinds of investment or other transaction;*
  - b) *the differing degrees of experience and expertise that different consumers may have;*
  - c) *the needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose;*
  - d) *the general principle that consumers should take responsibility for their decisions;*
  - e) *the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question;*
  - f) *the differing expectations that consumers may have in relation to different kinds of investment or other transaction; ...".<sup>37</sup>*
16. As part of its operational objectives, the FCA must maintain arrangements for supervising authorised firms.<sup>38</sup>

---

<sup>36</sup> Section 1B(3) FSMA, as inserted by section 6 FS Act 2012.

<sup>37</sup> Section 1C(2) FSMA.

<sup>38</sup> Section 1L FSMA.

17. Finally, the FCA has to apply a number of regulatory principles<sup>39</sup> in the discharge of its function, including: (i) the need to use resources in the most efficient and economical way,<sup>40</sup> and (ii) exercise its functions as transparently as possible.<sup>41</sup>

**C. Powers to Make Rules and to Give Guidance: the Handbook**

18. Under FSMA, the FSA (and subsequently the FCA) was given powers to make rules and provide guidance. Those rules and guidance are required to be published and are commonly referred to as the Handbook. The Handbook sets out the provisions made under the powers given to the FSA and FCA by FSMA. The Handbook is made up of instruments made by the Board to implement these provisions.
19. The Handbook is divided into blocks (sometimes referred to as "Sourcebooks" or "modules") and contains (so far as relevant):
- a. High-Level Standards, which contain overarching requirements, including:-
    - i. the Principles for Businesses,<sup>42</sup> which outline fundamental obligations of all regulated firms;<sup>43</sup>
    - ii. the Senior Management Arrangements, Systems and Controls,<sup>44</sup> which outline how firms are to manage and arrange their regulatory requirements;
  - b. Business Standards, which outline the day-to-day conduct rules that apply to all regulated firms. Most relevant for present purposes are the Conduct of Business rules (as contained in "COB" until 31 October 2007 and "COBS" thereafter);
  - c. Regulatory Process modules, which describe the operation of the FSA/FCA's supervisory and disciplinary functions as well as requirements for firms relating to the supervisory function:

---

<sup>39</sup> Section 3B FSMA.

<sup>40</sup> Section 3B(1)(a) FSMA.

<sup>41</sup> Section 3B(1)(h) FSMA.

<sup>42</sup> See the PRIN Principles for Businesses module of the FCA Handbook.

<sup>43</sup> See PRIN 1.1.2 G.

<sup>44</sup> See the SYSC Senior Management Arrangements, Systems and Controls module of the FCA Handbook.

- i. the Supervision manual,<sup>45</sup> which applies to every firm regulated by the FSA and FCA (with limited exceptions);<sup>46</sup> and
  - ii. the Decision Procedure and Penalties Manual,<sup>47</sup> which concerns the decision-making procedure and the giving of statutory notices, penalties and investigations;
- d. Regulatory Guides, such as the Enforcement Guide,<sup>48</sup> and
- e. Redress modules, such as the Consumer Redress Schemes sourcebook, which provides details of redress schemes under section 404 FSMA where there has been widespread or regular failure by a relevant firm to comply with requirements in respect of a specific activity and consumers have suffered loss which a court would remedy.<sup>49</sup>
20. Each of the relevant modules or Sourcebooks is discussed in greater detail below, including, where appropriate, how the rules and guidance have changed.

## **Section 2 – What are Interest Rate Hedging Products?**

21. IRHPs are a form of derivative.<sup>50</sup> They are financial instruments that can be used to modify a party's interest rate exposure. In the context considered by this Review, IRHPs were used to enable customers to manage (or hedge) their exposure to fluctuating interest

---

<sup>45</sup> See the SUP Supervision module of the FCA Handbook.

<sup>46</sup> See SUP 1A.1.1 G.

<sup>47</sup> See the DEPP Decision Procedure and Penalties Manual contained of the FCA Handbook.

<sup>48</sup> See the EG The Enforcement Guide contained in the FCA Handbook.

<sup>49</sup> See the CONRED Consumer Redress Schemes Sourcebook contained in the FCA Handbook.

<sup>50</sup> A derivative is defined in International Financial Reporting Standards 9 (Appendix A) as a financial instrument or other contract within the scope of IFRS 9 with all three of the following characteristics:

(a) its value changes in response to changes in the "underlying", i.e. the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable (in case of a non-financial variable, the variable must not be specific to a party to the contract);

(b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts with a similar response to changes in market factors; and

(c) it is settled at a future date.

They include financial instruments such as options, warrants, futures contracts, forward contracts, and swaps.

rates on the money they borrowed from banks. They are a financial instrument separate from any lending arrangement between relevant customers and their banks. This is similar to the definition used in the Scheme and is to be distinguished from bank/customer loan agreements which include embedded terms that operate in a manner similar to IRHPs.

22. The IRHPs that are the subject of this Review were invariably bespoke, individually negotiated "over the counter" (OTC) transactions rather than standardised exchange-traded derivatives. Such bespoke OTC transactions may be documented in a variety of transactional forms, but were frequently entered into under a standard form Master Agreement published by the International Swaps and Derivatives Association: the "ISDA Master Agreement". The ISDA Master Agreement is used in conjunction with a schedule tailored to the customer/bank relationship and a transaction-specific "confirmation" or "confirm", which would ordinarily specify terms such as the notional amount of the IRHP, the relevant interest rates and any cap, floor, and/or collar arrangements.<sup>51</sup> Each of these concepts is described further below.
23. IRHPs have an ongoing value over their duration or "tenor". Under fair value accounting, banks perform a calculation known as "mark to market" ("MTM") on an ongoing basis and accordingly will regularly reassess the value of the IRHPs in their books. In simple terms, the banks calculate the net present value of the respective expected cash flows under the interest rate swap or other product according to a series of generally accepted conventions. The present value of the future cash flows is obtained by discounting the respective cash flows at market rates. In more complex transactions, such as those involving floors, caps or other components, the MTM of the transaction will be the sum of the MTMs of each component.<sup>52</sup>
24. Set out below is a brief explanation of each of the main types of IRHPs that were the subject of the Scheme.

---

<sup>51</sup> Lomas -v- JFB Firth Rixson Inc [2010] EWHC 3372 (Ch) per Briggs J, 7 and 8.

<sup>52</sup> Dexia Crediop S.p.A. -v- Comune di Prato [2015] EWHC 1746 (Comm), per Mr Justice Walker, 39.

i) *Interest rate swaps*

25. Interest rate swaps are agreements between two parties whereby the customer "swaps" one type of interest payment obligation (often, a floating rate) for another interest payment obligation (often, a fixed rate). Under a simple interest rate swap, Party A (in the context of the Review, ordinarily the customer) agrees to pay Party B (ordinarily the bank) a predetermined payment based on, for example, a fixed rate of interest on a notional principal on specific dates for a specified period of time. Concurrently, Party B agrees to make payments based on a floating interest rate to Party A on that same notional principal on the same specified dates for the same specified time period. The customer continues to make its usual interest payments under the loan. In practice, parties only pay the difference between the fixed and variable interest amounts. A floating to fixed swap represents the position of a customer exchanging their floating interest rate for a fixed rate. Since the customer's floating interest rate obligation may fluctuate from time to time in line with changing market conditions, the economic effect for the customer of entering into a floating to fixed interest rate swap is that the customer will not benefit if there is a fall in interest rates (i.e. its periodic loan interest payments will fall if interest rates reduce, but it will make offsetting payments<sup>53</sup> under the interest rate swap). On the other hand, the customer will not face exposure to rising rates (i.e. its periodic interest payments will rise if interest rates increase, but they will receive payments under the interest rate swap offsetting the increase in interest payable).<sup>54</sup> The customer therefore has certainty about what their payment obligations will be over the life of the loan. Interest rate swaps are widely used by those wishing to protect themselves against the impact of a change in interest rates. Depending upon the directional movement of interest rates, the swap could work to the economic advantage or disadvantage of the customer when compared with

---

<sup>53</sup> Where the parties have agreed only to pay the difference between the fixed and variable interest amounts, the customer will pay the swap counterparty the difference between the now lower variable rate and the fixed rate.

<sup>54</sup> Where the parties have agreed only to pay the difference between the fixed and variable interest amounts, the customer will be paid by the swap counterparty the difference between the now higher variable rate and the fixed rate.

their floating rate interest exposure, and that would have an equal and opposite impact on its bank counterparty.

26. Interest rate swaps have been considered in a number of English court cases and this Review adopts a number of the definitions accepted by the English courts.<sup>55</sup>

*ii) Interest rate caps*

27. An agreement to enter into an interest rate cap involves one party (the seller of the cap, ordinarily the bank in the context of this Review) agreeing to pay to the other party (the buyer of the cap, i.e. the customer) sums equivalent to a floating interest rate above a specified level (known as the cap or ceiling) if interest rates increase above that level based upon a notional principal on specific dates and for a specified period of time. The economic effect of buying an interest cap is that the customer fixes the maximum interest level they will need to pay on any borrowing.

28. Ordinarily, a cap is bought for a premium payable to the seller (the bank) by the buyer (the customer) at inception of the trade – an 'upfront premium - rather than the cost being incurred over time'. The lower the level of the cap rate, the higher the upfront premium. A cap would work to the customer's advantage in the event that interest rates rose above the level of the cap but could not have a negative economic impact (save for the upfront premium cost). As such, unlike swaps and collars (the latter are described below), an interest rate cap will not have a potentially negative mark to market or break cost for the customer on early termination.

*iii) Simple interest rate collar*

29. An interest rate collar is a financial instrument that includes both an interest rate cap component or "leg" coupled with an interest rate floor component or "leg".

---

<sup>55</sup> See, for example: Mr Justice Walker in Dexia Crediop S.p.A. -v- Comune di Prato [2015] EWHC 1746 (Comm), paras. 33-40; and Mr Justice Andrew Smith in Credit Suisse International -v- Stichting Vestia Groep [2014] EWHC 3103 (Comm), para. 44. In addition, the FCA intervened in the case of John Green and Paul Rowley -v- Royal Bank of Scotland plc [2013] EWCA Civ 1197, and the FCA's Counsel's skeleton argument also included a useful description of the different types of IRHPs/swaps relevant to the FSA's Scheme: FCA Records, *Email attachment*, 23 August 2013, 1276769, Schedule C, p. 19.



30. A floor operates in the opposite way to a cap. It is an arrangement under which one party (the seller of the floor) agrees to pay the difference between a floating rate and a specified level (known as the floor) to the other (the buyer of the floor), if the floating rate falls below that specified level. If the floating rate falls below the floor, then the seller (usually the borrower/customer) makes a payment to the buyer (usually the bank) calculated by applying the difference between the, now lower, prevailing interest rate and the floor level to the notional sum. In particular, the floor component was ordinarily only "sold" by the customer in combination with buying the benefit of a cap, thereby avoiding the need to pay the simple cap's upfront premium.
31. As identified by the FCA in John Green and Paul Rowley v The Royal Bank of Scotland plc<sup>56</sup> ("Green and Rowley"), often a collar "*is sold by banks to small businesses as a means of 'limiting' interest rates within certain pre-agreed levels*".<sup>57</sup> An interest rate collar protects the borrower against the risk that the floating rate interest may exceed the collar ceiling. However, the borrower sacrifices what it would otherwise gain if the floating rate of interest drops below the floor.

iv) *Structured interest rate collar*

32. A more complex form of IRHP is a structured collar which is similar to a simple interest rate collar as a means of "limiting" interest rates within certain pre-agreed levels. However, while the cap leg may operate in a similar way, the floor is more complex. Under a structured collar, the customer can be required to pay an extra amount if the floating interest rate falls below the level of the floor. For example, if the prevailing floating rate of interest were to drop by, for example, 1 per cent below the floor, the terms of the structured collar may require the customer to pay not only that 1 per cent difference applied to the notional sum, but a further 1 percentage difference applied to the notional sum.

---

<sup>56</sup> [2013] EWCA Civ 1197.

<sup>57</sup> See FCA's Written Submissions in Green and Rowley; FCA Records, *Email attachment*, 23 August 2013, Schedule C, p. 20.

- v) *Loan agreements with embedded swap/hedging terms, sometimes also referred to as Tailored Business Loans – TBLs*
33. Loan agreements which include embedded swaps or hedging terms are products that combine a loan and an interest rate hedge in one agreement. These are distinct from the IRHPs described above, which are stand-alone agreements separate from lending arrangements. These TBLs were sold to SMEs in very similar ways to stand-alone IRHPs and incorporated within them many similar features to stand-alone IRHPs. From a borrower's perspective, they had a similar effect to stand-alone IRHPs. For instance, the cash flows payable under the loan (i.e. the interest rate) mirror the net cash flows payable under a variable rate loan with a separate IRHP. Additionally, upon termination of such loans by the customer, the borrower would be obliged to cover the economic value or cost to the bank of termination of embedded swap terms (or would benefit from any gains, if the mark to market was positive). Therefore, even though the borrower has not entered into a stand-alone hedging trade, the potential break costs of the hedging are "embedded" in the loan and, as noted by the FCA, "*are calculated in the same way as the cost to exit a separate IRHP – i.e. on a mark-to-market basis (except for caps)*".<sup>58</sup>

### **Section 3 – Regulatory status of IRHPs and the relevant Principles and rules in relation to sales of IRHPs**

#### **A. The regulatory status of IRHPs**

34. "Regulated activities" are carried on within the meaning of section 22 FSMA if carried on by way of business in relation to investments of a specified kind ("specified investments"). The RAO determines what activities constitute regulated activities, which include (amongst others):
- a. dealing in investments as principal (article 14 of the RAO);
  - b. dealing in investments as agent (article 21 of the RAO);
  - c. arranging deals in investments (article 25 of the RAO); and

---

<sup>58</sup> FCA Records, *Memorandum – 'Embedded' interest rate hedging products ('IRHPs')*, 13 March 2013, 450178, p. 1.

- d. advising on investments (article 53 of the RAO).
35. The RAO also establishes what instruments shall be regarded as "specified investments". Under article 85 of the RAO<sup>59</sup> these include "Contracts for differences etc." which are described as rights under:
- a. *"a contract for differences; or*
  - b. *any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in –*
    - i. *the value or price of property of any description; or*
    - ii. *an index or other factor designated for that purpose in the contract."*
36. The purpose of stand-alone IRHPs is to secure a profit or avoid a loss by reference to fluctuations in interest rates.<sup>60</sup> Stand-alone IRHPs are and were during the Relevant Period regarded for regulatory purposes as contracts for differences ("CFDs") under article 85 of RAO.<sup>61</sup> They were recognised by the FSA as being CFDs<sup>62</sup> and as such were treated as regulated financial instruments falling within the FSA's (and later FCA's) regulatory remit.<sup>63</sup>
37. In contrast to the position in relation to stand-alone CFDs, TBLs were essentially commercial lending contracts not covered under the relevant regulation. Therefore, entering into or terminating such contracts did not constitute a regulated activity. TBLs,

---

<sup>59</sup> The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/544, article 85(1).

<sup>60</sup> See the letter addressed from FCA employee RS to Andrew Tyrie MP, then Chairman of the Treasury Select Committee: FCA Records, *Letter*, 26 June 2014, FCA-ADD-0051, p. 2.

<sup>61</sup> FCA Records, *Letter*, 26 June 2014, FCA-ADD-0051, p.2.

<sup>62</sup> See FCA employee P's email: FCA Records, *Email*, 18 July 2012, 294237.

<sup>63</sup> MiFID revised the Investment Services Directive (93/EC/EEC) of 10 May 1993, which set out the conditions on which authorised investment firms and banks could provide specified investment services. The Directive applied to the financial instruments listed in section B of the Annex, which included interest rate swaps and related products. Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [2004] OJ L145/1; Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field [1993] OJ L141/27.

thus, fell outside of the FSA/FCA's remit, despite their economic similarities to IRHPs. From an early stage, the FSA had concluded that TBLs would be excluded from the scope of the Scheme, on the basis that they fell outside of the FSA's regulatory perimeter.<sup>64</sup> This is discussed in more detail in Chapter 5.<sup>65</sup>

## **B. The relevant Principles and rules**

38. The FSA, and later the FCA, applied a hierarchy of "Principles" and more granular rules in relation to the carrying on of regulated activities. Set out below is:

- a. a general account of their operation, including how the FSA and FCA required customers/clients of regulated firms to be classified for the purposes of applying the Principles and rules; and
- b. how they applied specifically to the sales of IRHPs.

### *i) Principles for Businesses (PRIN)*

39. The Principles for Businesses module consists of 11 Principles. The Principles are a general statement of fundamental obligations of firms under the regulatory system.<sup>66</sup> These Principles apply in whole, or in part, to all authorised firms.<sup>67</sup> They derive their authority from the FCA/FCA's rule-making powers in FSMA and reflect their statutory objectives.

40. From 2001, all regulated firms must act in accordance with the Principles, which have remained largely unchanged since their inception.

41. Breaching a Principle makes an entity to which the Principles apply liable to disciplinary sanction. What constitutes a breach of a Principle will be determined by the standard of conduct required by the Principle in question.<sup>68</sup>

---

<sup>64</sup> FCA Records, *Email*, 16 July 2012, 002677.

<sup>65</sup> See Chapter 5, Section 3, paras. 143-48.

<sup>66</sup> PRIN 1.1.2 G.

<sup>67</sup> PRIN 1.1.1 G.

<sup>68</sup> PRIN 1.1.7 G.

42. The Principles are also relevant to the FSA/FCA's powers of information-gathering, varying a firm's permission, and of investigation and intervention. They provide a basis on which the FSA and FCA may apply to a court for, for example, a restitution order or to require a firm to make restitution.<sup>69</sup> A breach of a Principle does not, however, give rise to action for damages by a private person, as discussed further below.<sup>70</sup>
43. The Principles of particular relevance to this Review are as follows:

<p>(...)</p> <p><u>6 Customers' interests</u></p> <p><i>A firm must pay due regard to the interests of its customers and treat them fairly.</i></p> <p><u>7 Communications with clients</u></p> <p><i>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.</i></p> <p><u>8 Conflicts of interest</u></p> <p><i>A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.</i></p> <p><u>9 Customers: relationships of trust</u></p> <p><i>A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.</i></p>
--

44. Principles 6 and 7 are supplemented and amplified by the COB and COBS rules, including the client categorisation rules, as relevant. These are discussed further below.

ii) *Systems and Controls Sourcebook (SYSC)*

45. A firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business. The nature and extent of those systems and controls which

---

<sup>69</sup> PRIN 1.1.8 G.

<sup>70</sup> PRIN 3.4.4 R. and see para. 101 below.

a firm must maintain will depend on a number of factors, including the nature, scale and complexity of its business and the degree of risk associated with each area of operation.<sup>71</sup> The relevant rules are contained in the SYSC module, the purpose of which is to require firms to establish and maintain governance and controls in respect of their businesses. These rules are designed: (i) to encourage firms' directors and senior managers to take appropriate practical responsibility for their firms' arrangements on matters likely to be of interest to the FSA/FCA because they impinge upon the FSA/FCA's statutory objectives under FSMA, and (ii) to create a common platform of organisational and systems and controls requirements for regulated entities.<sup>72</sup> It also amplifies Principle 3, which requires firms to take reasonable care to organise and control their affairs responsibly and effectively with adequate risk management systems.<sup>73</sup>

*iii) Regulating conduct of business of authorised firms: COB and COBS*

46. During the Relevant Period, the FSA regulated authorised firms' conduct through the obligations set out in the Handbook.
47. Prior to 1 November 2007, the rules regarding authorised firms conducting regulated business were broadly contained in the "Conduct of Business sourcebook" or "COB" (in addition to the Principles).<sup>74</sup> With effect from 1 November 2007, the Handbook was amended in order to implement MiFID and its implementing legislation.<sup>75</sup> MiFID entered into force on 21 April 2004 and was supplemented on 10 August 2006 by the MiFID implementing Directive. MiFID was implemented by revision of the FSA rules on 1 November 2007, which were (amongst others) contained in the renamed "Conduct of Business Sourcebook", known as "COBS".<sup>76</sup>

---

<sup>71</sup> SYSC 3.1.1 R and SYSC 3.1.2 G.

<sup>72</sup> SYSC 1.2.1 G.

<sup>73</sup> SYSC 1.2.1 G.

<sup>74</sup> The COB Conduct of Business sourcebook in the, now replaced, FSA's Handbook.

<sup>75</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [2004] OJ L145/1; and Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive [2006] OJ L241/26.

<sup>76</sup> The COBS Conduct of Business Sourcebook in the FCA's Handbook.

48. Broadly, MiFID changed the boundaries between MiFID/COBS customer classifications and those under the previous COB regime. In particular, more clients were likely to be classified as Retail Clients, compared with those that were classified as Private Customers under the pre-MiFID regime: as part of the FSA's process of consulting on the implementation of MiFID in its August 2006 paper on Implementing MiFID's Client Categorisation Requirements, the FSA stated that it expected more clients to be classified as Retail Clients under the MiFID rules than as Private Customers under pre-MiFID FSA rules.<sup>77</sup>

#### Classification of customers/clients under COB and COBS

49. The COB and COBS Sourcebooks both incorporated provisions requiring customers/clients to be classified in one of three categories, with different conduct of business rules applying to each particular client category.

#### COB

50. The UK operated a tiered client classification system prior to the implementation of MiFID. Chapter 4 of COB<sup>78</sup> contained the customer classification rules whereby a customer could be classified as:
- a. a "private customer" (referred to in this Report as a 'Private Customer');
  - b. an "intermediate customer" (referred to in this Report as an 'Intermediate Customer'); or
  - c. a "market counterparty".
51. The different classifications distinguished between customers based upon characteristics such as their nature, size and activities as well as knowledge, expertise and experience.

---

<sup>77</sup> Financial Services Authority, "Financial Services Authority Implementing MiFID's Client Categorisation requirements", August 2006, accessible at [https://webarchive.nationalarchives.gov.uk/20130424021920/http://www.fsa.gov.uk/pubs/other/mifid\\_classification.pdf](https://webarchive.nationalarchives.gov.uk/20130424021920/http://www.fsa.gov.uk/pubs/other/mifid_classification.pdf). (ARTICLE 028), p. 3. FSA noted: "More retail clients - MiFID introduces new quantitative thresholds for 'large undertakings' and a quantitative test for retail clients requesting treatment as a professional client. As these thresholds are higher than those in existing COB, we expect there to be more clients categorised as retail under MiFID than as private customers under existing COB".

<sup>78</sup> COB 4.

A Private Customer was afforded the highest level of protection.<sup>79</sup> Clients in the other categories were presumed to be more experienced, knowledgeable and skilled and were afforded less regulatory protection.

52. Under the COB rules a "Private Customer" was defined as a client who was not a market counterparty or an Intermediate Customer, including an individual who was not a firm.<sup>80</sup> In contrast, an "Intermediate Customer" was defined as a client who was not a market counterparty and who was:

- a. a local authority or public authority;
- b. a body corporate whose shares have been listed or admitted to trading on any European Economic Area exchange;
- c. a body corporate whose shares have been listed or admitted to trading on the primary board of any International Organization of Securities Commissions member country official exchange;
- d. a body corporate (including a limited liability partnership) which has or any of whose holding companies or subsidiaries has, or has had at any time during the previous two years, called-up share capital or net assets of at least £5 million (or its equivalent in any other currency at the relevant time);
- e. a special purpose vehicle;
- f. a partnership or unincorporated association which has, or has had at any time during the previous two years, net assets of at least £5 million (or its equivalent in any other currency at the relevant time) and calculated in the case of a limited partnership without deducting loans owing to any of the partners;
- g. a trustee of a trust (other than an occupational pension scheme, small self-administered pension schemes or stakeholder pension scheme) which has, or has had at any time during the previous two years, assets of at least £10 million (or its equivalent in any other currency at the relevant time) calculated by aggregating the

---

<sup>79</sup> For example, COB 4.1.3 G.

<sup>80</sup> COB 4.1.4 R.



value of the cash and designated investments forming part of the trust's assets, but before deducting its liabilities.<sup>81</sup>

53. If a customer did not qualify as an Intermediate Customer, but it nonetheless wished to be treated as such, it could "opt up" or "elect" to be classified as an Intermediate Customer if the requirements set out in COB 4.1.9 R were met:

*"(1) A firm may classify a client who would otherwise be a private customer as an intermediate customer if:*

*a) the firm has taken reasonable care to determine that the client has sufficient experience and understanding to be classified as an intermediate customer; and*

*b) the firm:*

*(i) has given a written warning to the client of the protections under the regulatory system that he will lose;*

*(ii) has given the client sufficient time to consider the implications of being classified as an intermediate customer; and*

*(iii) has obtained the client's written consent, or is otherwise able to demonstrate that informed consent has been given.*

*(2) For the purposes of (1), a client's consent to being classified as an intermediate customer may be limited to one or more types of:*

*a) designated investment; or*

*b) designated investment business."*

54. To determine whether a customer had sufficient experience and understanding to "opt up", a firm was required to have regard to (more than one of) the below criteria:

---

<sup>81</sup> Definition of "Intermediate Customer" in COB 4.

- a) *"the client's knowledge and understanding of the relevant designated investments and markets, and of the risks involved;*
- b) *the length of time the client has been active in these markets, the frequency of dealings and the extent to which he has relied on the advice on investments of the firm;*
- c) *the size and nature of transactions that have been undertaken for the client in these markets;*
- d) *the client's financial standing, which may include an assessment of his net worth or of the value of his portfolio."*<sup>82</sup>

55. COB 4.1.11 E contained a further precautionary measure to ensure that customers were not inappropriately "opted up". Firms were required to give a written warning to the customer of the protection they would lose by virtue of the re-classification as an Intermediate Client, including COB 3 (Financial promotion), COB 4.3 (Disclosing information about services, fees and commissions - packaged products), COB 5.1 (Advising on packaged products), COB 5.4 (Customers' understanding of risk), and the right of access to the FOS.

The COBS

56. The post-MiFID client classification rules are found in Chapter 3 of COBS and, as noted above, came into force in the UK by amendments to the FSA's rules on 1 November 2007.

57. Chapter 3 of COBS provides for three classes of client:<sup>83</sup>

- a. a "retail client" (referred to in this Report as a 'Retail Client');
- b. a "professional client" (referred to in this Report as a 'Professional Client'); and
- c. an "eligible counterparty".

58. Under the COBS rules, a Retail Client is defined as a client who is not a Professional Client or an eligible counterparty. Professional Clients are divided into two categories:

---

<sup>82</sup> COB 4.1.10 G.

<sup>83</sup> COBS 3.

per se and elective Professional Clients. The former category includes, for example, other regulated banks, investment firms, collective investment and pension schemes, and institutional investors. In addition, they included:

*"(2) in relation to MiFID or equivalent third country business a large undertaking meeting two of the following size requirements on a company basis:*

*a) balance sheet total of EUR 20,000,000;*

*b) net turnover of EUR 40,000,000;*

*c) own funds of EUR 2,000,000".<sup>84</sup>*

59. To be classified as a per se Professional Client, at least two of the above quantitative parameters must be met. They apply on a company basis as opposed to a group basis. That approach differs from the pre-MiFID rules, which took a group approach and under which the size thresholds were lower.

60. Similarly to the opting up rules under COB, COBS 3.5.3 R also provides that a firm may treat a client as an elective Professional Client if it satisfies certain requirements. The relevant rules set out certain quantitative and qualitative requirements that must be satisfied and this enables a firm to "opt up" a client who does not meet the per se professional threshold.

61. First, in all circumstances, to opt up the "qualitative" requirements must be met: under COBS 3.5.3 R(1) a firm is required to carry out an adequate assessment of the expertise, experience and knowledge of the client to obtain a reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making its own investment decisions and understands the risks involved.

62. Second, depending on the type of business, it must meet the quantitative criteria of COBS 3.5.3 R(2):

*"(2) in relation to MiFID or equivalent third country business in the course of that assessment, at least two of the following criteria are satisfied:*

---

<sup>84</sup> Per se professional clients: COBS 3.5.2(2)R.

- a) *the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;*
- b) *the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds EUR 500,000;*
- c) *the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged;*

*(the "quantitative test")".*

63. Third, a prescribed process must be followed under COBS 3.5.3 R:
- a. the client must state in writing to the firm that it wishes to be treated as a Professional Client either generally or in respect of a particular service or transaction or type of transaction or product;
  - b. the firm must give the client a clear written warning of the protections and investor compensation rights the client may lose; and
  - c. the client must state in writing, in a separate document from the contract, that it is aware of the consequences of losing such protections.

*Pre-MiFID: the Principles, the COB Sourcebook and Private Customers*

64. The FSA identified the relevant Principles and COB/COBS rules applicable to the sale of IRHPs for the purposes of the Scheme,<sup>85</sup> as follows:
- a. Principles 6 and 7, which applied throughout the Review Period;
  - b. for sales up to 31 October 2007: COB 2.1.3 R, COB 5.2.5 R, COB 5.4.3 R to COB 5.4.6 E and COB 5 Annex 1; and

---

<sup>85</sup> FCA Records, *Interest Rate Hedging Products - Pilot Findings*, January 2013, FCA-ADD-0267, p. 12, footnote 6.

- c. for sales from 1 November 2007: COBS 2.1.1 R, COBS 2.2.1 R, COBS 4.2.1 R, COBS 14.3.2 R.
65. The FSA's Principles for Businesses applied both pre- and post-MiFID. Principle 6 (customers' interest) and Principle 7 (communications with clients) required a firm to pay due regard to the interests of its customers and to their information needs, to treat them fairly and to communicate information to them which is clear, fair and not misleading. Both the COB and COBS rules amplified these Principles.
66. So far as relevant, the COB rules required firms to comply with the following requirements:
- a. COB 2.1.3 R required that, when a firm communicates information to a customer, the firm must take reasonable steps to communicate in a way which is clear, fair and not misleading. When considering this requirement, firms were required to have regard to the customer's knowledge of the designated investment business to which the information relates.<sup>86</sup>
- b. As regards inducements, COB 2.2 required a firm to conduct its business with due regard to the interests of its customers and to treat them fairly (as set out in Principle 6): "*the purpose of [that] section is to ensure that a firm does not conduct business under arrangements that might give rise to a conflict with its duty to customers*".<sup>87</sup>
- c. COB 5.2.5 R concerned personal recommendations to customers and the requirement to know your customer.<sup>88</sup> Before a firm gave a personal recommendation concerning an investment to a Private Customer, it was required to take reasonable steps to ensure that it was in possession of sufficient personal and financial information about that customer relevant to the services that the firm had agreed to provide.

---

<sup>86</sup> COB 2.1.3 R and COB 2.1.4 G.

<sup>87</sup> COB 2.2.1 R and COB 2.2.2 G. This rule was not referred to in the FSA's Interest Rate Hedging Products Pilot Findings report; see FCA Records, *Interest Rate Hedging Products - Pilot Findings*, January 2013, FCA-ADD-0267, p. 12, footnote 6.

<sup>88</sup> COB 5.2.5 R.

- d. COB 5.4 concerned customers' understanding of risk and required that a firm must not make a personal recommendation of a transaction or arrange or execute a deal in a derivative (including an IRHP) with, to, or for a Private Customer unless it has taken reasonable steps to ensure that the Private Customer understands the nature of the risks involved. The reasonable steps were required to include the steps set out in COB 5.4.6 E. In relation to derivatives (other than a retail securitised derivative or an option or contract for differences), the firm was required to provide the Private Customer with a form of notice prescribed in COB 5 Annex 1 E (a warrants and derivatives risk warning notice); and the Private Customer was required to have acknowledged receipt of the notice and confirm acceptance of its contents, in writing.<sup>89</sup> Additionally, where a firm made recommendations concerning designated investment (for example, in relation to IRHPs) to a Private Customer, it had to take reasonable care to ensure the suitability of its advice.<sup>90</sup> Again, this amplified Principle 9.

Post-MiFID: the Principles, the COBS and Retail Clients

67. As mentioned previously, the FSA's Principles for Businesses, and specifically Principles 6 and 7, applied both pre- and post-MiFID. Post-MiFID, the relevant COBS rules are summarised below:
- a. COBS 2 imposed three core obligations:<sup>91</sup>
- i. the obligation to act honestly, fairly and professionally in accordance with the best interests of clients (COBS 2.1.1 R(1));
  - ii. a prohibition that prevented firms from seeking to exclude or restrict the firm's duties or liabilities to a client under the regulatory system (COBS 2.1.2 R); and
  - iii. an obligation to provide certain basic information to clients about the firm and its business (COBS 2.2.1 R). This third obligation required firms to

---

<sup>89</sup> COB 5.4.3 R to COB 5.4.6 E and COB 5 Annex 1.

<sup>90</sup> COB 5.4.1 R, COB 5.3.4 G and COB 5.3.5 R.

<sup>91</sup> COBS 2.1.

provide "appropriate information" in a comprehensible form to a client about the firm and its services, designated investments and proposed investment strategies, including appropriate guidance on and warnings of the risks associated with investments in those designated investments or in respect of particular investments, execution venues and costs, and associated charges.

- b. COBS 4.2.1 R required firms to ensure that any communication or a financial promotion to clients was fair, clear and not misleading.<sup>92</sup>
- c. COBS 9.2.1 R concerned personal investment recommendations and required a firm to take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client.<sup>93</sup> When making the personal recommendation, the firm was required to obtain the necessary information regarding the client's:
  - i. knowledge and experience in the investment field relevant to the specific type of designated investment or service;
  - ii. financial situation; and
  - iii. investment objectives,so as to enable the firm to make the recommendation, or take the decision, which is suitable for the client.<sup>94</sup>
- d. COBS 10.2.1 R concerned the firm's obligation to assess the appropriateness of an investment for a client.<sup>95</sup> The firm was required to ask the client to provide information regarding its knowledge and experience in the investment field relevant to the specific type of product or service, so as to enable the firm to assess whether the service or product envisaged was appropriate for the client. When assessing appropriateness, a firm had to determine whether the client had the

---

<sup>92</sup> COBS 4.2. R.

<sup>93</sup> COBS 9.2.1. R.

<sup>94</sup> This rule was not referred to in the Financial Services Authority Interest Rate Hedging Products Pilot Findings, January 2013, FCA-ADD-0267, p. 12, footnote 6.

<sup>95</sup> COBS 10.2.

necessary experience and knowledge in order to understand the risks involved in relation to the product or service being offered or demanded.<sup>96</sup>

- e. COBS 14.3.2 R<sup>97</sup> required firms to provide clients with a general description of the nature and risks of designated investments, taking into account, in particular, the client's categorisation as a Retail Client or a Professional Client. That description must:
- i. explain the nature of the specific type of designated investment concerned, as well as the risks particular to that specific type of designated investment, in sufficient detail to enable the client to take investment decisions on an informed basis; and
  - ii. include, where relevant to the specific type of designated investment concerned and the status and level of knowledge of the client, the following elements:
    1. the risks associated with that type of designated investment, including an explanation of leverage and its effects and the risk of losing the entire investment;
    2. the volatility of the price of designated investments and any limitations on the available market for such investments; and
    3. the fact that an investor might assume, as a result of transactions in such designated investments, financial commitments and other additional obligations, including contingent liabilities, additional to the cost of acquiring the designated investments.

### **C. Powers in respect of IRHPs**

68. Set out below is a summary of the relevant information-gathering, supervisory and enforcement powers available to the FSA and FCA. As a result of the FS Act 2012, from

---

<sup>96</sup> This rule was not referred to in the FSA's Interest Rate Hedging Products Pilot Findings report; see FCA Records, *Interest Rate Hedging Products - Pilot Findings*, January 2013, FCA-ADD-0267, p. 12, footnote 6.

<sup>97</sup> COBS 14.3.



1 April 2013 some of the powers described below were amended, as indicated below (where relevant). The FSA's consideration of these powers and decisions about the use of its powers is described in Chapters 3 and 4.<sup>98</sup>

69. The FSA/FCA has a variety of powers that it could deploy to address the specific circumstances of a given situation. Its information-gathering and certain other powers are used to support both its supervisory functions and the exercise of its enforcement powers.
70. During the Review Period, the FSA/FCA had the following relevant statutory powers available to it:
  - a. As regards information-gathering and investigations, the FSA and FCA could use:
    - i. its section 165 FSMA powers to require information and documents from regulated firms to support both its supervisory and enforcement functions;
    - ii. its section 166 FSMA powers to require a regulated firm to provide a report by a Skilled Person; and
    - iii. its sections 167 and 168 FSMA powers, if it decided to undertake an investigation.
  - b. As regards supervisory powers under FSMA, the FSA/FCA could rely on a firm requesting voluntarily to agree to vary its permissions and impose a requirement. The FS Act 2012 largely replaced these powers with new FSMA sections, although the remit remained mostly unchanged. Alternatively, the FSA/FCA could vary a firm's permissions on its own initiative.
  - c. As regards its enforcement powers, as a result of its investigative work, the FSA/FCA could seek to:
    - i. take disciplinary measures using formal enforcement powers;
    - ii. establish a consumer redress scheme to deal with widespread or regular failings by firms under section 404, and also section 404F(7) FSMA;

---

<sup>98</sup> See Chapter 3, Sections 4 and 5, paras. 34-65; and Chapter 4, Section 1, para. 38.

- iii. obtain a restitution order pursuant to section 382 or 384 FSMA.
- i) *Information-gathering: Power to Require Information and to require the Appointment of a Skilled Person*
71. Under section 165 FSMA, the FSA/FCA was able, by notice in writing given to an authorised person, to require a person to provide specified information or information of a specified description or to produce specified documents or documents of a specified description. This power could only be exercised where the information and documents were reasonably required by the FSA/FCA in connection with its exercise of functions conferred by or under FSMA.
72. Under section 166 FSMA, the FSA/FCA had the power to require a firm to provide a report by a Skilled Person on any matter about which it had required or could require the provision of information or production of documents under section 165 FSMA. Following an amendment made by the FS Act 2012, the FCA itself could also appoint a Skilled Person.<sup>99</sup> The FSA/FCA was able to use its section 166 FSMA power to require reports by Skilled Persons to support both its supervisory and enforcement functions.<sup>100</sup>
73. A Skilled Persons' report is an information-gathering power and cannot be used on its own to require a firm to pay redress. However, it can be used, for example: (i) to assist in the design of a customer redress programme; (ii) to assist in the design of a remedial action plan; and (iii) to oversee and report on a remedial action plan.<sup>101</sup> In deciding whether to use its section 166 FSMA powers, the FSA was required to take account of the following legal and procedural matters:
- a. whether one of the other available statutory powers was more appropriate for the purpose than a Skilled Persons' report;
  - b. whether it was desirable to obtain an authoritative and independent report for use in any subsequent proceedings;

---

<sup>99</sup> SUP 5 gives guidance on the FCA's power under section 166 FSMA.  
<sup>100</sup> Para. 3.4 EG (Aug 2007): <https://www.handbook.fca.org.uk/handbook/EG/PDF/Archive/?view=chapter>  
<sup>101</sup> SUP 5.3.1 G and SUP 5 Annex 1 Examples of when the FSA may use the Skilled Person tool: <https://www.handbook.fca.org.uk/handbook/SUP/5/Annex1.html?date=2011-11-01>

- c. whether it was important that relevant rules in the Handbook should apply.<sup>102</sup>
74. Two other considerations were relevant in determining whether a Skilled Persons' report was appropriate: cost and resources/expertise.<sup>103</sup>
- a. Firstly, if the FSA used the section 166 FSMA power, the firm would pay for the services of the Skilled Person. If the FSA used its other information-gathering and investigation power, it would either appoint its own staff to undertake the information-gathering or pay for the services of external competent persons to do so.<sup>104</sup>
  - b. Secondly, the FSA would consider whether it had the necessary expertise, whether it had the necessary resources to make the required enquiries and whether the exercise would be the best use of its resources and time.<sup>105</sup>

ii) *Supervision: Variation of permissions and requirements*

75. The FSA/FCA had (and has) a number of powers that it could exercise both as a supervisory and enforcement tool. It could either: (i) vary (or cancel) a firm's regulatory permissions, and/or (ii) impose requirements on the firm to take specified actions or refrain from taking specified actions.<sup>106</sup> It could do this at its own initiative where it had concerns about the way a firm's business was being or had been conducted, or at the firm's request on a voluntary basis.

Own Initiative Powers: variation and requirements

76. Under section 45 FSMA,<sup>107</sup> the FSA had the power to vary a firm's permissions by way of an own initiative variation of permissions (known as an "OIVOP"). The equivalent power is now found in section 55J FSMA. OIVOPs can be used both in the supervisory or enforcement context.

---

<sup>102</sup> SUP 5.3.6 G.: <https://www.handbook.fca.org.uk/handbook/SUP/5/3.html?date=30-03-2013&timeline=True>

<sup>103</sup> SUP 5.3.8 G to SUP 5.3.10 G.

<sup>104</sup> SUP 5.3.8 G.

<sup>105</sup> SUP 5.3.10 G.

<sup>106</sup> Sections 42-45 FSMA, as substituted by sections 55J, 55L and 55N FSMA.

<sup>107</sup> Section 45 FSMA.

77. Under section 45(1)(c) FSMA, the FSA could vary a firm's permission when it appeared "*desirable to exercise that power in order to meet any of its regulatory objectives*".<sup>108</sup> Broadly, the same power is now found under section 55J(c) FSMA.
78. Similarly, as a result of amendments made to FSMA by the FS Act 2012, the FCA has had a specific power pursuant to section 55L FSMA to impose a new requirement on a firm or to vary or cancel a requirement it had previously imposed on a firm (known as an "OIRReq"). Prior to 1 April 2013, this power was effectively exercised by use of the OIVOP power under section 45 FSMA, in conjunction with section 44 FSMA. When the firm's permissions were varied, new requirements could be added and/or old requirements removed, as appropriate.
79. The section 55L FSMA power can also be used to impose a past business review on a firm. Where a past business review is imposed, the scope of the review is not limited by the Limitation Act 1980, as there is no requirement in section 55L FSMA for actionability.
80. Similarly, section 55N(5) FSMA provides that a requirement imposed by the FCA may refer to the past conduct of the person concerned, for example, by requiring that firm to review or take remedial action in respect of past conduct.
81. This new power was again introduced as a result of the FS Act 2012. Previously, this power was covered under the FSA's OIVOP powers to require a firm to carry out a past business review, but not to pay redress.<sup>109</sup>

#### Voluntary variation of permission and requirements

82. Prior to the FSA/FCA exercising its own initiative powers, it may first attempt to persuade the regulated firm to seek a voluntary variation of permissions or a voluntary imposition of requirement (as appropriate). In the course of its supervision and monitoring, where the FSA/FCA makes clear that it expects firms to take certain steps to ensure that they continue to meet regulatory requirements, the FSA/FCA envisaged "*that firms will normally take these steps without the need for it to use its own-initiative powers*."

---

<sup>108</sup> Section 45(1)(c) FSMA.

<sup>109</sup> Section 45 in conjunction with sections 40 and 43 FSMA

*In the vast majority of cases the FSA will seek to agree with a firm those steps the firm must take".<sup>110</sup>*

83. Prior to 1 April 2013, the process for voluntarily varying a firm's permissions ("VVOP") was found in section 44 FSMA. Broadly, the same power is now found in section 55H FSMA.
84. From 12 October 2010, both the imposition of requirements and variations of permissions could be used alongside section 404F(7) FSMA powers to require a single firm to establish a consumer redress scheme.<sup>111</sup>

*iii) Remedies: Power to Require Restitution*

85. The FSA had the power to seek restitution from firms (either through obtaining a High Court order under section 382 FSMA or directly requiring restitution to be made by a regulated firm under section 384 FSMA) where a firm had contravened a Relevant Requirement<sup>112</sup> as a result of which the firm made a profit or the other person suffered loss or been otherwise adversely affected as a result of the contravention. Those same powers were also available to the FCA.
86. At the relevant time, the FSA/FCA's power under section 382 FSMA was a power to bring civil proceedings in the High Court, pursuant to which the court was empowered to order a person who had contravened a Relevant Requirement, or had been knowingly concerned in such a contravention, to pay restitution. It provided for payment to the FSA/FCA (for onward distribution) of such sum as appeared to the court to be just having regard to profits accrued by the relevant person, loss or other adverse effect suffered as a result of the contravention, or both. The FSA/FCA's separate section 384 FSMA power to directly require certain persons to pay restitution has rarely been used. It is more limited than court-ordered restitution as it extends (so far as relevant) only to those that

---

<sup>110</sup> Para. 8.3, EG (Aug 2007): <https://www.handbook.fca.org.uk/handbook/EG/PDF/Archive/?view=chapter>

<sup>111</sup> See para. 95 below.

<sup>112</sup> Under section 382(9) and 384(7) FSMA, a "Relevant Requirement" includes:  
(a) a requirement imposed by or under FSMA or by a directly applicable Community regulation or decision made under MiFID;  
(b) a requirement which is imposed by or under any other Act conferring power to prosecute on the FSA.

are an "*authorised person*".<sup>113</sup> Subject to the defences available at the relevant time<sup>114</sup>, if the FSA/FCA determined that an authorised person had contravened a Relevant Requirement, or been knowingly concerned in a contravention, and that profits had accrued to the authorised person, or that one or more persons had suffered loss or been otherwise adversely affected as a result of the contravention, the FSA/FCA could require that person to provide payment of such sums as appeared just to the appropriate person(s) having regard to the profit and/or losses.<sup>115</sup>

87. At the relevant time, in deciding whether to seek to exercise their restitution powers, both the FSA and the FCA considered the same criteria. These included, for example, whether quantifiable profits had been made which were owed to identifiable persons; whether there were identifiable persons who could be shown to have suffered quantifiable losses or other adverse effects; the cost to the FSA/FCA of securing redress and whether that was justified by the benefit to persons that would result from that action; whether redress be obtained through other means or another regulator; whether persons could bring their own proceedings; and what other powers might be available.<sup>116</sup>
88. Procedurally, the FSA/FCA was required to issue a warning notice, followed by a decision notice, which was challengeable by the firm via the (then) Financial Services and Markets Tribunal.<sup>117</sup>

---

<sup>113</sup> Section 384(1) FSMA.

<sup>114</sup> For example, section 384(4) FSMA, repealed by SI 2016/680, reg 10(1), (16)(c), as from 3 July 2016.

<sup>115</sup> Section 384(1)-(5) FSMA.

<sup>116</sup> Para. 11., EG (Aug 2007): <https://www.handbook.fca.org.uk/handbook/EG/PDF/Archive/?view=chapter>

<sup>117</sup> Section 385 and section 386 FSMA. .

iv) *Remedies: Power to Establish a Consumer Redress Scheme*

Industry-wide schemes

89. As from 12 October 2010, the Financial Services Act 2010 amended section 404 FSMA<sup>118</sup> to enable the FSA to make rules to require firms to establish and operate "industry-wide" consumer redress schemes where:
- a. it appeared to the FSA that there may have been a widespread or regular failure by relevant firms to comply with requirements applicable to the carrying on by them of any activity;
  - b. it appeared that, as a result, consumers<sup>119</sup> had suffered loss or damage in respect of which, if they brought legal proceedings, a remedy would be available in the proceedings; and
  - c. the FSA considered that it was desirable to make rules for the purpose of securing that redress be made to consumers in respect of the failure (having regard to the other ways in which consumers may obtain redress).
90. A redress scheme pursuant to section 404 FSMA can only compensate for loss or damage "*in respect of which a remedy or relief would be available in civil proceedings*". The FCA now maintains a Consumer Redress Sourcebook,<sup>120</sup> which, amongst other things, indicates that the FCA would seek Leading Counsel's opinion as to whether the failures identified and to be addressed by such a scheme are those that a court would find constitute failures to comply with a requirement.
91. Accordingly, a consumer redress scheme under these provisions could not be used to require redress: (i) for breach of the FCA's Principles for Businesses, (ii) for breaches of

---

<sup>118</sup> Sections 404 – 404G FSMA were substituted for the original section 404 FSMA, by section 14(2) of the Financial Services Act 2010. This substitution has effect in relation to failures occurring before 12 October 2010.

<sup>119</sup> The definition of "consumers" in section 404E FSMA comprises persons who have used, or may have contemplated using, any of the services set out within sub-section (2) (which in turn includes authorised persons carrying on regulated activities).

<sup>120</sup> The CONRED module in the Handbook. CONRED 1.3.16 indicates that consumer redress schemes can only be used to require redress in relation to those failures in respect of which a remedy or relief would be available in legal proceedings.

any other FCA rules where a right of action under section 150 (latterly section 138D) FSMA has been "switched off", or (iii) where the claimant did not meet the definition of a private person.<sup>121</sup>

92. The power to require an industry-wide consumer redress scheme is a rule-making power, which requires consultation on the proposed rules before the rules come into force. The power also permits the taking of disciplinary action against the firm for failing to operate schemes properly<sup>122</sup> and also the right to take over an investigation required under the scheme or appoint a third party to do so under section 404A (1)(k) FSMA.<sup>123</sup>
93. Under section 404D, any person (including regulated firms under the relevant scheme) may apply to the Upper Tribunal for a review of any rules made under section 404.<sup>124</sup> The Upper Tribunal may: (i) dismiss the application; or (ii) make an order quashing any rules made under section 404 or any provision of those rules.<sup>125</sup>
94. Under section 404D(5), the general rule is that, in determining an application, the Upper Tribunal is to apply the principles applicable on an application for judicial review. However, under section 404D(6), if (or so far as) an application relates to any examples set out in the scheme rules of things done, or omitted to be done, that are to be regarded as constituting a failure to comply with a requirement, the Upper Tribunal may determine whether the example constitutes a failure to comply with the requirement in question.

#### Single firm consumer redress scheme

95. From 12 October 2010, under section 404F(7) FSMA,<sup>126</sup> the FSA/FCA could use its own initiative power to vary a firm's permission or authorisation so as to impose requirements on a firm to establish and operate a scheme which corresponds to, or is similar to, a consumer redress scheme.<sup>127</sup>

---

<sup>121</sup> See paras. 100-1 below.

<sup>122</sup> Section 404C FSMA.

<sup>123</sup> Section 404A(1)(k) FSMA.

<sup>124</sup> Section 404D(1) FSMA.

<sup>125</sup> Section 404D(2) FSMA.

<sup>126</sup> Section 407F(7) FSMA.

<sup>127</sup> Variations of a firm's permissions are referred to at para. 76 and the imposition of requirements both on a voluntary basis and own initiative powers are referred to at para. 77 and following.



96. This power is similar to an industry-wide consumer redress scheme, albeit the triggers may be different. The main difference is that the trigger to use this power is the same that would apply to the imposition of VVOP or OIVOP,<sup>128</sup> which are supervisory tools and not subject to the FSA/FCA's rule-making processes. As a result, the FSA/FCA would not be required to consult the public or the FOS because it affects a single firm. That is despite the fact that the same consumer redress scheme may apply to a number of banks or firms regarding similar behaviour<sup>129</sup> and may include requirements of a kind which could be included under an industry-wide consumer redress scheme under section 404 FSMA.

v) *Disciplinary measures*

97. Under sections 204A, 205 and 206 FSMA, if the FSA/FCA considered that an authorised person had contravened a "relevant requirement" imposed upon them, it may publish a statement to that effect (section 205 FSMA – Public Censure) or impose a financial penalty (section 206 FSMA – Financial Penalty) in respect of that contravention of such amount as it considers appropriate. For these purposes, section 204A FSMA provides (and section 205 FSMA provided) that a "relevant requirement" includes a requirement imposed by or under FSMA and so would include the Principles and rules, including the COB/COBS.

98. The FSA/FCA enforcement procedure is well known and is not repeated here. Suffice to say, if such matters are contested, it can take many months or even years to be resolved. Enforcement action does not lead to any direct redress/compensation being required of regulated firms in favour of customers. Any financial penalty is payable to the FSA/FCA.

---

<sup>128</sup> See The Financial Conduct Authority, "Use of s404f(7) power on single firms", 11 November 2011, accessible at <https://webarchive.nationalarchives.gov.uk/20130411142044/http://www.fsa.gov.uk/library/policy/guidance/2011/s404f.shtml>. See also section 404F (8) FSMA.

<sup>129</sup> The power was used on three firms individually at the same time in respect of the redress scheme for investors in Arch Cru funds.

vi) *Action for damages by private person*

99. Section 150 FSMA and its successor, section 138D FSMA, provide that contravention of particular rules by an authorised person may be actionable for damages by certain persons<sup>130</sup> who suffer loss as a result of the contravention.
100. The Financial Services and Markets Act 2000 (Rights of Action) Regulation 2001<sup>131</sup> defines a "private person" as:
- a. any individual, unless the loss is suffered in the course of carrying on a regulated activity (or in the course of carrying on any activity which would be a regulated activity apart from any exclusion made by article 72 (overseas person) or article 72A (information society service providers) of the RAO); and
  - b. any person who is not an individual, unless he suffers the loss in question in the course of carrying on a business of any kind.
101. Not all breaches of the rules give rise to a civil damages claim by a "private person". A breach of almost all of the COB/COBS rules may give rise to a right of action by a "private person" under section 150 FSMA (now section 138D).<sup>132</sup> However, breaches of the Principles were (and are) not actionable by private persons. Only the FSA/FCA can investigate and take enforcement action on the basis of a breach of the Principles.

#### **Section 4 – Litigation in respect of the mis-sale of IRHPs**

102. As set out above, section 150 (and later section 138D) FSMA provided certain individuals with a possible route to pursuing a damages claim in the civil courts where the mis-sale of IRHPs constituted a breach of particular FSA/FCA rules and caused loss to the individual. In addition, customers had the option of bringing various statutory or common law claims against the banks by virtue of their advisory relationship.

---

<sup>130</sup> Ordinarily this means a "private person" as defined in the Financial Services and Markets Act 2000 (Rights of Action) Regulation 2001 (SI 2001/2256) but can extend to other persons in limited circumstances, which are not relevant for the Review.

<sup>131</sup> SI 2001/2256, regulation 3.

<sup>132</sup> COBS 4.2.6 R provides that "*if, in relation to a particular communication or financial promotion, a firm takes reasonable steps to ensure it complies with the fair, clear and not misleading rule, a contravention of that rule does not give rise to a right of action under section 138D of the Act*".

103. In general, however, customers who claimed to have been mis-sold IRHPs were often unsuccessful in the civil courts. Below are set out, in summary form, some of the common hurdles encountered by those customers that chose to take private legal action:
- a. The direct civil cause of action for breach of COB/COBS rules under section 150 and/or (later) section 138D FSMA was unlikely to be available to SMEs since only those who qualified as a "private person" were entitled to pursue such claims. As set out above,<sup>133</sup> this was limited to individuals (unless carrying on a regulated activity) and only applied to persons who were not individuals where they did not suffer the loss in the course of "*carrying out business of any kind*". In practice, this was broadly interpreted and the restriction meant that the availability of rights of action for non-individuals was limited. In Titan Steel Wheels -v- Royal Bank of Scotland plc,<sup>134</sup> the court adopted a wide interpretation of the wording "*carrying out business of any kind*",<sup>135</sup> holding that it extended to losses sustained by a manufacturing company in connection with a currency swap entered into in respect of foreign currency income. On the basis of that reasoning, in Bailey and Mtr Bailey Trading Limited -v- Barclays Bank Plc,<sup>136</sup> the court rejected a claim under section 150 FSMA, for a breach of COBS rules, brought by a company which had entered into an IRHP in connection with a loan to buy its business premises.
  - b. In cases where a customer pursued a claim in negligence, the banks would often be able to establish that they gave no investment advice and/or owed no advisory duties. For example, the banks could rely upon contractual terms and conditions whereby the customer acknowledged that it understood the potential risks and rewards of the transaction, would consult its own advisers, accepted that the bank

---

<sup>133</sup> See para.100.

<sup>134</sup> [2010] EWHC 211 (Comm).

<sup>135</sup> See paras. 44 - 76. At para. 70, the Judge stated "*I recognise that corporate entities who sustain losses as a result of the purchase of financial products will usually be in business of some kind. As the 1990 consultation paper states, charities and similar bodies are the more obvious exceptions. It follows that a wide interpretation of Regulation 3(1)(b) would exclude little in terms of liability of a regulated body. But I prefer the view that the words can properly be construed as having their wide meaning as contended for by the Bank*".

<sup>136</sup> [2014] EWHC 2882 (QB) at paras. 37-51. See also Grant Estates Ltd -v- Royal Bank of Scotland Plc [2012] CSOH 133 at paras. 43-62; and Thornbridge Ltd -v- Barclays Bank PLC [2015] EWHC 3430 (QB) at paras. 138-41.

would not act as its investment adviser, and/or placed no reliance on the bank for any advice or recommendation. Such a contractual delineation of responsibility and allocation of risk would generally preclude the customer from relying on the actual events (for example where advice was in fact given). English law also characterised the effect as a matter of contractual estoppel.<sup>137</sup> Such terms were often held to be "basis clauses" rather than exclusion clauses, which were required to be reasonable under section 2 (1) of the Unfair Contract Terms Act 1977.<sup>138</sup>

- c. In claims based on alleged misrepresentation, the banks were often held to be able to rely on contractual terms and conditions whereby the customer acknowledged that:
  - i. it was relying upon its own independent decisions to enter into the relevant transaction and as to whether that transaction was appropriate or properly based upon its own judgement and advice from its own advisers; and
  - ii. it was not relying on any communication of the other party as investment advice or as a recommendation to enter into the transaction.<sup>139</sup>
- d. Some customers succeeded in establishing a so-called mezzanine intermediate duty owed by the banks. However, this success was relatively short-lived:

---

<sup>137</sup> See for example, Crestsign Ltd -v- National Westminster Bank Plc and Royal Bank of Scotland Plc [2014] EWHC 3043 (Ch) at paras. 84-122. Green and Rowley -v- Royal Bank of Scotland PLC [2012] EWHC 3661 (QB) at paras. 110-7. Grant Estates Ltd -v- Royal Bank of Scotland Plc [2012] CSOH 133 at paras. 68 to 80. Titan Steel Wheels -v- Royal Bank of Scotland plc 2010] EWHC 211 (Comm) at paras. 85-92. Thornbridge Ltd -v- Barclays Bank PLC [2015] EWHC 3430 (QB) at paras. 96 -117. Marz Ltd – v – Bank Of Scotland PLC [2017] EWHC 3618 (CH) at paras. 244-69.

<sup>138</sup> See Crestsign Ltd -v- National Westminster Bank Plc and Royal Bank of Scotland Plc [2014] EWHC 3043 (Ch) at para. 199 and Grant Estates Ltd -v- Royal Bank of Scotland Plc [2012] CSOH 133 at paras. 80-4. Marz Ltd -v- Bank of Scotland PLC [2017] EWHC 3618 (CH) at paras. 270-75. However, see Ramesh Parmar & Anor -v- Barclays Bank Plc [2018] EWHC 1027 (Ch) at para. 133 in which the Court held that COBS 2.1.2 "*prevent[ed] a party creating an artificial basis for the relationship, if the reality is different*". See also Fine Care Homes Limited -v- (1) National Westminster Bank Plc (2) Natwest Markets Plc [2020] EWHC 3233 (Ch) at paras. 118-23.

<sup>139</sup> Property Alliance Group Limited -v- Royal Bank of Scotland Plc [2016] EWHC 3342 (Ch) at para. 231.

- i. At first instance, the High Court held that a "mezzanine" intermediate duty was owed. Even if a bank had no duty to explain the nature and effect of the proposed arrangement, if it did nevertheless choose to give an explanation or tender advice, it owed a resulting duty to give that explanation or advice fully, accurately and properly.<sup>140</sup> This duty went beyond the duty not to make any negligent misstatement per Hedley Byrne -v- Heller and Partners.<sup>141</sup>
- ii. However, both at first instance and on appeal in the later case Property Alliance Group Limited -v- Royal Bank of Scotland Plc,<sup>142</sup> the court found that it was wrong to say that such a duty went beyond the Hedley Byrne duty not to misstate and that no mezzanine duty arose.
- e. The Court of Appeal in Green and Rowley held that the mere existence of the COB rules did not give rise to a co-extensive duty of care at common law. Section 150/138D FSMA provided a remedy for contravention of COB rules in the shape

---

<sup>140</sup> Crestsign Ltd -v- National Westminster Bank Plc and Royal Bank of Scotland Plc [2014] EWHC 3043 (Ch).

<sup>141</sup> [1964] AC 465.

<sup>142</sup> [2016] EWHC 3342 (Ch). At para. 196, the Judge stated "*It seems to me therefore, without falling into the trap of construing Mance J's judgment as if it were a statute, that the potential duty of care under consideration is wider than a duty not to misstate, is fact dependent and as HHJ Moulder pointed out was being contemplated as a duty falling on the advisory spectrum. Accordingly, if the decision in Crestsign was intended to go further, and to suggest that once information is provided by a bank, a salesman is always under a duty to explain fully the products he wishes to sell without a broader advisory relationship having arisen, I decline to follow it. As HHJ Moulder pointed out, to take such an approach is to blur the line between a salesman and an advisor. In my judgment, such a conclusion is also consistent with the observations of Tomlinson LJ in Green & Rowley v RBS". In the Court of Appeal [2018] EWCA Civ 355 it was held at para. 67: "*The expression "mezzanine" duty or intermediate duty, first coined in Crestsign, is best avoided. It appears to reflect the notion that there is a continuous spectrum of duty, stretching from not misleading, at one end, to full advice, at the other end. Rather, concentration should be on the responsibility assumed in the particular factual context as regards the particular transaction or relationship in issue. The observation of Tim Kerr QC, sitting as a deputy High Court Judge, in Crestsign (at para. 155) that the bank's duty would extend to correcting any obvious misunderstandings communicated by the customer and answering any reasonable questions the customer might ask about those products in respect of which the bank had chosen to volunteer information might, depending on the particular factual context, be consistent with the standard Hedley Byrne duty not to misstate, including by omission*". See also Thornbridge Ltd -v- Barclays Bank PLC [2015] EWHC 3430 (QB) at paras. 118-31, Property Alliance Group Limited -v- Royal Bank of Scotland Plc [2016] EWHC 3342 (Ch) at paras. 194-205 and Property Alliance Group Limited -v- Royal Bank of Scotland Plc [2018] EWCA Civ 355 at paras. 37-67. London Executive Aviation Ltd -v- The Royal Bank of Scotland plc [2018] EWHC 74 (Ch) at paras. 235-8.*

of an action for breach of statutory duty, and there was no justification for the independent imposition of a duty of care at common law to advise as to the nature of the risks inherent in a regulated transaction.<sup>143</sup>

- f. The banks were, in general, able to argue successfully that their disclosure around the potential break costs in respect of IRHPs was sufficient, that they did not need to provide estimates or worked break cost examples/scenarios, and that they had no obligation to disclose to customers their own internal MTM valuations, nor their credit line utilisation or contingent liability calculations/figures.<sup>144</sup>

---

<sup>143</sup> [2013] EWCA Civ 1197 at paras. 23-31.

<sup>144</sup> Green and Rowley [2012] EWHC 3661 (QB) at paras. 40-1 and 83-7. Green and Rowley [2013] EWCA Civ 1197 at para. 17. Crestsign Ltd -v- National Westminster Bank Plc and Royal Bank of Scotland Plc [2014] EWHC 3043 (Ch) at paras. 165-9 and in particular at paras. 166-7: "166. The warning about break costs being "substantial" first appeared in the introductory remarks at the start of the Risk Management Paper, beneath the heading "Important Information". The warning was generic and preceded the descriptions of the four individual structures, though the reference to break costs (without repetition of the word "substantial") also appeared in the description of each product. The word "substantial" in the introductory section was preceded by an explanation that breakage costs "will be calculated by reference to prevailing market conditions and include costs incurred by us in terminating any related financial instrument or trading position". 167. That language might well have invited further enquiry. What was the formula for calculating break costs? How much might they be on various assumptions, from the lowest end to the highest end of the likely range? I have come to the conclusion that the provision of full and non-misleading information about the products on offer from the banks, did not extend to proffering that level of detail in the absence of such an enquiry being made of them... ". Property Alliance Group Limited -v- Royal Bank of Scotland Plc [2016] EWHC 3342 (Ch) at para. 197-205 and Property Alliance Group Limited -v- Royal Bank of Scotland Plc [2018] EWCA Civ 355 paras. 71-86. In particular, the Court of Appeal held: "79. In a number of first instance decisions on swap transactions between a bank and its customer it was observed that it was not the normal practice to disclose the CLU [worst case scenario figure] or similar predictions and it was held that there was no breach of duty by the bank in failing to disclose them: Bankers Trust, Crestsign, Thornbridge Ltd v Barclays Bank plc [2015] EWHC 3430 (QB), Marz Ltd v Royal Bank of Scotland plc [2017] EWHC 3618 (Ch), London Executive Aviation Ltd v The Royal Bank of Scotland plc [2018] EWHC 74 (Ch). Although there is now greater disclosure by banks in relation to break costs than before, RBS still does not disclose the CLU. 80. The CLU is the product of the subjective view of RBS about many matters, including possible movements in interest rates in the future and the length of the outstanding term of the swaps at the time of the break, and involves a complex computer programme into which is fed a large number of different scenarios. It is an internal and subjective assessment by RBS of risk inherent in the swaps. Whether or not PAG and its advisers had the sophistication and IT facility to carry out a similar exercise, based on their own predictions of possible future movements in interest rates over the period of the Swaps, is not to the point. 81. Any worked break cost scenarios, intended to show what the break costs might be at any particular moment during the lifetime of the Swaps, would similarly be based on RBS's own subjective opinion of what might happen to interest rates in the future and would not necessarily reflect RBS's view of the degree of likelihood

- g. The banks were held to be able to rely upon arguments that customers could not prove that in fact they had relied upon alleged misrepresentations or omissions, and/or that the banks had otherwise caused their losses.<sup>145</sup>
- h. Finally, the banks could often rely on limitation defences under the Limitation Act 1980.<sup>146</sup>

---

*of the scenario actually occurring. Insofar as it is suggested that the break cost scenarios ought to have been provided merely to illustrate how the break cost methodology would work, whatever future interest rates might be, the methodology was clearly stated in the material given to PAG and it is not suggested that PAG or its advisers could not have provided worked up examples themselves. 82. Moreover, under the standard terms of the ISDA Master Agreement, as well as the express terms of each individual swap contract, PAG represented that it understood and accepted the risks of the transaction and was capable of assuming, and assumed, those risks". Thornbridge Ltd -v- Barclays Bank PLC [2015] EWHC 3430 (QB) at paras. 118-31 and 144-77. In particular, at para. 169 the Court held: "Accordingly on the evidence in my view Barclays cannot be criticised for failing to give illustrations showing greater falls in interest rates. It is only with the benefit of hindsight that one can suggest that such low rates were reasonably to have been foreseen. Mr Croft rejected the comparison with earlier periods and across countries and I accept his view that such comparisons are inappropriate as they depend on the particular economic and political conditions prevailing at such times and in the relevant countries. Given this and the view that interest rates might rise, it cannot therefore be said to have been misleading for Mr Burgess not to give illustrations of the possible effects of more significant falls in interest rates". Marz Ltd -v- Bank of Scotland PLC [2017] EWHC 3618 (CH) at paras. 306-312 and in particular 306 "Marz's next contention, that BoS' credit line should have been disclosed, was rejected in Crestsign at [157], the experts in that case (who included Mrs Bowie for the claimant) agreeing that the credit line was "an internal measure not normally disclosed to a bank's customers". See Ramesh Parmar & Anor -v- Barclays Bank Plc [2018] EWHC 1027 (Ch) at paras. 207-17. In particular at para. 209(3), the Court held: "I accept the submissions of Mr Sutcliffe that the CEE is not a "contingent liability" of the Claimants. It represents the Bank's exposure in a near worst-case scenario. As the Claimant's expert agreed, it is not payable by the customer. It is an internal risk management limit which enables the Bank to monitor its risks associated with products in respect of which its exposure depends upon future movement. The CEE represents the Bank's estimated exposure in a hypothetical near worst-case market conditions. Conversely, the breakage costs under the swaps represent the mark to market value of those contracts based on replacement contracts from the market at the prevailing rate at the time". See also London Executive Aviation Ltd -v- The Royal Bank of Scotland PLC [2018] EWHC 74 (Ch) at paras. 244-54, Fine Care Homes Limited -v- (1) National Westminster Bank Plc (2) Natwest Markets Plc [2020] EWHC 3233 (Ch) at paras. 125-38.*

<sup>145</sup> Green and Rowley [2012] EWHC 3661 (QB) at para. 88. Property Alliance Group Limited -v- Royal Bank of Scotland Plc [2016] EWHC 3342 (Ch) at paras. 417-9. Marz Ltd -v- Bank Of Scotland PLC [2017] EWHC 3618 (CH) at paras. 227-31 and 338-48. Ramesh Parmar & Anor -v- Barclays Bank Plc [2018] EWHC 1027 (Ch) at paras. 157-60. Ramesh Parmar & Anor -v- Barclays Bank Plc [2018] EWHC 1027 (Ch) at paras. 222-9. London Executive Aviation Ltd -v- The Royal Bank of Scotland PLC [2018] EWHC 74 (Ch) at paras. 244-74.

<sup>146</sup> For example, Orchard (Developments) Holdings Plc And Orchard (Huthwaite) Ltd – v – National Westminster Bank Plc [2017] EWHC 2144 (QB) at paras. 39-49.

104. Cumulatively, these issues, and the various cases in which they arose, illustrate that, where parties chose to bring an action in their own right, they faced considerable hurdles in achieving a successful outcome. Irrespective of which cause of action they pursued, the prospects of customers who elected to pursue redress via the courts were relatively poor. A number of the customers who pursued legal action, however, settled with the banks on a confidential basis, including the claimant in the Crestsign<sup>147</sup> case cited above prior to appeal. It is unknown whether these settlement agreements provided customers with a better outcome than they might have achieved under the Scheme.

---

<sup>147</sup> Crestsign Ltd -v- National Westminster Bank Plc and Royal Bank of Scotland Plc [2014] EWHC 3043 (Ch).



## Chapter 3

### Events leading to the introduction of the Initial Scheme (March to June 2012)

1. This Chapter deals with the events leading up to the introduction of the Initial Scheme, between March and June 2012.

#### Section 1 – Background

##### A. Events prior to March 2012

2. The FSA was aware of concerns regarding the alleged mis-selling of IRHPs from at least March 2010. In evidence given in R. (on the application of Holmcroft Properties Ltd) - v- KPMG LLP<sup>148</sup> ("Holmcroft"), the FCA stated that: (i) "*the FCA first became aware of complaints about the sale of IRHPs in 2010 when the FCA was informed of a small number of complaints from small businesses relating to Barclays ... [the FCA's] review identified minimal issues and concluded that most sales met relevant conduct requirements*"<sup>149</sup>; and (ii) "*At the time, the FCA also considered the outcome of complaints that had been made relating to the sales of IRHPs to the [FOS] ... [the FCA] found that a large percentage of complaints made to the FOS had been decided in the bank's favour and against customers*".<sup>150</sup> In its evidence given in Holmcroft, the FCA explained that, in light of these findings: "*... which did not indicate that there were widespread issues, the FCA did not at that stage pursue the matter further*".<sup>151</sup>
3. In its internal "*Lessons Learned Review of Interest Rate Hedging Products*",<sup>152</sup> however, the FSA concluded that there were opportunities for the FSA to have taken earlier action

---

<sup>148</sup> [2016] EWHC 323 (Admin).

<sup>149</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 5.1.

<sup>150</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 5.2.

<sup>151</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 5.3.

<sup>152</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425.

if it had "joined the dots".<sup>153</sup> The review concluded that: "*between March 2010 and March 2012, the FSA could have identified a wider, growing issue with IRHPs. While the FSA received intelligence about IRHPs, it was fragmented, received separately and not centrally coordinated. There was, however, a common theme running throughout the intelligence, which emanated from a range of sources including two former bank employees, two law firms and consumers, through complaints, section 150 claims and consumer action group websites. Instead of dealing with the intelligence in a coordinated way, the information was disseminated to the individual Supervisory Teams to assess the information and determine the most appropriate way forward*".<sup>154</sup>

4. The first substantive complaint raised with the FSA about IRHPs appears to have been sent in February 2010.<sup>155</sup> At that point, a customer who had purchased a Structured Collar from Barclays in June 2008 wrote to the FSA, enclosing copies of its complaint to the FOS in relation to the sale of that product.<sup>156</sup> An FSA employee reviewed the complaint and noted a "*possible action point*" arising from the letter: "*it would be interesting to see if this is a wider issue for the firm or could be an issue in the future – depending on how many of these products have been sold/ current economics around them?*".<sup>157</sup> The FSA received a further complaint in March 2010, in relation to a number of Barclays' SME customers who had allegedly been mis-sold IRHPs. Considering additional information received about that complaint, an FSA employee commented that "*this does look very bad*" and had "*the potential to be explosive*".<sup>158</sup>
5. The FSA made some enquiries to better understand the hedging products in question and the extent of complaints. At a meeting in July 2010, Barclays agreed to undertake a review, "*the scope of which included a review of the appropriateness of the sales process and marketing material provided to retail customers, including a review of the risk*

---

<sup>153</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 3.

<sup>154</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 12.

<sup>155</sup> FCA Records, *Letter and attachments*, 26 February 2010, 360731.

<sup>156</sup> FCA Records, *Letter and attachments*, 26 February 2010, 360731.

<sup>157</sup> FCA Records, *Email*, 23 March 2010, FCA-ADD-011-0789.

<sup>158</sup> FCA Records, *Cover email and attachment*, 17 June 2010, FCA-ADD-011-0815 and FCA-ADD-011-0816.

warnings".<sup>159</sup> That review, termed Project Aries, covered the period from January 2007 to July 2010 and was, to some extent, supervised by a large international law firm.<sup>160</sup> The resulting report was provided to the FSA in September 2010, and concluded that the bank's "end to end sales processes have complied with the regulatory requirements" save for a handful of cases which it found did not meet the bank's "usual standards", but which it considered did not "represent a systemic issue with our processes".<sup>161</sup>

6. In January 2011, the FSA Supervision team asked Barclays for an update on outstanding FOS cases and complaints. The bank responded: "*The proportion of substantive decisions on cases within the FOS in favour of Barclays has continued to be around 90%, with 14 of the 16 decisions received by Barclays since the report being in favour of the bank ... since the report, 33 new complaints have been received. Total open complaints at 11 February [2011] was 100 ...*".<sup>162</sup> The FSA then decided not to undertake further work "*based primarily on the Barclays' report, FOS outcomes and other work priorities*".<sup>163</sup>
7. Further complaints and concerns regarding the alleged mis-selling of IRHPs were raised throughout 2011, including by MPs on behalf of their constituents,<sup>164</sup> in the courts,<sup>165</sup> in

---

<sup>159</sup> FCA Records, *ESRC Summary Paper*, 21 March 2012, 261617, Annex 3, para. 17. These risk warnings were standard form warnings the FSA required banks to provide to Private/Retail Customers when selling IRHPs.

<sup>160</sup> FCA Records, *Terms of Reference Project Aries*, 21 July 2010, 270129.

<sup>161</sup> FCA Records, *Project Aries Final Report*, 21 September 2010, FCA-ADD-011-0656, p. 3 and Executive Summary, p. 4.

<sup>162</sup> FCA Records, *Email*, 15 February 2011, FCA-ADD-011-0785.

<sup>163</sup> FCA Records, *ESRC Summary Paper*, 21 March 2012, 261617, Annex 3, para. 21. Upon revisiting its supervisory response to Project Aries in April 2012, the FSA concluded that it "*was appropriate in light of the information available to [the FSA] at the time*" but that "*while superficially the report gave [the FSA] comfort, it [was] impossible to tell from simply reading the report ... whether the evidence used to support [the] conclusions [was] robust and whether Barclays [had] genuinely attempted to consider the spirit of the requirements rather than carry out a 'tick and bash' exercise*"; see FCA Records, *Memorandum – IRS Barclays Project Aries*, 15 June 2012, 285808.

<sup>164</sup> See, for example, FCA Records, *Letter*, 18 February 2011, FCA-ADD-0305; FCA Records, *Cover email and attachment*, 4 April 2011, FCA-ADD-011-0651 and FCA-ADD-011-0652.

<sup>165</sup> See, for example, FCA Records, *Email*, 6 April 2011, FCA-ADD-011-0688; FCA Records, *Email*, 6 September 2011, FCA-ADD-011-0666.

the media,<sup>166</sup> and directly with the FSA's whistleblowing team.<sup>167</sup> In response to the last of these, the FSA's whistleblowing team stated that customers were able to complain directly to their banks, and failing that to the FOS. The FSA could exercise powers in individual disputes between banks and customers if the FOS formally advised the FSA that there may be a widespread issue. The whistle-blower pointed out that this was of limited assistance to the many SMEs who did not meet the "*micro-enterprise*" criteria to be eligible for referral to the FOS,<sup>168</sup> but the FSA took no further action at that point.

8. In August 2011, the FSA requested information from Lloyds about its sales of IRHPs. It was assured that the bank had "*reviewed the allegations around the risk warnings given to customers on the risk of interest rate decreases and are comfortable,*" and that the FOS had upheld only two complaints against the bank to date.<sup>169</sup> Further enquiries with Barclays around that time yielded a similar response.<sup>170</sup> In March 2012, the FSA learned that in October 2011 HSBC had commenced an internal review into the sale of interest swaps to customers.<sup>171</sup>
9. Therefore, at no point between 2010 and March 2012 did the FSA carry out its own assessment of whether IRHPs had been mis-sold, nor commission an independent third party, such as a Skilled Person appointed under section 166 FSMA, to do so.

## **B. The position in March 2012**

10. By March 2012, the FSA was facing increasing public and political pressure to intervene in respect of the allegations regarding the mis-selling of IRHPs. Amongst other things, such pressure included:

---

<sup>166</sup> See, for example, Sky News, "*Banks 'Mis-Sold' Interest Rate Protection*", 30 August 2011, accessible at <https://uk.news.yahoo.com/banks-accused-interest-rate-insurance-scam-044128636.html?guccounter=1> (ARTICLE 008); BBC News, "*Do UK banks face another mis-selling scandal?*", 22 November 2011, accessible at <https://www.bbc.co.uk/news/business-15358930> (ARTICLE 003).

<sup>167</sup> FCA Records, *Letter and attachments*, 7 March 2011, FCA-ADD-0307; FCA Records, *Email*, 18 April 2011, 267538.

<sup>168</sup> FCA Records, *Email*, 7 March 2011, 267538.

<sup>169</sup> FCA Records, *Email*, 30 August 2011, FCA-ADD-011-0669.

<sup>170</sup> FCA Records, *Email*, 30 August 2011, FCA-ADD-011-0669.

<sup>171</sup> FCA Records, *Email*, 12 March 2012, 269736.

- a. The campaigning group Bully-Banks, which had been set up in November 2011 as a website,<sup>172</sup> launched social media accounts on both Twitter and Facebook in March 2012.<sup>173</sup> These quickly gained a considerable number of followers and were used to "*co-ordinate complaints by the owners of small and medium sized UK businesses against the conduct of Banks when mis-selling Interest Rate Swap Agreements*".<sup>174</sup> Bully-Banks' social media efforts were reinforced by a string of organised public meetings and extensive direct interactions between affected individuals, which gradually picked up momentum. As a representative of Bully-Banks put it in their evidence to this Review: "*I talked – particularly in the first two years I was on the phone from 8 o'clock in the morning to 10 o'clock at night seven da[ys] a week chatting to people ... I became aware that something really wrong had happened. ... and I'm ashamed of what the banks did and I'm ashamed of how the FCA responded to what happened*".<sup>175</sup>
- b. The FSA had also received a number of letters from MPs on the issue.<sup>176</sup> One particularly active individual in this area was Guto Bebb MP, then backbench Conservative MP for Aberconwy, who assisted constituents in pursuing complaints and raised concerns about IRHPs in several Parliamentary debates.<sup>177</sup>

---

<sup>172</sup> Meeting Transcript W (P6:L6 and P7:L7-10).

<sup>173</sup> Bully-Banks' Twitter page, accessible at [https://twitter.com/bully\\_banks?lang=en](https://twitter.com/bully_banks?lang=en), see reference to "Joined March 2012" on home page; Bully-Banks' Facebook page, accessible at <https://en-gb.facebook.com/BullyBanks/>, see "Page created" dated 23 March 2012 in "Page transparency" section.

<sup>174</sup> FCA Records, *Email*, 20 July 2013, 405682.

<sup>175</sup> Meeting Transcript W (P6:L17-20 and P7:L2-6).

<sup>176</sup> FCA Records, *ESRC Summary Paper*, 22 March 2012, FCA-B-0004; see also FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.1.

<sup>177</sup> See, for example, House of Commons Debate, "*Interest Rate Swap Products*", 21 June 2012, Hansard vol. 546, cols. 1047-88, accessible at <https://hansard.parliament.uk/Commons/2012-06-21/debates/12062137000003/InterestRateSwapProducts?highlight=guto%20bebb#contribution-12062137000362>; House of Commons Debate, "*Interest Rate Swap Derivatives*", 24 October 2013, Hansard vol. 569, cols. 456-63, accessible at <https://hansard.parliament.uk/Commons/2013-10-24/debates/13102453000001/InterestRateSwapDerivatives>; and House of Commons Debate, "*Tomlinson Report*", 17 December 2013, Hansard vol. 572, cols. 147WH-154WH, accessible at <https://hansard.parliament.uk/Commons/2013-12-17/debates/13121743000001/TomlinsonReport>.

- c. A number of former IRHP traders founded specialist consultancy organisations to advise on concerns relating to IRHPs and derivatives, and assist affected customers in making complaints.<sup>178</sup> Many of these advisers considered that the complexity and risks of these products were not widely understood and that "*there was pretty much nowhere where businesses were able to get independent advice.*"<sup>179</sup> The availability of such advisory services likely made it easier for affected individuals to raise their concerns and therefore increased the number of complaints. At least some of the advisers also raised their concerns with the FSA. For example:
- i. A former bank employee who had sold IRHPs to customers set up Benchmark Standard Ltd in early 2010. He later reflected that: "*the pressure to sell these products was immense. We weren't there to help customers or mitigate their exposure.*"<sup>180</sup> The same individual met with the FSA to raise their concerns. He stated: "*I think my FCA rules and regulations said that if I saw anything coming down the road that could impact the market I should let them know, and I did and nothing happened.*"<sup>181</sup> Subsequently, he was interviewed by the media, resulting in a Sky News report on 30 August 2011, in some of the earliest national coverage on IRHP mis-selling.<sup>182</sup>
- ii. Another consultant specialising in this area, was also a former bank employee and IRHP trader. After leaving that role, they founded Vedanta Hedging and eventually also approached the FSA about their concerns regarding mis-selling. They stated that: "*It wasn't a particularly pleasant experience. I got through [to] a call centre ... the other person on the line just had no idea what I was even talking about.*"<sup>183</sup>

---

178 Examples of such consultancies included Vedanta Hedging and Benchmark Standard Ltd..

179 Meeting Transcript N (P5:L7-8).

180 Sky News, "*Banks 'Mis-Sold' Interest Rate Protection*", 30 August 2011, accessible at <https://uk.news.yahoo.com/banks-accused-interest-rate-insurance-scam-044128636.html> (ARTICLE 008).

181 Meeting Transcript O (P43:L19-L22).

182 Sky News, "*Banks 'Mis-Sold' Interest Rate Protection*", 30 August 2011, accessible at <https://uk.news.yahoo.com/banks-accused-interest-rate-insurance-scam-044128636.html> (ARTICLE 008).

183 Meeting Transcript N (P6:L19-21 and P7:L1-2).

- d. Following the early media stories, there was growing interest in IRHPs in the national media:
- i. The Daily Telegraph and The Sunday Telegraph, in particular, published a series of articles between 10 and 13 March 2012, detailing alleged incidents of IRHP mis-selling and profiling several of the affected businesses and individuals. For example, the first such article highlighted Winking Willy's, a fish and chip shop in Scarborough, North Yorkshire, selling cod and chips, bread and butter and a cup of tea for £7.90. That café had taken its bank, HSBC, to court over the mis-selling of interest rate swaps. The Telegraph reported the café owners had settled their claim out of court in 2011 and signed a confidentiality agreement preventing them from speaking to the media. The report also highlighted the case of Adcocks, in Norfolk, a long-standing family business selling consumer electronics and white goods. Its third-generation owner, Paul Adcock, took out an "*asymmetric leverage collar*", arranged by Barclays Capital, on a £970,000 bank loan from Barclays in February 2007. Paul Adcock said: "*The damage it has caused us is unbelievable. We are just a family electrical business, just wanting to get on. Now the best part of £180,000, has gone out and that is in addition to what we have paid in loan repayments*".<sup>184</sup>
  - ii. A further article published on 14 March 2012 noted that "*dozens of small firms have complained to the Telegraph*" and reported that Andrew Tyrie MP, Chairman of the TSC between 10 June 2010 and 3 May 2017, intended to

---

<sup>184</sup> The Telegraph, "*Bank mis-selling victims: from the chippy to the small hotel*", 10 March 2012, accessible at <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9135986/Bank-mis-selling-victims-from-the-chippy-to-the-small-hotel.html> (ARTICLE 030). See also The Telegraph, "*This product was not right for my business*", 10 March 2012, accessible at <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9135947/This-product-was-not-right-for-my-business.html> (ARTICLE 034); The Telegraph, "*Treasury acts on interest rate swap claims*", 12 March 2012, accessible at <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9139606/Treasury-acts-on-interest-rate-swap-claims.html> (ARTICLE 035); and The Telegraph, "*Farmers 'hit hardest' in rate swaps scandal*", 13 March 2012, accessible at <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9141788/Farmers-hit-hardest-in-rate-swaps-scandal.html> (ARTICLE 031).

write to the FSA and request "an explanation of how this issue is being handled".<sup>185</sup>

- iii. The Financial Times, on 18 March 2012, reported that the FSA raised concerns about banking customers being told by their banks to withhold information from the FSA about the possible mis-selling of IRHPs: "*If we find widespread evidence of [regulatory] breaches or mis-selling we will take action,*" the FSA said, adding that it was unacceptable for any firm to try and prevent its customers from speaking to the regulator. The FSA added that it had "taken this up with the firm concerned and it has apologised and agreed to write to all the customers affected".<sup>186</sup>

## Section 2 – The start of the FSA's involvement

11. By 12 March 2012, FCA employee M had requested the first-tier banks supervision teams' input on the current position for each of those banks in respect of media attention regarding the sale of IRHPs. In response, the supervision team for HSBC informed M that, following a review of material from October 2011, it "*found that HSBC has commenced a review of [IRHPs] to investigate the possibility that HSBC might have mis-sold these products to retail customers*".<sup>187</sup>
12. In the light of increasing pressure regarding the issue,<sup>188</sup> on 13 March 2012, Clive Adamson, then the FSA's Director of Supervision, asked that it be considered by the ESRC, "*a high-level Executive Committee of the FCA*".<sup>189</sup> FCA employee G also recalled

---

<sup>185</sup> The Telegraph, "*FSA called to account on interest rate swap concerns*", 14 March 2012, accessible at <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9144445/FSA-called-to-account-on-interest-rate-swap-concerns.html> (ARTICLE 032).

<sup>186</sup> Financial Times, "*Interest rate swap mis-selling probed*", 18 March 2012, accessible at <https://www.ft.com/content/b58e12f4-711f-11e1-a7f1-00144feab49a> (ARTICLE 005). An internal FSA note confirmed that: "*our line is that it is unacceptable for any firm to try and prevent its customers from speaking to the FSA ... the FSA has taken this up with the firm concerned and it has apologised and agreed to write to all customers affected*"; FCA Records, *Email*, 19 March 2012, 391265.

<sup>187</sup> FCA Records, *Email*, 12 March 2012, 266298.

<sup>188</sup> Meeting Transcript Adamson (P7:L12-17).

<sup>189</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcraft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.1.



that: *"there were articles in the newspaper, I think The Telegraph was running articles, that was talking about problems with these particular products and how they had been sold and how they had been sold by the four banks. So there were questions to be asked about: is this true? What are the problems? What is happening? So there were questions to be asked and [M] and I asked some questions"*.<sup>190</sup>

13. Perhaps the first specific IRHP case to be considered by the FSA in 2012 was that of Oxbridge Carpets Limited. The business had complained about being mis-sold an IRHP.<sup>191</sup> At the request of FCA employee G, FCA employee Z was asked to review the available documentation and *"work out if it was something we needed to look into in more detail"*.<sup>192</sup> As Z acknowledged: *"I realise the FSA had looked at this previously,<sup>[193]</sup> but I didn't know anything about that back then, and I'm not sure whether [G] would have known or not. So, from our perspective this was a new issue. And it's a pretty common occurrence that something pops up like that, a complaint or a bit of intelligence from another part of the organisation or a bit of information we've gathered on a visit or something like that, and there's something that needs more investigation, either to take it on and do something about it or to close it down because we think it's either nothing or it's very small harm and we want to prioritise something else. So I went through those papers and thought that here was something that we should explore in more detail"*.<sup>194</sup> Z explained that *"it was a combination of the complexity of the products and my judgment of the sophistication of the typical customers that made me think we need to look into this in more detail"*.<sup>195</sup>
14. FCA employee Z contacted the GCD to obtain legal advice on the FSA's jurisdiction and the applicable rules, in view of raising the issue with the ESRC.<sup>196</sup> Both this email and

---

<sup>190</sup> Meeting Transcript G (P10:L6-13).

<sup>191</sup> FCA Records, *Letter and attachments*, 26 February 2010, 360731.

<sup>192</sup> Meeting Transcript Z (P9:L7-8).

<sup>193</sup> Z subsequently explained that this earlier consideration by the FSA was in the context of Project Aries, *"a couple of years previously"*: Meeting Transcript Z (P11:L12-17); see also (P18:L24-P19:L2); see further footnote 163 above.

<sup>194</sup> Meeting Transcript Z (P9:L18-P10:L7).

<sup>195</sup> Meeting Transcript Z (P11:L5-8).

<sup>196</sup> FCA Records, *Email*, 14 March 2012, 272702.

the 15 March 2012 response from FCA employee P referred to the recent media coverage of IRHPs.<sup>197</sup>

15. By 16 March 2012, the FSA was treating the mis-selling of IRHPs as an issue requiring further investigation. Internal documentation acknowledged the apparent increase in complaints and instigated an internal information-gathering exercise.<sup>198</sup> It stated that: *"Further action may be required, including assessing appropriateness, sales practices, and product design"*.<sup>199</sup> FCA employee Z noted that *"the thing that probably wasn't referred to in this document that was going on at the time was the intense, or it felt quite intense, scrutiny by The Telegraph newspaper of these sales of interest rate swaps. And so that's probably why we went from that documents-landing-on-my-desk moment to this in pretty short order. This was quicker than it would normally happen and I think it would have been the press coverage that drove that"*.<sup>200</sup>
16. In interview, Clive Adamson explained: *"I felt at the time, I recall strongly, that there was a potential significant issue here, given the campaign in The Telegraph and other information that was coming in, so I felt it was something that was started to be looked at to see whether it was a significant issue or it was just noise"*.<sup>201</sup> The minutes of a meeting held between FSA staff and HSBC record an FSA representative stating at the outset that: *"the FSA had asked for a meeting in response to media attention, HMT investigation and parliamentary questions"*.<sup>202</sup> One of the banks which gave evidence to the Review summarised the background to the FSA's involvement more bluntly: *"My understanding of why they did [this] was because the Bank of England ... had decided to slash interest rates to try and help small businesses as a response to the financial crash and there was a lot of noise from SMEs with fixed rate loans saying, 'That's not helping*

---

<sup>197</sup> FCA Records, *Email*, 15 March 2012, 272702.

<sup>198</sup> See, for example, FCA Records, *CBU Supervision Team Weekly Update*, 16 March 2012, FCA-B-0001, p. 5: *"In light of an apparent increase in complaints banks' mis-selling of interest rate hedge products, we have under-taken a very quick review of past FSA action in the area and the scope for future consumer detriment for ESRC"*.

<sup>199</sup> FCA Records, *CBU Supervision Team Weekly Update*, 16 March 2012, FCA-B-0001, p. 5.

<sup>200</sup> Meeting Transcript Z (P12:L25-P13:L8).

<sup>201</sup> Meeting Transcript Adamson (P8:L12-18).

<sup>202</sup> FCA Records, *Note For Record*, 21 March 2012, 279964, p. 2.

*me because I've got a swap and I'm locked in." So the pressure was brought to bear for the FCA to have a look. The FCA agreed they would".*<sup>203</sup>

17. On 19 March 2012, Andrew Tyrie MP wrote to the FSA's Chairman, Lord Turner.<sup>204</sup> He expressed concern regarding "*recent reports from a number of small businesses over the way they have been sold complex interest rate derivative products by the major banks*".<sup>205</sup> He enquired whether there was "*any evidence that banks have inappropriately sold these products to businesses on a widespread basis*" and sought confirmation that the FSA intended to investigate the matter and take action. The letter was published by the TSC.<sup>206</sup>

### Section 3 – Initial information-gathering exercise

18. On 21 March 2012, the FSA set out an initial plan for a more detailed information-gathering exercise.<sup>207</sup> Amongst others, the steps proposed included information requests to banks and follow-up meetings to discuss these requests, as well as meetings with other interested parties such as affected customers, organisations such as the Federation of Small Businesses and Bully-Banks, and the FOS. The FSA thereby hoped to gain a greater understanding of "*the design of the products*", the extent to which the processes and practices used to sell them were appropriate and rule-compliant, and the scale of any mis-selling as well as any remedial measures already taken by the banks.<sup>208</sup>
19. Another issue highlighted in the initial plan was "*incentives*", with requests meant to target information pertaining to matters such as the "*profitability of each product*" and "*sales targets/incentives on staff*".<sup>209</sup> The stated aim of this was to help "*us understand the root cause of the problem (eg profitability)]*".<sup>210</sup> Commenting in their evidence to this Review, FCA employee M stated: "*we did request from the firms exactly the profitability of the products and the incentive schemes in place and I do recall there were*

---

<sup>203</sup> Meeting Transcript CT (P15:L12-20). For the avoidance of doubt, the Bank of England's approach to interest rates is not within the scope of this Review and it makes no findings in respect of that.

<sup>204</sup> FCA Records, *Letter*, 19 March 2012, FCA-B-0002.

<sup>205</sup> FCA Records, *Letter*, 19 March 2012, FCA-B-0002.

<sup>206</sup> FCA Records, *Letter*, 19 March 2012, FCA-B-0002.

<sup>207</sup> FCA Records, *Internal Document*, 21 March 2012, FCA-B-0003.

<sup>208</sup> FCA Records, *Internal Document*, 21 March 2012, FCA-B-0003, p. 2.

<sup>209</sup> FCA Records, *Internal Document*, 21 March 2012, FCA-B-0003, p. 2.

<sup>210</sup> FCA Records, *Internal Document*, 21 March 2012, FCA-B-0003, p. 2.

quite significant incentive schemes in place... we were very conscious, and there was history going back if you look at PPI, around the incentives in place around sales incentives for frontline staff on PPI, and also profitability.... [S]o it was very important for us, as supervisors, to understand what was driving the reason and whether there were reasons or additional drivers for sales of these products".<sup>211</sup> In their view, such incentives were one of the root causes of the mis-selling.<sup>212</sup> Despite this, no detailed assessment of "incentives" appears to have been carried out by the FSA.

20. The initial plan was summarised in the ESRC Summary Paper of 22 March 2012. The paper noted that: "*a number of customers have complained about the large banks' mis-selling of products designed to allow small businesses borrowing funds to hedge against interest rate fluctuations. We first became aware of this in around 2010, but it has been the subject of recent press coverage*".<sup>213</sup> In line with the initial plan, it recommended "*undertaking a short (one month) piece of further discovery work to better quantify the scale of the problem, and report back to ESRC*".<sup>214</sup>
21. At that point, the FSA had only a limited understanding of the scale of the issue. It assumed a mis-selling rate of only around 5 per cent, based on the FOS complaint uphold rates.<sup>215</sup> The ESRC Summary Paper of 22 March 2012 explained that "*the FOS has dealt with a number of complaints on these products. However, based on data we have received from some of the banks, it appears that the FOS has rejected around 95% of complaints. We understand that the findings in favour of the firms are typically made on the basis of the clarity of the documentation provided*".<sup>216</sup> It later became clear to the FSA that the mis-selling rate was likely to be much higher than first thought.<sup>217</sup>

---

<sup>211</sup> Meeting Transcript M (P12:L25-P13:L9).

<sup>212</sup> Meeting Transcript M (P13:L10-13) "*I think there were a number of root causes. I think this [i.e. incentives] was one of them. Yes, I'll leave it at that. I think this was one of them*". G agreed that "*there was some evidence of poor incentives*" but considered that "*I don't think there was the same heinous behaviour as there has been in other areas*", such as PPI; Meeting Transcript G (P108:L10-18).

<sup>213</sup> FCA Records, *ESRC Summary Paper*, 22 March 2012, FCA-B-0004, p. 1.

<sup>214</sup> FCA Records, *ESRC Summary Paper*, 22 March 2012, FCA-B-0004, p. 3.

<sup>215</sup> FCA Records, *ESRC Summary Paper*, 22 March 2012, FCA-B-0004, p. 2.

<sup>216</sup> FCA Records, *ESRC Summary Paper*, 22 March 2012, FCA-B-0004, p. 2.

<sup>217</sup> By the end of May 2012, the FSA estimated that the mis-selling rate was between 5 per cent and 30 per cent and used an estimate of 20 per cent for the purposes of determining the redress

22. FCA employee G explained that this assumption reflected the lack of evidence the FSA had at the time. G stated that "*at that stage we had no information directly on the number of customers who had been sold these products or the sales practices of the firms or the likelihood ... that was the best piece of information that we could use to make an assessment of at that time ... we had no information [on] which to choose another figure*".<sup>218</sup> However, FCA employee Z noted: "*5% was nothing more than a scenario at that time. We didn't know any more than that*".<sup>219</sup> While the contemporaneous documentation acknowledges "*gaps in information*" and "*the limited information we have to-date*", it is much less explicit about the scale of these gaps.<sup>220</sup>
23. The initial information-gathering exercise was approved by the ESRC on 22 March 2012, with the aim of identifying the nature, size and scale of potential issues,<sup>221</sup> and started shortly thereafter.<sup>222</sup> Information requests were sent to the first-tier banks (Barclays, HSBC, Lloyds and RBS).<sup>223</sup> Amongst others, the FSA requested information on the scale and number of relevant sales,<sup>224</sup> the nature of the products,<sup>225</sup> complaint volumes,<sup>226</sup> and documents such as facility letters, term sheets, end-to-end process maps, training

---

estimate for swaps and collars; see FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, pp. 9-10 and 29.

<sup>218</sup> Meeting Transcript G (P14:L24-P15:L8); see also (P15:L14-22).

<sup>219</sup> Meeting Transcript Z (P21:L24-25).

<sup>220</sup> FCA Records, *ESRC Summary Paper*, 22 March 2012, FCA-B-0004, pp. 3-4.

<sup>221</sup> FCA Records, *ESRC Minutes*, 22 March 2012, 281154, p. 2; see also FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, paras. 6.1-2.

<sup>222</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, paras. 6.2-3. See, for example, an internal FSA email and attachment setting out key action points; FCA Records, *Cover email and attachment*, 23 March 2012, 267511 and 267512. See also an internal FSA email from FCA employee Z, which provides an update on progress in respect of the earlier action points: FCA Records, *Email*, 27 March 2012, FCA-B-0005.

<sup>223</sup> See, for example, the 26 March 2012 information requests sent to HSBC: FCA Records, *Cover email and letter*, 26 March 2012, 267201 and 267202; and to Barclays: FCA Records, *Letter*, 26 March 2012, 289215.

<sup>224</sup> See, for example, FSA emails with Barclays of 28-29 March 2012: FCA Records, *Email*, 28 March 2012, 268463; FCA Records, *Email*, 29 March 2012, 278054.

<sup>225</sup> See, for example, FSA emails with RBS of 4 April 2012: FCA Records, *Email*, 4 April 2012, 267090.

<sup>226</sup> See, for example, FSA emails with Lloyds of 2 April 2012: FCA Records, *Email*, 2 April 2012, 266657.

materials on interest rates, and other risk mitigation measures within the bank.<sup>227</sup> The FSA also met with organisations such as Bully-Banks and Vedanta Hedging.<sup>228</sup> The discovery exercise also entailed further investigatory work by GCD regarding the legal and regulatory framework.<sup>229</sup>

24. In addition, the FSA undertook a closer examination of the FOS decisions on which its initial assessment of the likely scale of the issue had been based. The FSA did this by reviewing ten FOS complaints supplied to it by Barclays.<sup>230</sup> It also requested a meeting with the FOS, but the FOS declined,<sup>231</sup> likely due to resource pressures it was facing.<sup>232</sup> In its representations to this Review, however, the FOS noted that there was "*active engagement between the FSA and the FOS in early 2012 (and probably earlier), when the FSA began looking into sales of interest rate swaps to small business customers. The FOS spoke to the FSA on a number of occasions around this time.*"<sup>233</sup> On the basis of its review, the FSA concluded that: "*we cannot overly rely on the FOS uphold rate, since the FOS appears to have focused on the contractual provisions, rather than the inequality in the bargain[ing] positions of the parties and the potential for mis-selling.*"<sup>234</sup> FCA employee G recalled that: "*at that stage we still didn't know what the population of customers was that these products had been sold to, but we certainly knew that [among] the ones that they had been sold to there was a much higher incidence of perhaps a potential mis-sell than we had originally assumed.*"<sup>235</sup> The FSA therefore attempted to assess the potential detriment by other means.<sup>236</sup>

---

<sup>227</sup> See, for example, FSA emails with HSBC of 2 April 2012: FCA Records, *Email*, 2 April 2012, 287238.

<sup>228</sup> Meeting Transcript Z (P31:L9-12).

<sup>229</sup> See, for example, internal FSA emails from FCA employee P: FCA Records, *Email*, 23 March 2012, 271966; FCA Records, *Email*, 12 April 2012, 272731 and 272732.

<sup>230</sup> Meeting Transcript A (P11:L23-P12:L11).

<sup>231</sup> FCA Records, *Internal Document*, 277925, p. 8.

<sup>232</sup> FCA employee G stated: "*I just think they were really busy and their priorities were to deal with other things at that time*"; Meeting Transcript G (P18:L24-25).

<sup>233</sup> Written Representations FOS, 1 September 2021.

<sup>234</sup> FCA Records, *Internal Document*, 16 April 2012, 268773; FCA Records, *Internal Document*, 16 April 2012, 268757.

<sup>235</sup> Meeting Transcript G (P16:L4-9).

<sup>236</sup> See, for example, FCA Records, *Internal Document*, 24 April 2012, 274093.

25. More generally, the FSA reached the preliminary view that complaints to the FOS were unlikely to offer affected consumers an adequate remedy. The author of the review of FOS cases, FCA employee A, was critical of the FOS's approach in determining these cases and concluded "*that relying too heavily on the FOS in this case probably wasn't the right outcome*".<sup>237</sup> To similar effect, FCA employee G considered that "*this was probably not a matter that the FOS could have provided an appropriate outcome for consumers on*", given the limitations on its jurisdiction and procedures.<sup>238</sup> Specifically, the role and responsibilities of the FOS and FSA were different, with the FOS limited to considering complaints from consumers or microbusinesses and looking at issues across a broad range of criteria. Further, at the time, the FOS's maximum award limit was £150,000.
26. On 17 April 2012, Lord Turner responded to Andrew Tyrie MP.<sup>239</sup> He indicated that in 2010 and 2011 the FSA became aware of a small number of complaints about the sale of interest rate products. He stated that it had "*looked into each issue at that time and instructed the firms to review their systems and correct any problems*".<sup>240</sup> He added that the FSA did not, at the time, see any widespread underlying problems. Lord Turner noted the further work the FSA was now doing to help assess the scale and severity of any potential issues and indicated that, if widespread evidence of breaches of the rules on mis-selling were found, the FSA would take action.
27. The timeline for the FSA's initial investigation was very tight, or, as FCA employee G described it, "*ambitious*".<sup>241</sup> Employee L of Lloyds noted that, while the requests were "*reasonable*", "*the timing was extremely demanding and therefore we were challenged to be able to provide everything that they had asked in the time that was allowed ... the [FSA] wanted to move at great pace*".<sup>242</sup>

---

<sup>237</sup> Meeting Transcript A (P13-L25-P14:L1).

<sup>238</sup> Meeting Transcript G (P19:L16-P20:L6).

<sup>239</sup> FSA letter from Lord Turner to Andrew Tyrie MP: FCA Records, *Letter*, 17 April 2012, 276737.

<sup>240</sup> FSA letter from Lord Turner to Andrew Tyrie MP: FCA Records, *Letter*, 17 April 2012, 276737, p. 4.

<sup>241</sup> Meeting Transcript G (P26:L9).

<sup>242</sup> Meeting Transcript Lloyds (P14:L4-10).

28. The time pressure was driven by the media coverage,<sup>243</sup> ongoing political pressure,<sup>244</sup> and the wish to avoid the kind of delays that had affected the PPI mis-selling investigation.<sup>245</sup> The FSA was also conscious of the need to provide prompt assistance to small businesses in distress. With regard to these small businesses, FCA employee G emphasised: "*We had a number of consumers who, as The Telegraph had portrayed us, were really suffering and were going bankrupt because of the payments that they were required to pay. So fast action, redress where it was due quickly, was also an important angle*".<sup>246</sup> As a result of such time pressures, the amount and quality of the information the FSA was able to gather was limited. For example, FCA employee Z suggested: "*If we had more time we could have asked for sales files at the time*",<sup>247</sup> or "*asked to interview some employees at the firms in question*".<sup>248</sup>
29. The results of the initial discovery exercise were presented to the ESRC at its next meeting on 25 April 2012,<sup>249</sup> the papers for which included a detailed presentation on "*Interest rate swaps – initial findings*".<sup>250</sup> The main preliminary conclusion was that "*there is sufficient prima facie evidence (of inappropriate or unsuitable products, poor practices and poor consumer outcomes) that we cannot walk away from this problem at this stage*".<sup>251</sup> Further, the paper stated that, while "*we do not have 'evidence' of how widespread the breaches are*", "*detriment is likely to be greater than initially estimated (at the March ESRC meeting) and outside the FSA's tolerance*".<sup>252</sup> At the meeting, it was "*noted that the data from FOS which highlighted 5% of complaints were upheld, was*

---

<sup>243</sup> See, for example, Meeting Transcript Z (P13:L12-15).

<sup>244</sup> In particular, on 24 April 2012, more than 40 MPs formed the All-Party Parliamentary Group (APPG) on Interest Rate Swap Mis-selling, with Guto Bebb MP as its chairman. The APPG called for a Parliamentary debate on the issue and for the TSC to launch an inquiry.

<sup>245</sup> See, for example, an internal FSA extract from the minutes of the Financial Services Consumer Panel Working Group A Meeting on 18 April 2012: FCA Records, *Financial Services Consumer Panel Working Group A Minutes*, 24 April 2012, 273562. See also Meeting Transcript G (P25:L20-22).

<sup>246</sup> Meeting Transcript G (P23:L16-20).

<sup>247</sup> Meeting Transcript Z (P16:L8-9).

<sup>248</sup> Meeting Transcript Z (P16:L12-13).

<sup>249</sup> FCA Records, *ESRC Summary Paper*, 25 April 2012, FCA-B-0006.

<sup>250</sup> FCA Records, *Internal Document*, 277925.

<sup>251</sup> FCA Records, *ESRC Summary Paper*, 25 April 2012, FCA-B-0006, p. 1.

<sup>252</sup> FCA Records, *ESRC Summary Paper*, 25 April 2012, FCA-B-0006, p. 2.



*misleading as the majority of complaints made were dealt with directly between banks and their customers, implying a higher proportion of misselling than 5%".*<sup>253</sup>

30. Overall, however, the authors of the 25 April 2012 ESRC Summary Paper considered that "*the picture is not yet sufficiently clear*" and therefore proposed to undertake further work before returning to the ESRC a month later with more detailed preliminary findings and options for regulatory intervention.<sup>254</sup> The ESRC approved this proposal, agreeing "*that possible misselling had been identified and that investigations should continue*".<sup>255</sup> The ESRC also "*noted that interest rate caps and fixed rate loans had been excluded from this piece of work as the presenting team wanted to focus its resources on the riskiest products*".<sup>256</sup>
31. A more detailed presentation on the initial findings indicated that over 13,000 IRHPs (excluding caps) had been sold between 2005 and 2008.<sup>257</sup> The presentation highlighted prima facie evidence of failures in sales processes, especially around unclear/misleading documentation (for example, insufficient explanation of risks, such as break costs) and "*over-hedging*", "*anecdotal evidence of sharp sales practices*", and "*incentives/rewards not obviously aligned with customer interests*".<sup>258</sup>
32. Figure 1 compares the total number of "*Retail sales*" of IRHPs sold between 2001 and 2011 (29,162) and between 2005 and 2008 (17,453) by each of the first-tier banks and the other banks.<sup>259</sup>

---

<sup>253</sup> FCA Records, *ESRC Minutes*, 25 April 2012, 276316, p. 2. In its representations to the Review however, the FOS noted that uphold rates were low until mid-2012 and increased thereafter. Written Representations FOS, 1 September 2021.

<sup>254</sup> FCA Records, *ESRC Summary Paper*, 25 April 2012, FCA-B-0006, p. 2.

<sup>255</sup> FCA Records, *ESRC Minutes*, 25 April 2012, 276316, p. 3. See also FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.3.

<sup>256</sup> FCA Records, *ESRC Minutes*, 25 April 2012, 276316, p. 2. See further the meeting transcript with FCA employee Z, in which they stated that: "*given the greater simplicity of the product, I think that was a reasonable decision to make at the time*": Meeting Transcript Z (P41:L14-P42:L18 and P43:L17-18).

<sup>257</sup> FCA Records, *Internal Document*, April 2012, 277925, slide 19.

<sup>258</sup> FCA Records, *Internal Document*, April 2012, 277925, slide 20.

<sup>259</sup> FCA Records, *Internal Document*, May 2012, 268304, slide 4.

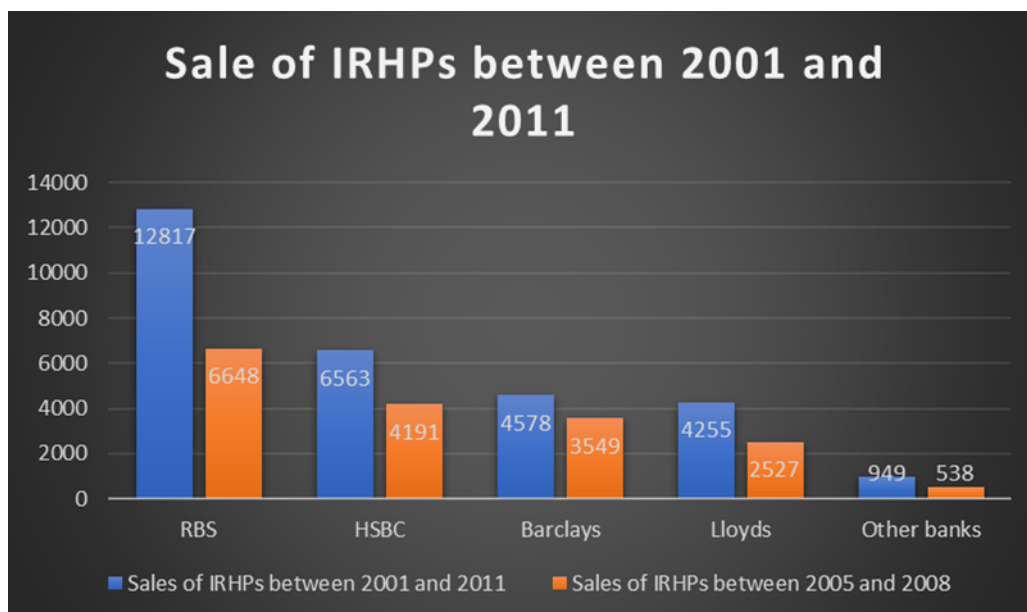


Figure 1 – Total number of "Retail" sales of IRHPs per bank between 2001 and 2011 and between 2005 and 2008.<sup>260</sup>

33. The FSA Board meeting on 26 April 2012 noted: *"the FSA's work reviewing whether there had been cases of mis-selling products that were designed to allow small businesses borrowing funds to hedge against interest rate fluctuations"*.<sup>261</sup> The supporting paper explained that: *"the Banking Sector team is now doing a one-month discovery exercise to understand in more detail the types of products that have been sold. Information has been requested from the four large banks, the Ombudsman, and a number of consumers that have been in contact with the FSA. This discovery work will help us assess the scale and severity of any potential issues. The areas of focus include product design, sales process and practices, and rewards/incentives for sales staff. This will enable an initial assessment of whether there may be a widespread issue and, if so, what further action the FSA should take"*.<sup>262</sup>

<sup>260</sup> FCA Records, *Internal Document*, May 2012, 268304, slide 4.

<sup>261</sup> FCA Records, *FSA and FCA Board Papers and Minutes*, 14 May 2013, 371428, p. 1. Note that the relevant paper was prepared in advance of a meeting held on 26 April 2012.

<sup>262</sup> FCA Records, *FSA and FCA Board Papers and Minutes*, 14 May 2013, 371428, p. 1. Note that the relevant paper was prepared in advance of a meeting held on 26 April 2012.

## Section 4 – Consideration of options for regulatory response

34. The FSA therefore continued its information-gathering exercise, extending it to a larger number of banks, including AIB, Santander and Co-op Bank.<sup>263</sup> It also developed a more comprehensive media strategy,<sup>264</sup> and updated interested Parliamentarians and HM Treasury regarding the ongoing work.<sup>265</sup> In a letter to Chris Leslie MP and Toby Perkins MP, Lord Turner committed to concluding the FSA's discovery work, and communicating what further action it may take, by the end of June.<sup>266</sup>
35. As such, the FSA also started exploring different options for a potential regulatory response.<sup>267</sup> As FCA employee G emphasised, the FSA "*certainly wanted to consider what the full range of approaches were here*".<sup>268</sup> These were summarised in a memorandum entitled "Options For Action On Interest Rate Derivatives", which was authored by FCA employee J. It considered "*what would be the most effective and proportionate response for [the FSA] to take to meet [its] objectives, and in particular to remedy past consumer detriment, and limit or prevent future detriment?*"<sup>269</sup> and outlined the respective advantages and disadvantages of the various options.

---

<sup>263</sup> See, for example, 2 May 2012 information requests sent to Santander: FCA Records, *Email*, 2 May 2012, 265233; FCA Records, *Email*, 2 May 2012, 265238. See also a note of FSA's call with AIB FCA Records, *Minutes of the call with AIB*, 4 May 2012, 264603. See also the representations to the Review by Clydesdale, which noted: "*the regulator considered us as a tier 2 organisation and, as such, we had no direct involvement in the FSA investigation that led to the review being initiated. That said, we did provide responses to requests for information from the regulator detailing the number of historic sales of IRHPs*": Written Representations Clydesdale, 15 November 2019, p. 2.

<sup>264</sup> See, for example, FCA Records, *Internal Document*, 30 April 2012, 281175; FCA Records, *Internal Document*, 10 May 2012, 261676.

<sup>265</sup> See, for example, an FSA email to HMT: FCA Records, *Email*, 1 May 2012, 264631; FCA Records, *Executive Communications Committee summary*, 18 May 2012, 285490. See also an internal FSA email to Martin Wheatley: FCA Records, *Email*, 13 June 2012, 269108.

<sup>266</sup> FCA Records, *FSA and FCA Board Papers and Minutes*, 14 May 2013, 371428, p. 2. Note that the relevant paper was prepared in advance of a meeting held in May 2012. See also FCA Records, *Internal Document*, 30 April 2012, 281175. See also FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-B-0010, p. 1.

<sup>267</sup> Meeting Transcript J (P9:L19-25 and P13:L12-21).

<sup>268</sup> Meeting Transcript G (P22:L8-9).

<sup>269</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, para. 2.

36. The options were assessed against the FSA's desired outcomes, which the memorandum identified as: (i) swift and appropriate remediation for customers who had suffered mis-selling; (ii) the need for the chosen option to "*lead to fairer and/or faster redress than consumers might otherwise receive (were we to take a different action, or none)*", "*be legally robust/enforceable/ etc.; and*", "*not [to] place unsustainable burdens on [the FSA's] resources given other supervisory priorities*"; and (iii) to ensure adequate mitigation against the re-occurrence of similar issues in the future.<sup>270</sup> The memorandum also emphasised that "*opting for what seems initially to be swifter actions generally makes in practice for messier and delayed solutions in the longer run. Early investment in gathering a strong evidence base speeds solutions in the long run*".<sup>271</sup>
37. In the light of these desired outcomes, the memorandum went on to suggest "*two suites of options ..., the first more pragmatic, the second more rigorous*".<sup>272</sup> Both of these options entailed progressing guidance and commencing enforcement referrals in respect of firms' specific "*SYSC*<sup>[273]</sup> *failings, poor record keeping etc*".<sup>274</sup> In addition, the first option (Option A) involved discussing with the firms the provision of voluntary redress for all Structured Collar sales and the voluntary review of all other derivative sales, although at this stage apparently limited only to sales to more vulnerable categories of consumers such as schools and charities. The second option (Option B) involved commissioning Skilled Person reports on some or all of the firms' interest rate derivative sales to Private/Retail Customers.<sup>275</sup> In its evidence given in Holmcroft, the FCA stated: "*The FCA's view at that stage was that this intervention could involve a voluntary*

---

<sup>270</sup> FCA records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, para. 3. See also Meeting Transcript G (P24:L7-10); and FCA Records, *ESRC Summary Paper and further internal document*, 31 May 2012, FCA-C-010-0004.

<sup>271</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, para. 17.

<sup>272</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, para. 14.

<sup>273</sup> See the FSA Handbook's sourcebook about Senior Management Arrangements, Systems and Controls (SYSC): The Financial Services Authority, *FSA Handbook of Rules and Guidance*.

<sup>274</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, para. 15.

<sup>275</sup> This would entail a review of a significant sample of sales files against conduct criteria provided by the FSA, supplemented by consumer interviews as necessary, as well as the calculation of fair redress for any mis-sales identified, calculated using a redress logic provided by the FSA; FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, paras. 15-16.

*approach to remedial action or the use of Skilled Persons to report on sales of IRHPs, if a more robust and prescriptive approach was required. The latter scenario appeared to us to be more likely, in particular that we would commission a focused and urgent Skilled Person's report on sales of the IRHPs. This would include the Skilled Person reviewing a significant sample of files against conduct criteria determined by the FCA and calculating fair redress for any mis-sales identified. Following the Skilled Person's report we thought that the FCA would be in a position to take a definitive decision on which of the options for redress it would take forward".*<sup>276</sup>

38. The paper contemplated a "*Collective voluntary agreement*". Referring to the example of "*Splits*",<sup>277</sup> it suggested that this would be a good solution where the number of firms and customers involved was small, the aggregate cost of the remedy was not too large by the banks' standards, and it was straightforward to decide objectively which consumers ought to be included in remedial action. The evidential hurdles were deemed to be "*ML*" (i.e. medium-low), with the speed of implementation dependent on how negotiations proceeded.<sup>278</sup> The negotiations would need to take place at the highest level and the FSA would need sufficient evidence to persuade the banks it was not worth trying to "*brazen out the issue*".<sup>279</sup> The FSA considered that the advantages of a collective voluntary agreement were that it would bring a consistent approach across firms and could be agreed relatively swiftly, depending upon the industry's mood. It would send a clear and

---

<sup>276</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.4.

<sup>277</sup> It appears this is a reference to the FSA having agreed a £194 million collective voluntary compensation scheme for investors in relation to the Split Capital Investment Trusts. The Financial Services Authority, "*FSA and firms announce details of Split capital investment trust settlement*", 24 December 2004, accessible at <https://webarchive.nationalarchives.gov.uk/20081112145919/http://www.fsa.gov.uk/Pages/Library/Communication/PR/2004/114.shtml> (ARTICLE 040). Guernsey Financial Services Commission, "*GSFC and Firms Announce Details of Split Capital Investment Trust Settlement*", 24 December 2004, accessible at <https://www.gfsc.gg/news/article/gfsc-and-firms-announce-details-split-capital-investment-trust-settlement> (ARTICLE 007).

<sup>278</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, pp. 2-3. In a later paper, the last comment about the need for pragmatism/compromise was supplemented to refer to "*if firms are to agree (e.g. around limitation issues, breaches of Principles, waiving of break clauses on a non-gratia basis)*": FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 30.

<sup>279</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, p. 10.

visible message, consistent with the future FCA's approach, and would require relatively limited resources on the part of the FSA. It could also encompass customers not eligible to complain to the FOS or who would be unable to benefit from a section 404 FSMA scheme, and it could include sales failings that breached only the FSA's Principles for Businesses. Potential disadvantages were considered to include banks' willingness to negotiate being reduced if redress quantum and administrative costs were large, and that they would likely hold out for some reduction in the quantum or scope of redress. Moreover, the FSA was concerned that a voluntary agreement may not lead to a fair outcome and that it would be hard for the FSA to give convincing communications about the "*horse trading*" involved. The risk of protracted negotiations and bargaining was also noted.<sup>280</sup>

39. Individually negotiated voluntary agreements were considered a potential alternative if a collective agreement could not be negotiated. These had very similar parameters, although the paper indicated that such agreements with individual firms "*could be dignified with a VVOP*".<sup>281</sup>
40. A number of other potential regulatory responses were considered but not recommended. These included, in particular:
  - a. A consumer redress scheme under section 404 FSMA.<sup>282</sup> FCA employee J noted that, "*we felt that the hurdle for starting the 404 scheme evidentially was quite high and we probably weren't meeting it ... we did not have much clear definitive evidence of rule breaches causing loss ... we would have needed to gather significant further, broader, deeper evidence of such to justify a 404*".<sup>283</sup> Clive Adamson also stated that: "*it's difficult to use, the bar is high, and in practice would probably have meant a significant degree more discovery work to even get to the*

---

<sup>280</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, p. 10.

<sup>281</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, pp. 3 and 11. In a subsequent FSA presentation, reference to a VVOP was supplemented by reference to section 404(7) FSMA, which is also described at Chapter 2, Section 3, paras. 95-96. See also FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 34.

<sup>282</sup> See description at Chapter 2, Section 3, paras. 89-96.

<sup>283</sup> Meeting Transcript J (P16:L22-24, P17:L7-8 and P17:L14-16).

*point of even proposing it".*<sup>284</sup> This was reinforced by FCA employee G, who stated: *"you'd say, well we want something that is going to deliver redress, not just a smack on the hand. But we're in a situation here where the legal position is not strong. So if you looked at a 404, for example, there was not evidence of widespread mis-selling so perhaps not in that space where we were".*<sup>285</sup> The FSA paper noted that complex redress calculations would be needed, that the evidential hurdle was medium-high, and that it would take quite a long time to set up.<sup>286</sup> As a formal scheme, it was open to challenge and there may be pressures towards *"purity"*. The paper also noted: (i) that such a scheme was confined only to redress that would arise and be payable in law. It would thus exclude sales solely in breach of the Principles for Businesses and the standard six-year limitation period would apply; and (ii) that there was a risk of litigation if the firms were unhappy with the scheme.<sup>287</sup> Moreover, a section 404 FSMA scheme was considered unlikely to be a viable option because of the restricted scope of that provision, which meant *"such a scheme would need to be based on failures relating to general law principles in respect of which businesses could obtain a remedy or relief (e.g. negligence, breach of contract, misrepresentation, etc.) rather than FSA rules"*.<sup>288</sup> At the time, GCD noted that *"limiting the ability to do 404s to cases where there is a legal liability is a key element of the historic compromise which is s 404, to prevent us simply inventing new grounds for redress"*.<sup>289</sup>

- b. Enforcement action (which FCA employee M defined in their evidence as *"enforcement under the FSA handbook which is referral to the Enforcement division of the FSA for investigation purposes"*).<sup>290</sup> This *"[w]ould be focused on*

---

<sup>284</sup> Meeting Transcript Adamson (P25:L2-5).

<sup>285</sup> Meeting Transcript G (P23:L21-P24:L2).

<sup>286</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, pp. 2 and 9.

<sup>287</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, pp. 2 and 9.

<sup>288</sup> FCA Records, *Email*, 7 June 2012, 001891.

<sup>289</sup> FCA Records, *Email*, 10 June 2012, 001891.

<sup>290</sup> Meeting Transcript M (P18:L12-14). Note, however, that FCA employee C cautioned that the *"shorthand of "Enforcement" is used quite liberally throughout all the papers and possibly at times there was some confusion about that"*: Meeting Transcript C (P11:L13-15).

*consideration of actual rule/Principles breaches*".<sup>291</sup> The paper stated that enforcement action could highlight shortcomings in the sales practices that breached the FSA's rules, provide clear market messages as to the FSA's expectations and determination, and encourage other firms with similar mis-selling practices to undertake voluntary remedial action. However, the paper considered that the evidence hurdle was medium-high and the "bite" of this option was only assessed as "medium", as it was backward-looking and had limited "read across" to other firms.<sup>292</sup> It was labour-intensive for the FSA to implement, with "evidence-gathering by expensive skilled resource", and it stated that this would be "hard to do for more than one or two large firms". Furthermore, it would be very slow, likely taking one to two years before any remedial action and redress would reach customers. In addition, the paper expressed reservations that "the 'encourage others' effect rarely happens in practice, so approach is not industry wide or scalable" and noted that "if all major banks are refer[red] to enforcement for the same issue, this negates the poor press which is a motivating factor for the retail banks" and that "[s]ettlement may not be perceived as transparent."<sup>293</sup> A later FSA paper reiterated that enforcement action was likely to be a good option where significant mis-selling was confined to "just one or two [banks] (such that [there would be] sufficient FSA resource to carry out investigation)".<sup>294</sup> Overall, the key issue with enforcement action appears to have been the lack of evidence at the time, with the options paper envisaging Skilled Person reports as a necessary precursor. It suggested that these "should be scoped with a view to providing sufficient evidential basis for the more rigorous of the options, namely section 404, OIVOP, or [referral for] enforcement action".<sup>295</sup> FCA employee G was blunt in their assessment: "Enforcement was kind of never off the table but at that time we had nothing that we could refer to Enforcement. If you said, "We've got some media

---

<sup>291</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 31.

<sup>292</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, pp. 5 and 13.

<sup>293</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, pp. 3 and 13.

<sup>294</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 31.

<sup>295</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, p. 7.



articles here. We'd like to refer a firm to Enforcement." They would have said, "Thank you very much. Don't waste our time." I'm portraying the extreme position, but you had to have something before you could refer to the Enforcement, and in a mis-selling case you would have had to have had significant and systematic problems, rule-breaches".<sup>296</sup> The likely delay caused by a referral to Enforcement was a further concern, with it being assessed as a "[v]ery slow route to redress"<sup>297</sup> and FCA employee Z suggesting that it "would delay redress potentially by, I don't know, a year, three years if there were challenges and appeals".<sup>298</sup> There is evidence to suggest that by May 2012, enforcement was seen as a "plan B", which "may be effective if we are unable to agree a voluntary redress settlement."<sup>299</sup>

- c. A further option considered was whether to impose a PBR through an OIVOP or VVOP.<sup>300</sup> Specifically, the paper suggested that "the FSA could impose, as a condition for each relevant firm continuing to do [retail derivative] business", a requirement to conduct a review of past sales, including a review by skilled persons.<sup>301</sup> The paper noted, however, that such an OIVOP would need to pass through the RDC and could be challenged by the firm, so a robust amount of evidence would be needed to justify and defend it.<sup>302</sup> The "pros" of this option included greater flexibility than a section 404 FSMA scheme; scope for assurance by Skilled Persons; and a need for fewer FSA resources once it had been imposed. The "cons" identified included that it might be open to challenge as a "backdoor" s404, which evades the additional disciplines (eg consultation) under s404"; that it

---

<sup>296</sup> Meeting Transcript G (P29:L21-P30:L5).

<sup>297</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 31.

<sup>298</sup> Meeting Transcript Z (P60:L18-20).

<sup>299</sup> See FCA Records, *Internal Document*, 4 January 2013, FCA-ADD-003-0057. In particular FCA employee C commented: "We kept saying about the plan B. We were trying to have a plan B developed in parallel with the plan A. It was never as well developed." and "Reading through these papers and what others have been telling us, there seems to be a plan B option that goes from being bold in April to option B in May." FCA Records, *ESRC Summary Paper*, 31 May 2020, FCA-C-010-0004 p. 4 and FCA Records, *ESRC Summary Paper*, 25 April 2012, FCA-B-0006.

<sup>300</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, p. 14; see further description at Chapter 2, Section 3, paras, 75-84.

<sup>301</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, p. 14.

<sup>302</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, p. 14

would require a separate OIVOP for each bank with separate evidence for each firm and individual consideration by the RDC; and that it could not be established in relation to matters for which a defence of limitation would be available (six years from the date of the rule breach).<sup>303 304</sup>

- d. The FSA restitutionary powers under sections 382 and 384 FSMA received less detailed consideration but in the FSA's view were similarly affected by the lack of evidence. The FSA's paper of 19 May 2012 noted that an application to court for a restitution order/injunction would have to be preceded by the use of a discovery tool such as a section 166 FSMA review, and that the "*evidence hurdle*" was "*H[igh]? [court standards]*" and "*would have to be pure, by legal precedents*". As such, it would take quite a long time to set up, albeit an injunction could potentially be secured more quickly.<sup>305</sup> A later FSA paper, in the context of seeking restitution either through the court under section 382 FSMA or by the FSA directly under section 384 FSMA, indicated that such redress "*would have to be based on breaches of rules (not Principles), requires [the] Court or FSA to be satisfied that loss has been suffered and quantification of customer loss*". It reiterated that these options entailed a high evidence hurdle.<sup>306</sup> As FCA employee G put it: "*The main problem was that we just didn't have evidence of rule breaches. Most of those you need to have a breach. You can't order restitution if you haven't actually got a breach of rules which has led to a loss. So when we worked through or when GCD worked through those particular options, the absence of rule breaches precluded most of them at that time*".<sup>307</sup> Overall, the FSA considered that restitutionary

---

<sup>303</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009, p. 14.

<sup>304</sup> A subsequent "FSA Restricted – Enforcement" document considered obtaining redress by imposing a PBR on the firm using an OIVOP. It noted that "*If we require the firm to review cases where the firm would have a limitation defence at law, our decision to do so could be challenged on the basis that this was not reasonable or proportionate*". FCA Records, *Email and attachment*, 25 June 2012, 004393 and 004394.

<sup>305</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009.

<sup>306</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 31.

<sup>307</sup> Meeting Transcript G (P30:L19-25). See also Meeting Transcript Adamson (P25:L8-12).

powers might be better suited "To follow up a discovery tool which cannot of itself require redress — eg [a] s166 review".<sup>308</sup>

- e. In late June 2012, the FSA also gave further consideration to the use of its section 384 FSMA powers.<sup>309</sup> In relation to the question of limitation, it expressed the view that, if the FSA ordered restitution in cases where the firm would have a limitation defence at law, "our decision to do so could be challenged on the basis that this is not "just"".
41. The outcome of the further information-gathering efforts, along with a recommended response, was presented to the CSRC on 31 May 2012,<sup>310</sup> supported by a Summary Paper of the same date<sup>311</sup> and a detailed annex entitled "Interest rate swaps — findings and recommendations for next steps":<sup>312</sup>
- a. Summarising the conclusions reached, the paper stated: "We believe we have evidence to suggest a number of poor selling practices for some interest-rate hedging products amongst the four largest retail banks (Barclays, HSBC, Lloyds and RBS). However, we do not yet believe we have sufficient evidence to exercise our statutory powers to require firms to pay redress".<sup>313</sup> In the context of complex products which "contain[ed] risks to consumers", the poor sales practices identified included, amongst others, failings in respect of the disclosure of break costs, non-advised sales, poor record-keeping, and the targeting of smaller customers, all potentially exacerbated by sales rewards/incentives schemes.<sup>314</sup>

---

<sup>308</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 31.

<sup>309</sup> FCA Records, *Email and attachment*, 25 June 2012, 004393 and 004394.

<sup>310</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.6. While the witness statement provided on behalf of FCA and the Summary Paper refer to the ESRC, the minutes of the Committee meeting suggest that it was in fact the CSRC; see FCA Records, *CSRC Minutes*, 31 May 2012, 285893. Z explained in their evidence that "it was a similar level committee, it was just one that was focused on conduct issues rather than any prudential issues reflecting the fact that around now we'd been split into the internal twin peaks model of prudential and conduct": see Meeting Transcript Z (P61:L5-9).

<sup>311</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-B-0010.

<sup>312</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004.

<sup>313</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-B-0010, p. 1.

<sup>314</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-B-0010, p. 2.

- b. The recommended response put forward was to *"require firms to fund an independent review (by a skilled person, under s166) of past sales to retail clients"*.<sup>315</sup> It suggested that the FSA *"would set the terms of the review and could ask the skilled person to focus on whether breaches [sic] of particular rules had occurred and the extent of any losses incurred by customers. Assuming the skilled person found breaches of rules, we would expect the banks to provide redress to customers mis-sold these products (but could mandate this subsequently, if necessary, through other powers). This option is likely to best balance robustness and speed"*.<sup>316</sup> While the recommended response referred to "retail clients", it is unclear whether, at this stage, the FSA had in mind all retail clients or a narrower subset. For example, the annex that accompanied the ESRC Summary Paper provided more detailed recommendations. It proposed that *"all 'retail' customers (or an agreed definition of SME..."* should be written to as part of the PBR.<sup>317</sup> In relation to the question *"What's in it for the banks?"*, the paper mentions, amongst other factors, *"not taking enforcement action against firm"* and *"avoids disciplinary action..."*.<sup>318</sup>
- c. The paper added that there was *"a range of alternative options within a spectrum of: negotiating a settlement with the banks (which could lead to a speedier resolution, but potentially less redress for consumers); and referring the matter to Enforcement (which may send out a strong signal, but is likely to be a slow route to a public outcome and redress) ..."*.<sup>319</sup> Elsewhere in the material for the meeting, however, there was an acknowledgement that *"we believe we have evidence to suggest that poor selling practices took place. However, we do not yet believe we have sufficient evidence to exercise our statutory powers to require firms to pay redress, due to the sample of files not being statistically significant — in some areas, our analysis depends heavily on our judgment in relation to the interpretation of*

---

<sup>315</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-B-0010, p. 3.

<sup>316</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-B-0010, p. 3. See also FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.7.

<sup>317</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 12.

<sup>318</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, Annex 6, p. 12.

<sup>319</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-B-0010, p. 4.

*certain specific rules" and "[a]t this stage we do not consider the current evidence would be sufficiently strong to require the banks to provide redress formally under e.g. a s.404 scheme".<sup>320</sup>*

42. At the same time, there was an ongoing debate within the FSA as to the level and content of disclosure required in relation to break costs. Some FSA staff took the view that statements indicating break costs could be significant were insufficient and that, amongst other things, a clear explanation of the formulae to be used to calculate break costs in different market conditions was required.<sup>321</sup> Eventually, the FSA concluded that "*We expect firms to give customers enough information during the sales process to understand the potential scale of the break costs and the circumstances when they were going to be applied*" and made clear that "*simply stating break costs exist or that they may be "substantial", with no indication of scale [was] insufficient*".<sup>322</sup>
43. In the meeting, the CSRC decided to adopt an approach that focused on reaching a voluntary agreement with the banks, and to appoint Skilled Persons to conduct a PBR at each bank.<sup>323</sup> The minutes state:<sup>324</sup>

*"CSRC discussed possible methods for securing redress for past sales, specifying that redress should not be paid for all cases where detriment had occurred, but rather only when the consumer had been mis-sold the product. It was noted that HSBC had already stated it was willing to pay redress on the most complex product it sold, and CSRC agreed that the FSA should take a tough negotiating stance. The committee also stressed the need to resolve this issue quickly as several SMEs were already in arrears, further increasing the potential detriment. CSRC agreed that the FSA should begin preparatory work for both a S. 166 report and an Enforcement review so that the FSA could have a range of strong credible threats for the negotiations with the banks".*

---

<sup>320</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 4 and p. 11.

<sup>321</sup> See, for example, FCA Records, *Email*, 11 May 2012, 001052.

<sup>322</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 18.

<sup>323</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.8.

<sup>324</sup> FCA Records, *CSRC Minutes*, 31 May 2012, 285893, p. 1.

44. In the light of that, the CSRC decided that: (i) "*preparatory work should commence on a S.166 report and an Enforcement review*", (ii) FCA employee M should "*commence negotiations with firms on securing redress for customers*", and (iii) a proposal be prepared "*for what would be required in terms of time and resource for the FSA to conduct a review itself, should the negotiations with the firms fail*".<sup>325</sup> In its evidence given in Holmcroft, the FCA subsequently described the agreed approach as follows:<sup>326</sup>

*"Based on the agreed strategy of securing redress and conducting a past business review, and taking into account the fact that the FCA had committed to reporting its findings relating to sales of IRHPs to the public by the end of June 2012, the ESRC meeting agreed the following specific actions:*

- (a) to commence discussions with the first-tier banks;*
- (b) to seek agreement from the banks with a view to implementing the strategy agreed on by the ESRC ...;*
- (c) to make clear to the firms that enforcement action was an option; and*
- (d) to prepare communications on the FCA's findings and next steps".*

45. Commenting on the decision in their evidence, FCA employee J stated: "*I think they did not favour the idea of doing a whole further preliminary period of discovery work to gather more evidence in mis-selling or other practices using a skilled person, which was one of the main suggestions in the May paper. I presume because they thought that would take too long.*"<sup>327</sup>

46. At the time, FCA employee G expressed concerns about "*not using a s.166 - because the use of an independent party will avoid criticism that we are leaving the solution in the hands of those who created the problem.*"<sup>328</sup> In their evidence to the Review, FCA employee G later stated that this was only "*in a theoretical sense I would be concerned*

---

<sup>325</sup> FCA Records, *CSRC Minutes*, 31 May 2012, 285893, p. 2.

<sup>326</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.9.

<sup>327</sup> Meeting Transcript J (P25:L15-20).

<sup>328</sup> FCA Records, *Email*, 7 June 2012, FCA-C-001-0001.

*if we didn't use a 166. But we did use a 166".*<sup>329</sup> Similarly, Clive Adamson confirmed that it was always envisaged that the Skilled Persons would be checking the decisions by the bank but not making the decisions themselves.<sup>330</sup>

47. In its evidence given in Holmcroft, the FCA stressed the voluntary nature of the Initial Scheme as "a key feature" underpinning the FSA's strategy.<sup>331</sup> It stated that: "*There were a number of advantages to entering into a voluntary agreement with the banks ... instead of taking formal action. One such advantage was that a voluntary agreement would potentially result in redress being provided more rapidly. This was because for formal action the FCA considered that it would have needed to establish further evidence of widespread failings and, if the banks had resisted, the matter would ultimately have been likely to have been referred to the Courts. Timing was an important consideration as the customers concerned were typically small businesses who might need the funds and there were concerns that some might become insolvent. A voluntary scheme also simplified issues around the legal eligibility of customers to claim redress. It would, for example, mean that the banks would not take any limitation points in assessing redress. The obligation to pay redress was also defined as what was "fair and reasonable" which was aligned with what customers would receive under the FOS regime and which would provide a better outcome for customers than an assessment based on that [sic] would be recoverable in legal proceedings.*"<sup>332</sup>

---

<sup>329</sup> Meeting Transcript G (P36:L4-6).

<sup>330</sup> Meeting Transcript Adamson (P23:L8-12).

<sup>331</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 7.6.

<sup>332</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 7.5.

## Section 5 – Discussions with the banks and the FSA's formulation of the Initial Agreement

48. Work on implementing the strategy agreed by the CSRC "*commenced promptly*"<sup>333</sup> and discussions with the first-tier banks began on 11 June 2012.<sup>334</sup> Clive Adamson "*led the meeting with the banks, basically reporting on the initial analytical findings and setting out what the FCA ... would then do about that*".<sup>335</sup> FCA employee G explained that Clive Adamson "*set it up for them to come back and provide a commitment on that but ... if they had questions they could ask [M] or myself about the particular terms and the detailed matters there*".<sup>336</sup>
49. The FSA's "*preferred approach*"<sup>337</sup> was to agree "*Heads of Terms*" (i.e. a voluntary agreement and an undertaking) with the first-tier banks.<sup>338</sup> It sought to do so within a very tight time frame, namely by the end of June 2012,<sup>339</sup> given that it "*had publicly committed to reporting what [it had] found and next steps*" by that point.<sup>340</sup> Several banks expressed concern at the continuing time pressure the FSA thus imposed on the process. Employee PT of Lloyds, for example, stated: "*We can ... speculate as to all the pressures that the [FSA] were under at that time to kick things off, but it did feel like it was rushed and there wasn't enough time to ... properly consider some of the potential complexities in agreeing scope, definitions and the rest of it. And in due course we needed to go back*

---

<sup>333</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.11.

<sup>334</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 8.1; FCA Records, *Letter*, 20 June 2012, 342568.

<sup>335</sup> Meeting Transcript Adamson (P9:L7-9).

<sup>336</sup> Meeting Transcript G (P50:L2-7). See also Meeting Transcript Adamson (P31:L1-5).

<sup>337</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 7.2.

<sup>338</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 7.1.

<sup>339</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 7.1.

<sup>340</sup> Meeting Transcript Adamson (P33:L7-9).



to the table to discuss those sorts of areas further, which we did ... in late 2012 and early 2013".<sup>341</sup>

50. Clive Adamson recalled: "*It was a difficult process in trying to get agreement to sign up the banks, the four banks initially, to move to the pilot phase, given what they felt about the whole thing. So I would say it was a pretty intense negotiation*".<sup>342</sup>
51. This assessment can be contrasted with the perception of the banks involved in the initial negotiations:
  - a. The recollection of employee ZP of RBS is illustrative: "*They went into sort of a conclave and reviewed those files [obtained as a result of the FSA's initial information requests] and then summoned us. It was some time in June, early June 2012 at this very first meeting that I did attend where they gave us the outcome of their analysis, their review of those Pilot files. So there had been zero discussion and they just announced broadly the shape of what ultimately would become the review*".<sup>343</sup> While he remembered some "*to-ing and fro-ing*"<sup>344</sup>, "*the undertaking that was signed very closely resembled -- I couldn't tell you a major change, because I don't think there were any from that initial presentation by the FCA... The undertaking, whilst with some refinement in areas, was pretty much a reflection of what they had originally decided should be the review*".<sup>345</sup>
  - b. To similar effect, employee L of Lloyds stated: "*Can I first take issue with the expression "negotiation", because I'm not sure it felt particularly like a negotiation. I think the regulator laid out what they believed was the right thing for the industry to do and that is for them to prescribe really. ... but I wouldn't want you to think it was a negotiation. It was largely the regulator telling us what they wanted us to*

---

<sup>341</sup> Meeting Transcript Lloyds (P16:L2-10). See further Chapter 4, Section 3, paras. 58-59 and 61, and Section 4, para. 109.

<sup>342</sup> Meeting Transcript Adamson (P31:L6-10).

<sup>343</sup> Meeting Transcript RBS (P15:L22-P16:L3).

<sup>344</sup> Meeting Transcript RBS (P16:L11).

<sup>345</sup> Meeting Transcript RBS (P16:L17-24).

do".<sup>346</sup> Employee PT of Lloyds, who had participated in the process, agreed: "*Definitely it didn't feel like a negotiation, from what I saw*".<sup>347</sup>

- c. Employee AE of HSBC, although not themselves involved in the discussions leading to the Initial Agreement, was also under the impression that "*it was very much the FCA laying down terms*".<sup>348</sup> They indicated that "*it was more we were told this is what's going to happen, more than a sort of negotiation of equals*".<sup>349</sup>
  - d. To similar effect, Barclays' written representations to the Review noted that "*Barclays had limited opportunity to comment on the terms which were being simultaneously negotiated between the FCA and all affected banks*".<sup>350</sup> The author of those written representations noted that they were not personally involved in those discussions.
52. Given the banks' reluctance – as Clive Adamson put it, they "*felt that they were being railroaded into something they didn't like doing*"<sup>351</sup> – the engagement was underpinned by a threat of enforcement action if no agreement was reached. There is relatively limited documentation detailing the further discussions (which, according to FCA employee G, mostly took place over the telephone<sup>352</sup>) and the contemporaneous evidence on the extent to which enforcement was used as an express "bargaining chip" is often contradictory. In the evidence to the Review, however, most FSA personnel agreed that, as FCA employee M put it, "*at no point – we were really careful about this: did we take enforcement off the table. We were trying to get redress quickly, but enforcement was always there*".<sup>353</sup>
53. Clive Adamson explained that "*the view was Enforcement should be kept on the table partly as a way of pressurising the banks to sign up to initially the pilot and then the full scheme. But also kept on the table to possibly take action at the end of the scheme for*

---

<sup>346</sup> Meeting Transcript Lloyds (P14:L23-P15:L2 and P15:L17-19).

<sup>347</sup> Meeting Transcript Lloyds (P16:L1-2).

<sup>348</sup> Meeting Transcript HSBC (P10:L25-P11:L1).

<sup>349</sup> Meeting Transcript HSBC (P14:L11-13).

<sup>350</sup> Written Representations Barclays, 19 December 2019, p. 2

<sup>351</sup> Meeting Transcript Adamson (P31:L15-16).

<sup>352</sup> Meeting Transcript G (P50:L14-15).

<sup>353</sup> Meeting Transcript M (P32:L15-18). This view is supported by a 7 June 2012 slide-deck which lists "*enforcement referral*" as one of the "*range of options...available at this stage*" see FCA Records, *Email and attachment*, 7 June 2012, 261889, slide 11.

*misbehaviour i.e. to penalise, as it were, the original mis-selling*".<sup>354</sup> FCA employee C from the then FSA's Enforcement division recalled that two of the key points from an Enforcement perspective were that if negotiations failed, Enforcement "*wouldn't come into it completely cold having not understood what had gone on before or what the organisation was seeking to achieve*" and "*making sure or trying to make sure that whatever we did protected the interests of Enforcement in the medium to long term...not saying or writing or doing something which is going to come back and hurt us in the event of Enforcement action of whatever kind of type*".<sup>355</sup> Despite these efforts though, the FSA's position at the time was tempered by its pessimistic view on the actual prospects of any enforcement action – as FCA employee G noted: "*we were really conscious that at this stage we didn't have evidence of mis-selling. We did not have any evidence that firms had necessarily done some things wrong*".<sup>356</sup>

54. There were also "pull-factors" for the banks to join the review:

- a. Employee AE of HSBC explained that: "*as interest rates dropped significantly after 2008/9 a lot of the products that were sold, especially the interest rate swaps, started to have very large marked-to-market losses for a lot of customers*"<sup>357</sup> and exit costs were high, which "*led a lot of the customers to start complaining to not just HSBC but all the banks*".<sup>358</sup> In the light of the volume of complaints, "*everyone was getting a bit overwhelmed, so that's when I understand HSBC and all the other banks voluntarily agreed to sort of corral all these complaints into a review and so they will all do them in a similar type of way*".<sup>359</sup> Employee L of Lloyds emphasised: "*We had no desire to try and say 'we think there is no need for a scheme here, therefore go and enforce on us if you think there is because we think you're wrong.'* The banks knew the right thing to do for customers was to get a scheme going, and

---

<sup>354</sup> Meeting Transcript Adamson (P15:L12-17). See also Meeting Transcript S (P24:L24-P25:L1).

<sup>355</sup> Meeting Transcript C (P15:L10-12).

<sup>356</sup> Meeting Transcript G (P51:L20-23).

<sup>357</sup> Meeting Transcript HSBC (P8:L6-10).

<sup>358</sup> Meeting Transcript HSBC (P8:L14-15). See also Meeting Transcript Lloyds (P7:L22-P8:L1).

<sup>359</sup> Meeting Transcript HSBC (P8:L22-P9:L2).

*that an industry scheme was the right thing. But we didn't have ... negotiating power, if you like, to define what that should be. It was more to opt in / opt out".*<sup>360</sup>

- b. There was also a degree of "peer-pressure". The banks had little, if any, knowledge of each others' positions at the time<sup>361</sup> but were concerned that "*the political climate was such that at least one or two of the banks were likely to agree*", putting the remainder at significant reputational risk if they did not also sign up.<sup>362</sup>
55. As to the Initial Scheme being agreed, in its evidence given in Holmcroft, the FCA stated, that while the FSA "*wanted to ensure that there was consistency across all of the banks in the key elements of the scheme to be put to them*",<sup>363</sup> the details "*developed in the course of discussions with the banks*".<sup>364</sup> Internal documentation suggests that any such evolution of the terms of the Initial Scheme may have been driven by FSA internal discussions as much as by pushback from the banks. One email exchange amongst key operational FSA staff preparing scripts for the discussions with the banks, for example, refers to the internal situation being "*fast moving*".<sup>365</sup> It identifies several points on which "*we are departing from the ESRC*" and asks whether someone had "*squared this off Martin [Wheatley] \ Clive [Adamson] \ the ESRC Secretariat*",<sup>366</sup> with FCA employee G responding that several of these issues had been "*left flexible*"<sup>367</sup> by the ESRC, and that there was a need to "*get more control over the details of the approach*".<sup>368</sup>
56. These initial discussions between the FSA and the banks also appear to have been, in part, the origin of the idea that the Initial Scheme be limited to only a subset of Private

---

<sup>360</sup> Meeting Transcript Lloyds (P16:L24-P17:L7).

<sup>361</sup> See, for example, Meeting Transcript DX (P19:L14-15).

<sup>362</sup> Meeting Transcript CT (P12:L3-7).

<sup>363</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 7.3.

<sup>364</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 7.4.

<sup>365</sup> FCA Records, *Email*, 7 June 2012, FCA-C-001-0001, p. 3.

<sup>366</sup> FCA Records, *Email*, 7 June 2012, FCA-C-001-0001, p. 3.

<sup>367</sup> FCA Records, *Email*, 7 June 2012, FCA-C-001-0001, p. 2.

<sup>368</sup> FCA Records, *Email*, 7 June 2012, FCA-C-001-0001, p. 1.

Clients/Retail Customers, by drawing a distinction between sophisticated and non-sophisticated customers:

- a. In a meeting between the FSA and Barclays on 11 June 2012 at which Clive Adamson presented the FSA's findings, a question was raised about the distinction between proactive redress and a proactive past PBR. In response, FCA Employee G explained that proactive redress was sought where the FSA believed there was prima facie evidence to suggest a product was mis-sold, but "*exceptions might exist where the customer was sufficiently sophisticated. If this is the case, this will have to be established on a case by case basis*".<sup>369</sup> To similar effect, in a call with RBS, FCA employee G referred to the sale of structured collars, indicating that the FSA was proposing that proactive redress be provided, except where firms can positively evidence that the client truly understood the risks involved. On the same call, FCA employee G indicated in respect of Structured Collars that the FSA considered there were certain features of these products which were "*unsuitable for unsophisticated retail customers*" and that in such cases redress should be offered quickly unless the bank could prove that the sales were suitable in terms of the customer fully understanding the risks; i.e. that the bank should provide redress "*except in cases where [the bank] can demonstrate that the customers were sufficiently sophisticated*".<sup>370</sup>
- b. The banks embraced these suggestions and emphasised that there needed to be a recognition of different levels of sophistication in the customer base and that there should not be a blanket approach to redress.<sup>371</sup>
- c. In a meeting with Barclays, FCA employee G accepted that "*structured collars may have been suitable for sophisticated retail customers and that the FSA is willing to work with Barclays to determine how "sophisticated" should be interpreted*".<sup>372</sup> In

---

<sup>369</sup> FCA Records, *Internal Document*, 11 June 2012, 262847, p. 4, para. 18.

<sup>370</sup> FCA Records, *Internal Document*, 19 June 2012, 266120, p. 3, para. 13. Note that the relevant call took place on 15 June 2012.

<sup>371</sup> See, for example, FCA Records, *Email*, 17 June 2012, 455287 and FCA Records, *Internal Document*, 18 June 2012, FCA-C-010-0006.

<sup>372</sup> FCA Records, *Internal Document*, 18 June 2012, FCA-C-010-0006, p. 2, para. 5.

the same meeting, FCA employee FP also stated that criteria for "sophistication" would be agreed, but their application would need to be independently reviewed.<sup>373</sup>

- d. HSBC subsequently proposed criteria for customer sophistication, suggesting that turnover<sup>374</sup> and/or number of staff be used as a proxy.<sup>375</sup>
- e. Following this, the FSA proceeded to include a sophistication test as an eligibility threshold for the Initial Scheme, initially drafting this test by reference to the Companies Act small companies criteria. An internal FSA email of 22 June 2012 explained that this made the sophistication test more objective, aligning it with the thresholds in the Companies Act for the definition of a small company on whom the reporting requirements were limited. It indicated that the FSA presumed larger firms would have had more burdensome reporting requirements and be more sophisticated. This approach broadly aligned with the HSBC proposal and it was indicated that if this approach was adopted then the Skilled Person would not have to review the firm's decision on sophistication. However, the email also warned that "*the arguments against are that it may be more arbitrary and is much less of an assessment of an individual*".<sup>376</sup>

57. While the banks at least had a forum in which to raise objections, there was only very limited opportunity for other stakeholders to provide input during this period of discussions.<sup>377</sup> This was the subject of some criticism. In evidence to the Review, representatives of the APPG stated: "*That agreement was reached in complete secrecy from any other parties*",<sup>378</sup> and that "*there was really no consultation and no meaningful engagement in terms of the terms of reference and how it would actually be executed*".<sup>379</sup> Clive Adamson, however, took the view that there had been sufficient consultation.<sup>380</sup>

---

<sup>373</sup> FCA Records, *Internal Document*, 18 June 2012, FCA-C-010-0006, p. 2, para. 6.

<sup>374</sup> £5 million and £6.5 million were suggested.

<sup>375</sup> FCA Records, *Letter*, 20 June 2012, 456320.

<sup>376</sup> FCA Records, *Email*, 22 June 2012, 847193.

<sup>377</sup> Bully-Banks did provide the FSA with its "*fact-finding study*" entitled "The Case Against the Banks; The Mis-selling of Interest Rate Swap Agreements", which was based on a survey of over 200 respondents (ARTICLE 037). The study was submitted to the FSA on 22 June 2012 and was considered by FCA Employee G and their team: FCA Records, *Email*, 29 June 2012, 300679.

<sup>378</sup> Meeting Transcript APPG (P20:L19-20).

<sup>379</sup> Meeting Transcript APPG (P21:L24-P22:L1).

<sup>380</sup> Meeting Transcript Adamson (P34:L22-23).

He stated that there was "*no requirement to formally consult*" as no new rules had been introduced,<sup>381</sup> that there was engagement with various stakeholders,<sup>382</sup> and that "*given the range of interests ... you are not going to satisfy everybody*".<sup>383</sup>

58. On 20 June 2012, the CSRC was given an update on the engagement with the banks to date.<sup>384</sup> At that point, HSBC and Lloyds had already agreed in principle and were in the process of trying to agree draft terms with the FSA,<sup>385</sup> whereas negotiations with Barclays and RBS were ongoing, with Barclays having raised concerns and RBS having rejected the FSA's findings.<sup>386</sup> The CSRC Summary Paper indicated that "*[i]n the event that Barclays and/or RBS do not agree to pay proactive redress, based on current evidence we could refer both firms to Enforcement for disciplinary action. This would have the advantage of distinguishing between Barclays and RBS and those firms who agreed to pay redress and enable us to draw that distinction in our proposed statement, but would not necessarily be beneficial in terms of securing redress in the short term*".<sup>387</sup> The paper also stated that the FSA was "*taking advice from Enforcement Legal on whether [it had] sufficient evidence to require redress for structured collars using [their] redress powers, and whether an independently reviewed PBR of all past sales under s166 is proportionate*".<sup>388</sup> At that point, the Enforcement team had already advised that the FSA would need further evidence to obtain redress via its formal powers and that such evidence could be obtained from an independent review.<sup>389</sup>

---

381 Meeting Transcript Adamson (P34:L8-10).

382 Meeting Transcript Adamson (P34:L10-21).

383 Meeting Transcript Adamson (P35:L1) and (P35:L4-5).

384 FCA Records, *CSRC Summary Paper*, 20 June 2012, FCA-B-0011.

385 While the CSRC Summary Paper refers to these banks as "*Broadly speaking ... [having] agreed in principle*" (FCA Records, *CSRC Summary Paper*, 20 June 2012, FCA-B-0011, p. 1), the subsequent correspondence suggests that there still remained significant areas of disagreement (see for example FCA Records, *Letter*, 25 June 2012, 460868 and FCA Records, *Letter*, 25 June 2012, 262914).

386 FCA Records, *CSRC Summary Paper*, 20 June 2012, FCA-B-0011, p. 3. See also FCA Records, *FSA and FCA Board Papers and Minutes*, 14 May 2013, 371428, p. 3. Note that the relevant meeting took place on 26 April 2012. As to the specific objections raised by Barclays, see, for example, the FSA's note of the 18 June 2012 meeting between the FSA and Barclays: FCA Records, *Meeting Minutes*, 18 June 2012, FCA-C-010-0006.

387 FCA Records, *CSRC Summary Paper*, 20 June 2012, FCA-B-0011, p. 4.

388 FCA Records, *CSRC Summary Paper*, 20 June 2012, FCA-B-0011, p. 3.

389 FCA Records, *CSRC Summary Paper*, 20 June 2012, FCA-B-0011, pp. 3-4.

59. The CSRC "*considered the willingness of the 4 banks to engage with the process*" and the potential "*use of restitution powers if any bank did not agree to the scheme*".<sup>390</sup> It agreed that:<sup>391</sup>
- a. efforts should continue "*to work with the four banks to agree a uniform heads of terms on voluntary redress and past business reviews before the public statement at the end of June 2012*";
  - b. "*the public statement should state the findings on mis-selling and state which banks had agreed to a redress scheme and which had not*" and "*that the four banks involved should be informed of this approach*"; and
  - c. the FSA should also "*contact [other] firms involved in mis-selling and encourage them to agree to the voluntary heads of terms*".
60. At the next meeting of the Board on 28 June 2012, the FSA's preferred approach was summarised as coalescing around the following three key elements: "*firstly for the banks to agree to redress customers who have been mis-sold, as this will provide a robust and earlier resolution. We would require a fast track review of sales of the most complex products as we see a stronger presumption of mis-sale; secondly to use skilled persons to ensure a degree of independent oversight; and thirdly considering requesting firms to stop marketing any or all of these products to retail customers until they have fixed sales and systems and controls failings*".<sup>392</sup> The Board paper contained no reference to enforcement being considered in the alternative.<sup>393</sup>
61. At a Parliamentary debate on IRHPs, on 21 June 2012, several MPs expressed their concerns regarding the mis-selling of these products.<sup>394</sup> Andrew Tyrie MP stated: "*the [Treasury] Committee is already looking into this matter and has written to the FSA and*

---

<sup>390</sup> FCA Records, *CSRC Minutes*, 20 June 2012, 394551, p. 1.

<sup>391</sup> FCA Records, *CSRC Minutes*, 20 June 2012, 394551, p. 2.

<sup>392</sup> FCA Records, *FSA and FCA Board Papers and Minutes*, 14 May 2013, 371428, p. 3. Note that the relevant meeting took place on 28 June 2012.

<sup>393</sup> FCA Records, *FSA and FCA Board Papers and Minutes*, 14 May 2013, 371428, pp. 2-3. Note that the relevant meeting took place on 28 June 2012.

<sup>394</sup> House of Commons Debate, "*Interest Rate Swap Products*", 21 June 2012, Hansard vol. 546, cols. 1047-1088, accessible at <https://hansard.parliament.uk/Commons/2012-06-21/debates/12062137000003/InterestRateSwapProducts>.



*the Financial Ombudsman Service asking them to investigate fully and get back to us. ... we also raised this issue with the chairman of the FSA, who has promised to provide a progress report by the end of July*".<sup>395</sup> Guto Bebb MP also emphasised that "*the FSA has promised to provide a progress report, and I sincerely hope that that will be with us before the end of July, if not sooner. My concern is that businesses are being put into administration as we speak - we have seen examples of that this week alone – and in the current economic climate we should not accept the loss of any businesses or jobs as a result of mis-selling*".<sup>396</sup> Chloe Smith MP, then Economic Secretary to the Treasury, confirmed that the FSA would report before the end of June.<sup>397</sup> Following the debate, on 25 June 2012, Martin Wheatley sent a note to the Chancellor, providing a summary of the FSA's work to date. He indicated that it would be finalising next steps with the first-tier banks over the following 48-72 hours.<sup>398</sup>

62. At this time, the FSA turned its attention to drafting the terms of its proposed Initial Scheme. On 22 June 2012, GCD circulated internally a draft Written Undertaking and Settlement Agreement for consideration within the FSA before proposing it to the first-tier banks. It included reference to the possibility of encompassing the terms in a VVOP.<sup>399</sup>
63. Consistent with the comments highlighted at paragraph 41.b above concerning the banks avoiding disciplinary action, the draft Settlement Agreement indicated that, subject to no new evidence coming to light and the relevant banks adhering to the agreed terms, entering into the agreement would settle all FSA claims and they would not take any

---

<sup>395</sup> House of Commons Debate, "*Interest Rate Swap Products*", 21 June 2012, Hansard vol. 546, col. 1049, accessible at <https://hansard.parliament.uk/Commons/2012-06-21/debates/12062137000003/InterestRateSwapProducts>.

<sup>396</sup> House of Commons Debate, "*Interest Rate Swap Products*", 21 June 2012, volume 546, cols. 1049-1050, accessible at <https://hansard.parliament.uk/Commons/2012-06-21/debates/12062137000003/InterestRateSwapProducts>.

<sup>397</sup> House of Commons Debate, "*Interest Rate Swap Products*", 21 June 2012, volume 546, col. 1086, accessible at <https://hansard.parliament.uk/Commons/2012-06-21/debates/12062137000003/InterestRateSwapProducts>.

<sup>398</sup> FCA Records, *Correspondence*, 25 June 2012, 288786, p. 1.

<sup>399</sup> FCA Records, *Internal FSA email and draft Written Undertaking and draft Settlement Agreement*, 003160 and 003162.

enforcement action.<sup>400</sup> This was reversed in the draft subsequently circulated to the banks, in which the FSA's right to pursue further action was expressly preserved.<sup>401</sup>

64. In parallel, the dispute regarding the disclosure of break costs continued. On 25 June 2012, for example, HSBC wrote to Clive Adamson arguing that "*so far as the rules are concerned*" it was not required to provide such disclosure as a matter of regulatory obligation, either under the pre-MiFID or under the post-MiFID framework.<sup>402</sup> In response, Clive Adamson reiterated the FSA's view that the bank's files demonstrated insufficient information that potential break costs had been provided to customers in a way that was clear, fair and not misleading, contrary to Principle 6 (treating customers fairly) and Principle 7 (having regard to customers' information needs and communicating information to them in a way which is clear, fair and not misleading).<sup>403</sup>
65. The FSA also continued to consider alternative options using its formal powers. A paper prepared by GCD identified four options available where a bank was not willing to make proactive redress for Category A products, including the use of restitutionary powers and/or section 166 FSMA powers.<sup>404</sup>

---

<sup>400</sup> "*Future Action - 7. Subject to the facts which are known or which ought reasonably to have been known to the FSA at the date of this Agreement, and provided that the Firm honours the Undertaking: (a) this Agreement is in full and final settlement of any and all matters directly or indirectly arising out of, or connected with, the Relevant Business; and (b) The FSA will not take any disciplinary action or any other regulatory action or intervention against the Firm in respect of the Relevant Business. - 9. Nothing in this Agreement prevents or in any other way limits the FSA from taking disciplinary action or taking any other regulatory action in respect of any other matter or business involving the Firm.*"

<sup>401</sup> See para. 77c below.

<sup>402</sup> FCA Records, *Letter*, 25 June 2012, 460868. The letter further stated: "*So far as the rules are concerned, we understand the position to be as follows. Firstly, pre-MiFID, we were required, before entering into a derivative contract with a private customer, to take reasonable steps to ensure the customer understood the nature of the risks involved. The rules provided that we could rely upon the provision (and written acknowledgement by the customer) of a standard form of notice prescribed by the FSA (the warrants and derivatives risk warning notice) as tending to establish that we had complied with this obligation. In practice, we went well beyond simply providing the standard form of notice*". Clive Adamson responded: "*Throughout the period in question, FSA's Principle 6 required firms to pay due regard to the interests of their customers and to treat them fairly, while Principle 7 required firms to pay due regard to the information needs of their customers, and communicate information to them in a way which was clear, fair and not misleading. These Principles did not change following the implementation of MiFID, and remain the same today.*" FCA Records, *Letter*, 25 June 2012, 262914.

<sup>403</sup> FCA Records, *Letter*, 25 June 2012, 262914.

<sup>404</sup> FCA Records, *Cover email and attachment*, 25 June 2012, 004393 and 004394.

66. Later that day, the FSA sent the first drafts of the proposed Initial Settlement Agreement, Initial Written Undertaking and Initial Appendix to the banks (together, the "draft Initial Agreement"):<sup>405</sup>
- a. The draft Initial Agreement included both proactive redress for Structured Collars (termed "*Category A*" products), which the FSA considered to be the most complicated, and a PBR of other IRHPs. As to the latter, it distinguished between Caps (termed "*Category C*"), which the banks would review only if there was a specific customer complaint, and all remaining products (termed "*Category B*"), for which there would be a PBR to be initiated by the banks.<sup>406</sup>
  - b. In respect of customers who had been sold Category A products (but not other products), the draft Initial Agreement provided that only customers deemed to be non-sophisticated would be entitled to proactive redress. Customers who met at least two of the Initial Sophisticated Customer Criteria would not be entitled to automatic redress, but would be entitled to participate in the Initial Scheme in respect of other IRHPs. In respect of Category B and Category C products, there was no such limitation in the draft Initial Agreement.
  - c. The draft Initial Agreement identified a number of detailed "*Sales Standards*", which all sales of IRHPs were to be assessed against: "*This review will assess the compliance of the sale of the relevant Interest Rate Hedging Product with the Regulatory Requirements, taking into account, in particular, the Sales Standards. Non-compliance with any of the Sales Standards will be indicative of the Firm having contravened the Regulatory Requirements*"<sup>407</sup>. The Sales Standards included:

*"[Sales Standard 2:] In good time before conclusion of the contract, the [bank] has provided the Customer with an appropriate, comprehensible and*

---

<sup>405</sup> See, for example, FCA Records, *Cover email and attachments*, 25 June 2012, 263741, 263742 and 263743. See also FCA Records, *Cover email and attachments*, 25 June 2012, 350753, 350754 and 350755. See further, Meeting Transcript G (P53:L19-25). A copy of the draft Initial Agreement is at Appendix 4.

<sup>406</sup> See, for example, FCA Records, *Email attachment*, 25 June 2012, 263743, pp. 1-2, para. (a) and p. 6.

<sup>407</sup> FCA Records, *Email attachment*, 25 June 2012, 263743, p. 9, cl. 3.12.

*fair, clear and not misleading disclosure of any potential break costs. This disclosure includes, for example, either a worked numerical example showing indicative break costs for the Interest Rate Hedging Product which align with the term and value of the Customer's borrowing under a range of interest rates and time periods, or a description of the potential break costs for the [IRHP] which take into account the anticipated payments over the remaining term of the contract.*

*[Sales Standard 5:] The [bank] has disclosed the nature of any conflicts of interest to the Customer before undertaking business for the Customer, including any fee income the [bank] may generate from the sale of the IRHP".*

67. The email to the banks attaching these documents<sup>408</sup> proposed a meeting for the following afternoon to discuss. Amongst other things, it noted that the FSA proposal was an objective test based on the Companies Act for determining whether a customer was sophisticated, but that it would be happy to consider any alternative solutions put forward.
68. FCA employee G recalled that: "*We wanted to achieve everything that we'd set out in the draft agreement ... but I think we recognised that what we'd done was stretch the envelope all the way along*".<sup>409</sup> As such, the FSA accepted that it might be required to make concessions.<sup>410</sup> Clive Adamson noted, however, that: "*there were red lines by the [FSA]: a) that there had been mis-selling ...; b) that there had to be this past business review and automatic redress for the complex products; c) that there had to be the independent review by skilled persons*".<sup>411</sup>
69. The issues raised by the banks in response were summarised in a table circulated by FCA employee M late on 26 June 2012, including to Clive Adamson and Martin Wheatley.<sup>412</sup> They included, amongst others, a number of the banks taking issue with the FSA's proposed requirements regarding disclosure of break costs (and, in particular, whether a

---

<sup>408</sup> See, for example, FCA Records, *Email*, 25 June 2012, 457828; and FCA Records, *Email*, 25 June 2012, 460322.

<sup>409</sup> Meeting Transcript G (P53:L11-15).

<sup>410</sup> Meeting Transcript G (P54:L1-7).

<sup>411</sup> Meeting Transcript Adamson (P32:L16-21).

<sup>412</sup> FCA Records, *Email*, 26 June 2012, FCA-C-010-0007.

worked numerical example showing indicative break costs had to be provided). Two banks requested that the Initial Sophisticated Customer Criteria be applied not just to customers who had been sold Category A products but also to those who purchased Category B products. One further bank questioned the geographic scope, and two banks questioned the temporal scope, of the review, whilst another queried whether too much power was vested in the Skilled Persons.<sup>413</sup> That version of the table did not yet contain any indication of the FSA's views on these issues, although the covering email noted that "*we have had a number of very helpful discussions this evening with Clive and the managers with proposed ways forward on each of these issues. We will ponder these overnight and reconvene first thing tomorrow morning to [fin]alise our proposed solutions for these*".<sup>414</sup> RBS's objection to the Initial Scheme, however, was more fundamental; it "*just said 'we don't agree' ... [and] objected to a lot of it*".<sup>415</sup>

70. The CSRC held a meeting on 26 June 2012, at which it was updated on the latest developments in the negotiations with the banks.<sup>416</sup> The CSRC "*considered the concerns of the various banks that they felt was [sic] preventing them from signing-up to the voluntary redress scheme*" and in particular the concern that "*informing customers of a break cost being payable but not disclosing the amount was being classed as mis-selling, and this could lead to instances of 100% mis-selling by some banks*".<sup>417</sup> The CSRC also "*noted the concerns that negotiations were moving slowly in relation to the target date for announcing the redress scheme of 29 June 2012*" and Martin Wheatley and Clive Adamson "*agreed to call the relevant senior figures [at the first-tier banks] to explain that a failure to reach a voluntary agreement by the deadline would lead to proceedings against the firms involved*".<sup>418</sup>

---

<sup>413</sup> FCA Records, *Email*, 26 June 2012, FCA-C-010-0007, p. 2. See also FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, paras. 8.3-8.5.

<sup>414</sup> FCA Records, *Email*, 26 June 2012, FCA-C-010-0007, p. 1.

<sup>415</sup> Meeting Transcript G (P54:L19) and (P55:L1).

<sup>416</sup> FCA Records, *CSRC Minutes*, 26 June 2012, 289471. It is also at this meeting that the CSRC agreed that bank CEOs "*should personally attest that customer complaints would be handled properly with foreclosure action not taken against customers while they were complaining*." See p. 5.

<sup>417</sup> FCA Records, *CSRC Minutes*, 26 June 2012, 289471, p. 5.

<sup>418</sup> FCA Records, *CSRC Minutes*, 26 June 2012, 289471, p. 5.

71. On the morning of 27 June 2012, a further version of the table summarising the issues raised by the banks was circulated amongst various members of the FSA team. This version now included the FSA's "*agreed solution*" to the various issues, with the covering email referring to "*our discussions last night / this morning*".<sup>419</sup> Amongst other things, the FSA agreed internally that:<sup>420</sup>
- a. the Initial Sophisticated Customer Criteria would be amended to include a new subjective test, allowing banks to assess a customer's knowledge, which was to be signed off by the Skilled Person;
  - b. in accordance with the request from the banks, the Initial Sophisticated Customer Criteria should be applied to all customers who had been sold Category B products – the FSA's view was: "*Yes – but definition to be amended to add an additional subjective test allowing firms to assess customer's knowledge. Skilled person to sign off this determination and customer to be told*";<sup>421</sup>
  - c. the position for Category C remained to be clarified; and
  - d. the FSA was not minded to dilute the role of the Skilled Persons, which it described as "*a necessary quid pro quo of case by case judgmental review by firms and more flexible sales standard definitions*".<sup>422</sup>
72. This Review has not identified any record of a meeting of the CSRC at which these matters were discussed, including in particular the implications of the extended application of the Initial Sophisticated Customer Criteria (see paragraph 71.b above) for the exercise of the FSA's jurisdiction over the sale of IRHPs. Despite this, on 27 June 2012, a revised version of the draft Initial Agreement was re-circulated to the first-tier banks.<sup>423</sup> In particular, these contained the following material changes:

---

<sup>419</sup> FCA Records, *Email*, 27 June 2012, FCA-C-010-0008.

<sup>420</sup> FCA Records, *Email*, 27 June 2012, FCA-C-010-0008.

<sup>421</sup> FCA Records, *Email*, 27 June 2012, FCA-C-010-0008, p. 3.

<sup>422</sup> FCA Records, *Email*, 27 June 2012, FCA-C-010-0008, p. 3.

<sup>423</sup> See, for example, FCA Records, *Cover email and attachments*, 27 June 2012, 349361, 349362 and 349363.

- a. The definition of Sophisticated Customer Criteria within the draft Initial Undertaking was amended (as outlined at paragraph 71.a above). An FSA representative highlighted this "*key change*" in a meeting with RBS on 27 June 2012.<sup>424</sup>
- b. Customers who were sold Category A products but deemed to be sophisticated were now to be excluded from participation in the Initial Scheme altogether, when previously they had been entitled to participate in the PBR in the same way as Category B customers.<sup>425</sup>
- c. Customers deemed sophisticated would also be excluded from the Initial Scheme if they had been sold Category B products.
- d. In respect of the application of the Sales Standards, the sentence "*Non-compliance with any of the Sales Standards will be indicative of the Firm having contravened the Regulatory Requirements*" was omitted.<sup>426</sup> The FSA told Barclays it was of the view that "*the materiality and impact of the failure to meet one standard would determine whether a mis-sale had occurred*".<sup>427</sup>
- e. The Sales Standards were amended:
  - i. Sales Standard 2, which had previously included detailed wording in respect of disclosure of break costs requiring either a worked numerical example showing indicative break costs for the IRHP or a description of the potential break costs which took into account the anticipated payments over the remaining term of the contract (see paragraph 66.c above), now omitted those requirements. In this regard, the FSA told Barclays that they had tried to take

---

<sup>424</sup> FCA Records, *Minutes of FSA and RBS meeting*, 3 May 2012, 267548. Note that the relevant call took place on 27 June 2012. FCA Records, *Email*, 28 June 2012, 325907

<sup>425</sup> See para. 66.b, above.

<sup>426</sup> See Initial Agreement and Appendix, FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 14, cl. 3.10, as compared to Draft Initial Agreement and Appendix, FCA Records, *Email attachment*, 25 June 2012, 263743, p. 9. cl. 3.12 (see para. 66.c, above).

<sup>427</sup> FCA Records, *Minutes of FSA and Barclays meeting*, 27 June 2012, 357252.

a more rounded view and "*just refer to disclosure specific circumstances or other evidence*".<sup>428</sup>

- ii. Sales Standard 5, requiring the disclosure of any conflicts of interest to customers, was deleted.<sup>429</sup>
  - f. The redress applicable in relation to Category B and Category C products was defined only as what was fair and reasonable in the circumstances, omitting the previously included further clarification that this was to be "*based upon putting the Customer in the position they would have been in if the breach of the Regulatory Requirements had not occurred*".<sup>430</sup>
73. Following intensive further negotiations over the next two days, "*eventually [the first-tier banks] did all agree right at the last moment to sign up to the pilot scheme*".<sup>431</sup> There appears to be no record of any discussion, either at the level of the Board or at the CSRC level, as to these further discussions, or as to what the response to the issues raised by the banks should be. Yet, within days of receiving the representations from the banks on the draft Initial Agreement, the FSA had materially altered the scope of the Initial Scheme by providing that the review of Category B and Category C products should be limited, as in the case of Category A products, to non-sophisticated customers. While it appears that this important change was made as a result of the banks' representations, it has never been disclosed in any public document by the FSA or the FCA and was brought to light only in the course of this Review.
74. There was concern within the FSA that at least two first-tier banks (HSBC and RBS) may not agree to the voluntary scheme and draft Enforcement Referral Documents were prepared in relation to potential enforcement action against them for breach of the FSA's Principles and COB/COBS rules. These were drafted in case the banks were unwilling to sign up to the voluntary agreement.<sup>432</sup> As the then Director of Enforcement, Tracey

---

<sup>428</sup> FCA Records, *Minutes of FSA and Barclays meeting*, 27 June 2012, 357252.

<sup>429</sup> See FCA Records, *Cover email and attachments*, 27 June 2012, 349361, 349362 and 349363.

<sup>430</sup> See FCA Records, *Cover email and attachments*, 27 June 2012, 349361, 349362 and 349363.

<sup>431</sup> Meeting Transcript Adamson (P32:L12-13).

<sup>432</sup> FCA Records, *Draft Enforcement Referral Documents*, 28 June 2012, 496452; FCA Records, *Draft Enforcement Referral Documents*, 28 June 2012, 276523.



McDermott, put it (after the Initial Agreement was signed up to), the referral to Enforcement was "*a back-up plan [the FSA] could credibly threaten if the firms did not sign up*".<sup>433</sup>

75. The agreements with the first-tier banks were publicly announced on 29 June 2012.<sup>434</sup> The FSA's press release that day stated: "*The FSA has today announced that it has found serious failings in the sale of interest rate hedging products to some small and medium sized businesses (SMEs). We believe that this has resulted in a severe impact on a large number of these businesses. In order to provide as swift a solution to this problem as possible we have today confirmed that we have reached agreement with Barclays, HSBC, Lloyds and RBS to provide appropriate redress where mis-selling has occurred*".<sup>435</sup> The FSA also contacted all individuals who had complained to it, as well as a range of key stakeholders, to inform them about the agreement.<sup>436</sup>

#### **A. The Initial Agreement**

76. The Initial Scheme agreed with the banks is set out in the "Agreement Relating to Past Sales of Interest Rate Hedging Products", appended to this Report.<sup>437</sup> This was a contract between the FSA and the banks, comprising an Initial Settlement Agreement, an Initial Written Undertaking to the FSA, and an Initial Appendix setting out the terms of the proactive redress exercise and PBR.

---

<sup>433</sup> FCA Records, *Email*, 29 June 2012, 423826.

<sup>434</sup> FCA Records, *Email*, 26 June 2012, FCA-C-010-0007, p. 2. See also FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 8.9. See also a final draft of the FSA's public statement in relation to their initial review into IRHPs: FCA Records, *Internal Document*, 29 June 2012, 266180. See further an internal FSA document summarising the key communications for the end of June: FCA Records, *Internal Document*, 28 June 2012, 274551.

<sup>435</sup> The Financial Services Authority, "*FSA agrees settlement with four banks over interest rate hedging products*", 29 June 2012, accessible at <https://webarchive.nationalarchives.gov.uk/20120818030500/http://www.fsa.gov.uk/library/communication/pr/2012/071.shtml>.

<sup>436</sup> See, for example, FCA Records, *Email*, 29 June 2012, 283861. See also an FSA internal note of Clive Adamson's meeting with Guto Bebb MP: FCA Records, *Meeting Minutes*, 10 July 2012, FCA-C-001-0003.

<sup>437</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001. See also Appendix 5 appended to this Report.

77. While individual provisions are discussed in other Chapters in more detail, in outline, key points in the Initial Agreement included:
- a. A confidentiality clause,<sup>438</sup> which stipulated that the Initial Settlement Agreement was not to be disclosed to any third party except for a number of limited reasons stipulated in the agreement. The Initial Settlement Agreement did provide that the FSA "*may publish statements*" relating to the subject matter of the Initial Written Undertaking.<sup>439</sup> Yet, the Initial Agreement was not published until 12 February 2015, following intervention by the TSC.<sup>440</sup> Asked about this, Clive Adamson could not recall "*whether [the confidentiality provision] was asked for by the banks or asked for by the [FSA]*" but stated that "*it would have been unusual to disclose that private agreement*".<sup>441</sup>
  - b. An express reference that: "*The FSA has found evidence of poor practices in the Firm's sale of interest rate hedging products ... to retail clients or private customers ... on or after 1 December 2001 ..., and is concerned that such practices, combined with product complexity, customer sophistication and sales incentives may lead to poor outcomes for customers*".<sup>442</sup>
  - c. A clause preserving the possibility of future enforcement action by the FSA: "*Nothing in this Agreement prevents or in any other way limits the FSA from taking disciplinary action or taking any other regulatory action in respect of any matter or business involving the Firm*".<sup>443</sup>

---

<sup>438</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 4, cl. 11.

<sup>439</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 2, cl. 3.

<sup>440</sup> The Financial Conduct Authority, "*IRHP: agreements with the banks and instructions to the independent reviewers*", 26 April 2016, accessible at <https://www.fca.org.uk/consumers/interest-rate-hedging-products/agreements-banks-instructions-independent-reviewers> (ARTICLE 022). See further discussion in Chapter 5, Section 3, paras. 95-100.

<sup>441</sup> Meeting Transcript Adamson (P43:L13-17).

<sup>442</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 1, rec.(A).

<sup>443</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 3, cl. 6.

- d. A clause excluding any third party's ability to enforce any term of the Initial Agreement, whether under the Contracts (Rights of Third Parties) Act 1999 or otherwise.<sup>444</sup>

78. The Initial Written Undertaking and the Initial Appendix provided for:

- a. The banks, upon receipt of a written notice from the FSA under section 166 FSMA, carrying out a review in accordance with the terms set out in the Initial Appendix.<sup>445</sup>
- b. The appointment of Skilled Persons to report on the banks' conduct of the review.<sup>446</sup>
- c. Limiting the customers eligible to benefit from the Initial Scheme to non-sophisticated customers, defined in accordance with the Initial Sophisticated Customer Criteria.<sup>447</sup> Under these criteria, derived from the Companies Act,<sup>448</sup> customers would be classed as sophisticated if they had at least two of the following: (i) a turnover of more than £6,500,000; (ii) a balance sheet total of more than £3,260,000; or (iii) more than 50 employees.<sup>449</sup> Alternatively, a customer would also be classed as sophisticated if the bank was able to demonstrate that "*at the time of the sale, the Customer had the necessary experience and knowledge to understand the service to be provided and the type of product envisaged, including their complexity and the risks involved*".<sup>450</sup>

---

<sup>444</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 3, cl. 9. This clause prevented a claim by customers in an attempt to enforce the Initial Agreement between the FSA and any banks, a matter that was considered in Suremime Ltd -v- Barclays Bank Plc [2015] EWHC 2277 (QB).

<sup>445</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, pp. 6-7, para. (a).

<sup>446</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 7, para. (b).

<sup>447</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, pp. 6-7, para. (a) and pp. 10-11, para. 1.11.

<sup>448</sup> In their evidence to the Review, M recalled that: "*we wanted an objective criteria. We looked at a number of different criteria. ... I can't quite remember but the reason we came up with the Companies Act criteria is that it was the widest criteria that we could find for an SME. Because most of the other criteria ... really severely limited the pool. ... What we were trying to do was to get to the best definition of a sophisticated customer, making sure that bed and breakfasts, farms, restaurants, care homes were included but the subsidiaries of [large multi-national oil and gas companies] were not, and it was trying to come up with the best definition that we could that was grounded in law, and so that's why, if I recall, the Companies Act was used*"; Meeting Transcript M (P35:L17-P36:L12).

<sup>449</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, pp. 10-11, para. 1.11.1.

<sup>450</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 11, para. 1.11.2.

- d. A distinction between three different types of IRHPs, each of which requiring a different response, as set out in the Initial Appendix:<sup>451</sup>
- i. **Category A:** proactive provision of fair and reasonable redress for all non-sophisticated customers who had been sold **Structured Collars**;<sup>452</sup>
  - ii. **Category B:** a PBR of sales of **all IRHPs other than Structured Collars and Caps** to non-sophisticated customers, leading to the provision of fair and reasonable redress where appropriate;<sup>453</sup>
  - iii. **Category C:** assessing any complaint by a non-sophisticated customer regarding the sale of **Caps** in accordance with the process for Category B.<sup>454</sup>
- e. The standards to assess compliance in the context of the PBR, including in particular the Sales Standards,<sup>455</sup> which included requirements regarding the "*disclosure of any potential break costs*"<sup>456</sup> and which drew a distinction between "*advised*", "*non-advised*" sales before 31 October 2007, and "*non-advised*" sales from 1 November 2007.<sup>457</sup>
- f. The cessation of "*all marketing of Structured Collars to retail clients*".<sup>458</sup>
- g. An attestation from each of the banks' Chief Executive Officers confirming they would have oversight of the relevant bank's review and that each CEO would ensure that their bank "*prioritises any Customers who are in financial difficulty and, except in exceptional circumstances, such as, for example, where this is necessary to preserve value in the Customer's business, will not foreclose on or adversely vary existing lending facilities (without giving prior notice to the*

---

<sup>451</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 1, para. (a) and p. 11, para. 2.

<sup>452</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, pp. 11-13, paras. 3.1-3.6.

<sup>453</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, pp. 13-15, paras. 3.7-3.16.

<sup>454</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 15, paras. 3.17-3.18.

<sup>455</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, pp. 9-10, para. 1.9. and p. 14, para. 3.10.

<sup>456</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 10, para. 1.9.2.

<sup>457</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 10, paras. 1.9.5-1.9.8.

<sup>458</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 7, para. (c).

*Customer and obtaining their prior consent) until [the bank] has issued a final redress determination and, if relevant, provided redress to that Customer".<sup>459</sup>*

79. Compared to the draft Initial Agreement sent to the banks just days earlier, the Initial Agreement contained a number of significant changes. In particular, these included:
- a. as addressed at paragraph 73 above, applying the Initial Sophisticated Customer Criteria to all three categories of IRHP, rather than just Category A, thereby reducing the number of customers eligible under the Initial Scheme;<sup>460</sup> and
  - b. removing the express requirement for a worked example/description of break costs.<sup>461</sup>
80. On the basis of the Initial Agreement, the FSA and the banks then proceeded to the commencement of the Initial Scheme.
81. FCA employee M emailed colleagues the same day to congratulate them on what M described as "*a better deal for the many SMEs affected*".<sup>462</sup> Martin Wheatley wrote to colleagues in similar terms, referring to the project as "*a great success for small business consumers and was a result of your hard work and determination and endeavour*".<sup>463</sup> Martin Wheatley also wrote to Andrew Tyrie MP of the TSC to provide him with an update on the agreement reached with the first-tier banks,<sup>464</sup> and Mark Hoban MP Financial Secretary to HMT between May 2010 and September 2012 in similar terms.<sup>465</sup> Speaking publicly, he emphasised that "*I am particularly pleased that the CEOs Bob Diamond, Brian Robertson, Antonio Horta-Osorio and Chris Sullivan have provided a personal assurance that they will have responsibility for oversight of this [restitution] work and will ensure that complainants are treated fairly*".<sup>466</sup> Mark Hoban MP, then

---

<sup>459</sup> FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, pp.7-8.

<sup>460</sup> FCA Records, *Cover email and attachment*, 25 June 2012, 263741 and 263743, pp. 1-2, para. (a).

<sup>461</sup> See FCA Records, *Email attachment*, 25 June 2012, 263743, pp. 4-5, para. 1.7.2. See also FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 9, para. 1.9.2.

<sup>462</sup> FCA Records, *Email*, 29 June 2012, 324788.

<sup>463</sup> FCA Records, *Email*, 29 June 2012, 324793.

<sup>464</sup> FCA Records, *Letter*, 29 June 2012, 276541.

<sup>465</sup> FCA Records, *Letter*, 29 June 2012, 496208.

<sup>466</sup> BBC News, "*Banks 'guilty of serious failings' in small-business sales*", 29 June 2012, accessible at <https://www.bbc.co.uk/news/business-18640346>.

Treasury Minister, speaking on BBC News, said: "*As the FSA said, there have been serious failings here and it's right that the FSA and the banks work together to tackle this because you know a lot of small businesses have paid out money on these hedging products and it's right that schemes are put in place to compensate them and that there is investigation of this*".<sup>467</sup>

---

<sup>467</sup> See video interview of Mark Hoban MP: BBC News, "*FSA finds banks guilty of mis-selling to small firms*", 29 June 2012, accessible at <https://www.bbc.co.uk/news/business-18640101>.

## Chapter 4

### Main Scheme (July 2012 to January 2013)

1. This Chapter deals with the events from the announcement of the Initial Scheme up to the introduction of the Main Scheme, covering the period between 1 July 2012 and 31 January 2013.

#### Section 1 - July–August 2012

2. As set out in Chapter 3, on 29 June 2012 the FSA announced the Initial Agreement it had reached with the first-tier banks, covering 90 per cent of the IRHPs sold to Private Customers/Retail Clients during the Relevant Period.<sup>468</sup>

#### A. Internal governance

3. In the days following the announcement of the Initial Agreement, the FSA sought to determine an appropriate structure and plan "*to take the key parts of this work forward ... (with pace)*".<sup>469</sup> In particular, the FSA set up a "*formal governance process*" over decision-making arising out of the work regarding the Initial Scheme. This governance process, which came to be known as the IRS Steering Group,<sup>470</sup> comprised FCA employees G and M, and FCA employee S together with the "*core bank supervision managers*" and delegates from Enforcement, GCD, Authorisations, and the Communications team.<sup>471</sup> In addition, a technical workstream also was established.<sup>472</sup> It was envisaged that "*the technical group would be experts from across the FCA that would have the technical knowledge to work through any knotty issues. And the steering group would be the...key decision-making committee body*".<sup>473</sup> The CBU ExCo decided

---

<sup>468</sup> FCA Records, *FSA Board Minutes*, 14 May 2013, 371428, p. 4. See also the statement published by the FCA on 23 July 2012, which refers to the second-tier banks constituting a small portion of overall sales ("*around 10%*"): The Financial Conduct Authority, "*Seven more banks agree to join FSA's review of sales of interest rate hedging products to SMEs*", 23 July 2012, accessible at

<https://webarchive.nationalarchives.gov.uk/20120818063423/http://www.fsa.gov.uk/library/communication/pr/2012/075.shtml>.

<sup>469</sup> FCA Records, *Email*, 3 July 2012, 297284.

<sup>470</sup> See, for example, FCA Records, *Email*, 12 July 2012, 291866.

<sup>471</sup> FCA Records, *Email*, 3 July 2012, 297284.

<sup>472</sup> See, for example, FCA Records, *Email*, 19 September 2012, 371988.

<sup>473</sup> Meeting Transcript S (P11:L24-P12:L3).

that Clive Adamson would take the strategic lead on the IRHP project, including "governance, communications and resourcing".<sup>474</sup>

## B. Responses to the Initial Agreement and stakeholder engagement

4. The conclusion of the Initial Agreement occurred at a time when the FSA's transition to the FCA was in contemplation, with the "cutover" date being 1 April 2013.<sup>475</sup> This created additional pressure for the Scheme to be delivered promptly and successfully<sup>476</sup> and to provide a "quick success" for the new organisation.<sup>477</sup> Speaking publicly on 4 May 2012, Martin Wheatley had indicated: "*In order for our regulation to work better than before, we need to understand why people make mistakes and why firms do what they do. So we are looking at consumer behaviour, and business models in firms to inform our new, more forward looking and intrusive supervision*".<sup>478</sup> The regulatory response to the IRHP issue was seen as a prime illustration of that new approach.<sup>479</sup>

---

<sup>474</sup> FCA Records, *CBU ExCo Minutes*, 3 July 2012, FCA-ADD-004-0012. The FCA stated that the IRS Steering Group was established in August 2012 to deliver the objective of the second phase of the project; see Confidential work package 1, 16 September 2020, p. 9, para. 5.3. (WORK PACKAGE 001). However, it seems the IRS Steering Group was established in August 2012 as the key decision-making body.

<sup>475</sup> See, for example, FCA Records, *Email*, 7 March 2013, 378306.

<sup>476</sup> FCA Employee G noted "*It was part of the culture to work at pace. So that's part of the cultural shift ... It kept pressure on the firms. We kept moving along*"; see Meeting Transcript G (P27:L15-17).

<sup>477</sup> As noted by one interviewee to this Review: "*the feeling was that the FSA's philosophy in doing these things was too passive ... the new organisation had to be bolder and act quicker and act in the interests of consumers, broadly defined, more assertively. So that was why pace was one of the features of this*"; See Meeting Transcript Adamson (P19:L4-15). See also a speech delivered by Martin Wheatley to the Chartered Institute of Bankers: The Financial Conduct Authority, "*Rebuilding trust and confidence in banks and bankers*", 4 May 2012, accessible at <https://webarchive.nationalarchives.gov.uk/20120818000943/http://www.fsa.gov.uk/library/communication/speeches/2012/0504-mw.shtml>.

<sup>478</sup> The Financial Conduct Authority, "*Rebuilding trust and confidence in banks and bankers*", 4 May 2012, accessible at <https://webarchive.nationalarchives.gov.uk/20120818000943/http://www.fsa.gov.uk/library/communication/speeches/2012/0504-mw.shtml>.

<sup>479</sup> An internal FSA email dated 29 June 2012 congratulated employees for their efforts in securing the Initial Agreement and stated: "*Today we have achieved a better deal for the many SMEs affected. We proved that we can act with pace*". See FCA Records, *Email*, 29 June 2012, 324788.



5. Yet, the announcement of the Initial Agreement precipitated a significant volume of (direct and indirect) representations from a range of third-party stakeholders, many of whom expressed reservations about the Initial Scheme that had been agreed. For example:
- a. On 3 July 2012, Bully-Banks' representatives met with Vince Cable MP, then Secretary of State for Business, Innovation and Skills.<sup>480</sup> Bully-Banks, now with nearly 900 members, was concerned that it had not been given the opportunity to provide final input on the Initial Scheme before the FSA's announcement.<sup>481</sup>
  - b. On 4 July 2012, Guto Bebb MP wrote to the FSA addressing various "*omissions*" in the Initial Scheme.<sup>482</sup> These included concerns about the Initial Sophisticated Customer Criteria and the lack of detail as to what constituted fair and reasonable redress (including whether it included consequential loss).<sup>483</sup> He also raised concerns regarding the lack of independence in the decision-making and oversight process.<sup>484</sup> Clive Adamson, FCA employee G and FCA employee LP met with Guto Bebb MP on 10 July 2012 to discuss these issues. In relation to fair and reasonable redress, and the possible inclusion of consequential loss, G explained that the FSA had "*not given guidance on this point but we haven't ruled it out*".<sup>485</sup>
  - c. On 11 July 2012, Bully-Banks wrote to the FSA, setting out its response to the Initial Scheme and outlining various concerns.<sup>486</sup> A Bully-Banks representative also presented the FSA with a proposed alternative redress scheme the following

---

<sup>480</sup> See FCA Records, *Email*, 6 July 2012, 355854.

<sup>481</sup> Bully-Banks asked Vince Cable MP's advisers: "*to read [their] concerns regarding the FSA's review and remedies as in their present form they are not practical, and deeply flawed*". Bully-Banks claimed the banks had been given the opportunity to discuss the best way forward in the early hours of Friday morning before the FSA published its release; see FCA Records, *Email*, 2 July 2012, 337144.

<sup>482</sup> FCA Records, *Letter*, 4 July 2012, 1130702.

<sup>483</sup> FCA Records, *Letter*, 4 July 2012, 1130702, pp. 2-3.

<sup>484</sup> FCA Records, *Letter*, 4 July 2012, 1130702, pp. 3-4.

<sup>485</sup> FCA Records, *Email*, 10 July 2012, 335849. See also an internal note ahead of the meeting between Clive Adamson and Guto Bebb MP: FCA Records, *Internal Document*, 10 July 2012, 293347. Consequential loss was ultimately included in the Main Scheme (see Chapter 4, Section 3, para. 106 below) and led to a number of issues during the implementation phase (see Chapter 5, Section 3, paras. 130-142).

<sup>486</sup> FCA Records, *Letter*, 11 July 2012, 1266380.

day.<sup>487</sup> At the time, the FSA noted internally that the biggest difference between the Initial Scheme and the scheme proposed by Bully-Banks was *"the approach to independence. Instead of our s166, they are proposing a scheme that is independently administered by a single entity, funded by the banks but selected and appointed by the FSA"*.<sup>488</sup>

- d. On 13 July 2012, Vince Cable MP wrote to the FSA, also raising a number of issues regarding the Initial Scheme, including the Initial Sophisticated Customer Criteria and the potential for their abuse.<sup>489</sup> Martin Wheatley responded on 24 July 2012 acknowledging the importance of ensuring that small businesses could be *"confident that the review of their case and any redress calculation is being conducted impartially"*.<sup>490</sup> Regarding the Initial Sophisticated Customer Criteria, he stated:

*"The criteria we are using to determine whether a customer is 'sophisticated' are taken from the Companies Act 2006 (in the context of the small companies regime). We consider that such customers are less likely to have staff or advisers with the necessary skills and knowledge to understand these products. We have also introduced a more subjective test which is based on companies' experience and knowledge and this reflects the fact that some customers may be small in size but nevertheless sophisticated users of financial products (e.g. special purpose vehicles). However, we share your concerns that the classification of customers should not be subject to abuse and that is why we have required every bank's assessment of whether a customer is 'sophisticated' to be scrutinised by the independent reviewer"*.<sup>491</sup>

---

<sup>487</sup> FCA Records, *Email*, 12 July 2012, FCA-ADD-011-0577.

<sup>488</sup> FCA Records, *Email*, 16 July 2012, FCA-ADD-011-0601.

<sup>489</sup> FCA Records, *Letter*, 13 July 2012, 358080.

<sup>490</sup> FCA Records, *Letter*, 24 July 2012, 318083.

<sup>491</sup> FCA Records, *Letter*, 24 July 2012, 318083.

- e. On 31 July 2012, the FSB wrote to HMT, raising its concerns regarding "*the definition of a 'sophisticated investor', what is 'fair and reasonable redress' and the role of an independent reviewer overseen by the FSA*".<sup>492</sup>
- f. The FSA's contact centre continued to receive queries from customers directly. For example, around mid-August 2012, a number of Barclays' customers contacted the FSA about Barclays' approach to complaint-handling in relation to IRHPs, requiring the FSA to agree "*lines on IRS complaints*".<sup>493</sup>
6. As the FSA acknowledged, improved processes were required to "*bring order immediately to the significant volume of external contact in response to our statements*".<sup>494</sup> Despite this, at the time, the organisation considered its stakeholder engagement in the run-up to the Initial Agreement – and the Initial Scheme more generally – a success. An internal FCA document prepared for the Board described the IRHP project as "*a key success*"<sup>495</sup> and emphasised that it had involved much more proactive customer engagement in the form of "*a customer contact exercise to obtain as much detail as possible about sales practices for customers who had contacted [the FSA] in the past. This provided a valuable source of intelligence and was instrumental in providing credible feedback to banks*".<sup>496</sup> In particular, it identified Bully-Banks as "*a key stakeholder in the IRHP Review [that] has been useful in helping us ensure the review is designed to suit customers, provided valuable intelligence on how banks were behaving and become an effective lobbying group that has developed the power to influence banks and HMT*".<sup>497</sup>

---

<sup>492</sup> FCA Records, *Letter*, 31 July 2012, 291699.

<sup>493</sup> FCA Records, *Email*, 17 August 2012, 361082.

<sup>494</sup> FCA Records, *Email*, 3 July 2012, 297284 (Original emphasis).

<sup>495</sup> FCA Records, *Internal Document*, April 2012, 001813, p. 1, para. 1. Note that this document is erroneously dated April 2012. FCA employee A first circulated the document internally on 4 April 2013. FCA Records, *Email*, 4 April 2013, 001812.

<sup>496</sup> FCA Records, *Internal Document*, April 2012, 001813, p. 6, para. 31. Note that this document is erroneously dated April 2012. FCA employee A first circulated the document internally on 4 April 2013. FCA Records, *Email*, 4 April 2013, 001812.

<sup>497</sup> FCA Records, *Internal Document*, April 2012, 001813, p. 6, para. 32. Note that this document is erroneously dated April 2012. FCA employee A first circulated the document internally on 4 April 2013. FCA Records, *Email*, 4 April 2013, 001812.

### C. Agreements with the second-tier banks

7. A key priority following the announcement of the Initial Agreement was to bring the second-tier banks "on board".<sup>498</sup> FCA employee M indicated on 3 July 2012 that "we have already signed up in principle NAGE and Santander and are progressing the others urgently. We would like to be in a position to issue [a] press release on this next week".<sup>499</sup> By 11 July 2012, Clydesdale,<sup>500</sup> Co-op Bank<sup>501</sup> and the Bank of Ireland<sup>502</sup> had signed up to the Initial Agreement. The following day, Santander<sup>503</sup> and Northern Bank<sup>504</sup> also signed the Initial Agreement, with AIB following shortly thereafter.<sup>505</sup>
8. As with the first-tier banks, at the time the FSA did not publish the Initial Agreements reached with the second-tier banks.<sup>506</sup> This issue was raised in a 19 July 2012 request under FOIA. The requestor sought the release of the Initial Agreement. The FSA concluded that it required the consent of each of the first-tier banks before it could publish the Initial Agreements.<sup>507</sup> Members of the IRS Steering Group drafted a letter which was to be sent to each of the four banks seeking such consent. An internal FSA email conveyed its position at the time as follows:<sup>508</sup>

*"The firm [bank] should not feel pressured into releasing this, so please tread carefully. If you speak to your firm about this you could explain that we are subject to the Freedom of Information Act, that we need to ask the question [consent from the banks] to show willing in case it goes to the Information Commissioner and that they [the banks] are under no pressure to agree".*

---

<sup>498</sup> FCA Records, *Email*, 3 July 2012, 297284.

<sup>499</sup> FCA Records, *Email*, 3 July 2012, 297284.

<sup>500</sup> FCA Records, *Undertaking*, 11 July 2012, 811399.

<sup>501</sup> FCA Records, *Agreement*, 11 July 2012, 847906.

<sup>502</sup> FCA Records, *Undertaking*, June 2012, 446898.

<sup>503</sup> FCA Records, *Email and Undertaking*, 12 July 2012, 342971-2.

<sup>504</sup> FCA Records, *Agreement*, 11 July 2012, FCA-C-010-0015. "The Pilot Findings Paper later noted that "Northern Bank subsequently confirmed they had not sold any IRHPs that would fall within the scope of the review to relevant customers" and, therefore they were not involved in the Scheme.

<sup>505</sup> FCA Records, *Undertaking*, 24 July 2012, FCA-B-0036.

<sup>506</sup> See Chapter 3, Section 5, para. 77a.

<sup>507</sup> See FCA Records, *Email*, 1 October 2012, FCA-C-003-0007.

<sup>508</sup> FCA Records, *Email and Letter*, 20 September 2012, 364875-6.

9. In the event, neither Lloyds nor Barclays consented to the FSA making public the Initial Agreement,<sup>509</sup> and on that basis the FSA declined to disclose it in response to the FOIA request. In the course of this Review, the FCA provided the following further explanation:<sup>510</sup>

*"... the scope of the confidentiality provision appears to have been limited to the June 2012 agreement (the "Agreement") and not to extend to the undertaking by the banks to carry out a s166 review that was appended to the Agreement (the "Undertaking"). It was the Undertaking, not the Agreement, that was of greatest relevance to IRHP customers ... [and that] the FCA is legally obliged to protect confidential information under section 348 FSMA. Section 348 applied to confidential information received during the negotiations that resulted in the June 2012 agreements, separately from any contractual obligations arising out of a confidentiality clause".*

10. The impact of the refusal to disclose the Initial Agreements, and the FSA's approach to transparency more generally, are discussed further in Chapter 5, as well as Chapters 7 and 8.
11. On 23 July 2012, the FSA publicly announced that AIB, Bank of Ireland, Clydesdale, Co-op Bank, Northern Bank and Santander had all agreed to review their IRHP sales in the UK.<sup>511</sup> In its press release, the FSA acknowledged it had *"not examined [the second-*

---

<sup>509</sup> FCA Records, *Email*, 26 September 2012, 805858; FCA Records, *Email*, 28 September 2012, 537701.

<sup>510</sup> Confidential work package 4, 16 September 2020, pp. 2-3, paras. 6 and 8 (WORK PACKAGE 004)

<sup>511</sup> The Financial Conduct Authority, *"Seven more banks agree to join FSA's review of sales of interest rate hedging products to SMEs"*, 23 July 2012, accessible at <https://webarchive.nationalarchives.gov.uk/20120818063423/http://www.fsa.gov.uk/library/communication/pr/2012/075.shtml>. Irish Bank Resolution Corporation Limited subsequently also signed up to the Initial Agreement on 9 October 2012; see FCA Records, *Cover email and attachments*, 9 October 2012, 455545, 455546 and 455547. However, on 7 February 2013, the Irish Government announced the liquidation of the Irish Bank Resolution Corporation. As a result, it did not take part in the Scheme. The Financial Conduct Authority, *"IRHP: background to the review"*, May 2016, accessible at <https://www.fca.org.uk/consumers/interest-rate-hedging-products/background-review> (ARTICLE 044).

tier banks'] sales of interest rate hedging products and so has not made any finding of mis-selling".<sup>512</sup>

12. The press release emphasised that "*the FSA has been working to ensure that banks fulfil their commitments to their customers as soon as practicable*" and that it "*expect[ed] these banks to proceed rapidly with their reviews*".<sup>513</sup>

#### **D. Board meeting on 26 July 2012**

13. At its meeting held on 26 July 2012, the Board received "*an update on the work on interest rate swaps, which would involve an independent reviewer scrutinising the work of each bank to provide redress. The FSA was now agreeing who the reviewer would be in each case*".<sup>514</sup> The Board also noted that agreement had also been obtained from a number of other banks to review their sales of IRHPs.<sup>515</sup> The supporting paper provided to the Board summarised the 29 June 2012 announcement, along with an outline of the Initial Scheme. It noted that the "*exercise for each bank will be scrutinised by an independent reviewer and overseen by the FSA*" and that the Initial Scheme was expected to lead to "*prompt redress*".<sup>516</sup>

#### **E. Appointment of the Skilled Persons**

14. Regarding the appointment of the Skilled Persons and scope of their responsibilities, the press release of 23 July 2012 quoted Clive Adamson: "*Following the agreement announced on 29 June [2012], we have pushed ahead with the necessary work to bring this announcement into reality. The terms of reference that we have agreed for the independent reviewers shows the detailed and thorough scrutiny that we will expect of*

---

<sup>512</sup> The Financial Conduct Authority, "*Seven more banks agree to join FSA's review of sales of interest rate hedging products to SMEs*", 23 July 2012, accessible at <https://webarchive.nationalarchives.gov.uk/20120818063423/http://www.fsa.gov.uk/library/communication/pr/2012/075.shtml>.

<sup>513</sup> The Financial Conduct Authority, "*Seven more banks agree to join FSA's review of sales of interest rate hedging products to SMEs*", 23 July 2012, accessible at <https://webarchive.nationalarchives.gov.uk/20120818063423/http://www.fsa.gov.uk/library/communication/pr/2012/075.shtml>.

<sup>514</sup> See FCA Records, *FSA Board Minutes*, 26 July 2012, 325367, p. 8.

<sup>515</sup> See FCA Records, *FSA Board Minutes*, 26 July 2012, 325367, p. 8.

<sup>516</sup> See FCA Records, *FSA Board Paper*, 26 July 2012, 371428, p. 3.

them".<sup>517</sup> Yet, the IRS Steering Group decided that it would be more appropriate to publish a "consumer friendly fact sheet about the 'role of the independent reviewer'", rather than the formal section 166 Requirement Notice, which defined its role.<sup>518</sup> That fact sheet, entitled "Role of the independent reviewer", was published as an annex to the FSA's announcement of 23 July 2012.<sup>519</sup> It sought to explain the role and responsibilities of the Skilled Person, but provided only a relatively high-level overview.

15. As noted by the Board, the appointments of Skilled Persons began around the end of July 2012. In its submissions to this Review, the FCA summarised its approach as follows:<sup>520</sup>

*"Fundamental to the appointment [of the Skilled Persons] is that the FCA deems the Skilled Person to be competent (has the right experience and skills), capable (right level of resourcing) and conflict free (ensures independence from the regulated firm). Given the scale of the IRHP reviews, it was sometimes necessary to have a second or even third Skilled Person to be appointed for a regulated firm. This is not typical for most s166 reviews".*

i) *Selection and vetting*

16. The banks selected their preferred Skilled Person(s) via "a tender process".<sup>521</sup> The banks and their proposed Skilled Person(s) then submitted proposals to the FSA (these differed amongst Skilled Persons and banks).<sup>522</sup>
17. The FSA considered each of the proposals and vetted the Skilled Persons – as it put it in the "Role of the independent reviewer" fact sheet: "we will either approve each bank's

---

<sup>517</sup> The Financial Conduct Authority, "Seven more banks agree to join FSA's review of sales of interest rate hedging products to SMEs", 23 July 2012, accessible at <https://webarchive.nationalarchives.gov.uk/20120818063423/http://www.fsa.gov.uk/library/communication/pr/2012/075.shtml>.

<sup>518</sup> FCA Records, *Email*, 6 July 2012, 326778.

<sup>519</sup> The Financial Conduct Authority, "Interest rate hedging products: Role of the independent reviewer", accessible at <https://webarchive.nationalarchives.gov.uk/20120817235637/http://www.fsa.gov.uk/static/pubs/other/factsheet-interest-rate-hedging-products.pdf> (ARTICLE 020).

<sup>520</sup> Confidential work package 5, 4 September 2020, p. 2, para. 8. (WORK PACKAGE 005).

<sup>521</sup> FCA Records, "Interest Rate Swap meeting with BIS", 6 July 2012, 460741.

<sup>522</sup> As one FCA employee noted to this Review: "the banks came back with I think some suggested options of who the skilled persons would be"; see Meeting Transcript E (P16:L5-6).

*nomination or we will ask the firm to nominate a different independent reviewer".*<sup>523</sup> FCA employee S recalled:

*"[T]he banks were given a very short amount of time ... to come back with their preferred skilled person, and they had to submit to us details of the skilled person and the team and what they brought. And I remember this because it was unusual. We didn't usually go through skilled person applications for want of a better word in quite so much scrutiny normally. But we went through all of those skilled person packs to see whether they had (A) sufficient resource (B) the expertise. And the expertise was very much from a number of different angles. It was about expertise of past business reviews. Expertise of doing a section 166. Expertise of the products, so the derivative products. And also expertise of small businesses as customers ... And we pushed back. I certainly remember pushing back on some of the skilled persons proposals. We got individuals changed because there wasn't enough expertise for instance on some teams that were put forward, and there were some conflicts on others. And we worked through that sort of thing".*<sup>524</sup>

18. At one point, the FSA "*objected to a whole team for a skilled person*".<sup>525</sup>
19. One concern repeatedly raised by MPs and consumer groups,<sup>526</sup> and shared by the FSA,<sup>527</sup> was the need to ensure each appointed Skilled Person was sufficiently independent of the banks it was meant to oversee. In deciding whether to approve a Skilled Person, the FSA attempted to "*deal with the conflict question upfront in oversight*" by asking for details of the proposed teams and how much of their revenue in

---

<sup>523</sup> The Financial Conduct Authority, "*Interest rate hedging products: Role of the independent reviewer*", accessible at <https://webarchive.nationalarchives.gov.uk/20120817235637/http://www.fsa.gov.uk/static/pubs/other/factsheet-interest-rate-hedging-products.pdf> (ARTICLE 020).

<sup>524</sup> Meeting Transcript S (P40:L10-P41:L11).

<sup>525</sup> Meeting Transcript G (P86:L13-14).

<sup>526</sup> See, for example, FCA Records, *Internal Document*, 6 July 2012, 293347; FCA Records, *Internal Document*, 27 November 2012, 328181\_D; and FCA Records, *Letter*, 16 December 2012, 491361.

<sup>527</sup> As noted by Clive Adamson in evidence to this Review: "*that role [of the Skilled Person] which we regarded as vital and we regarded as independent of both the FCA and the banks was very important*"; see Meeting Transcript Adamson (P24:L9-11). As noted by another interviewee to this Review: "*our intent ... was that the skilled person was there as an independent person providing the challenge to the firm*"; see Meeting Transcript S (P44:L12-15).



the last year had come from the bank in question.<sup>528</sup> One of the Skilled Persons recalled these conflict checks and explained: "*That doesn't mean we've had no dealings with them, and clearly we do have dealings with [the relevant bank] and other major institutions, but it is making sure that we are not in a situation where we would be marking our own homework effectively. So if we'd actually been involved in helping them to manage or devise some of these sales processes or something, then that would have been inappropriate. But also for these engagements we went broader than that*".<sup>529</sup>

20. Many of the Skilled Persons giving evidence to this Review emphasised their independence and the integrity of the appointment process. KPMG, one of the Skilled Persons for Barclays, for example, stated:

*"I thought it was extremely well done. I thought that the level required to report as a skilled person shouldn't be at an auditor's level. It would be very, very hard for all of the big four to remain auditor level of independence from all of the banks. That wouldn't provide the services required to the banking sector. So I think [the FSA] pitched it at the right level, from an independence point of view. There are, for example, constraints around if anybody owned shares in [bank], for example. There was a hiatus. You weren't permitted to do anything, you weren't permitted to buy more or sell any shares during the course of the engagement, for example. So there were safeguards in place for the levels of independence, but at no stage did I feel that [the FSA] were slack on the independence rules".<sup>530</sup>*

21. Despite this, the APPG remained critical of the independence of the Skilled Persons and their ability to provide effective oversight of the banks' decisions. In its written representations to this Review, it stated: "*If the Independent Reviewer [Skilled Person] was only able to approve or disapprove of what the Bank had selected then this could be seen as just marking the Bank's homework*".<sup>531</sup>

22. As noted by FCA employee S, the FSA also considered various other aspects of the Skilled Persons' suitability, such as their relevant experience and/or capacity. For

---

<sup>528</sup> Meeting Transcript G (P86:L14-15).

<sup>529</sup> Meeting Transcript FR (P10:L13-17).

<sup>530</sup> Meeting Transcript KPMG (P11:L7-22).

<sup>531</sup> Written Representations APPG, 17 July 2020, p. 44. (WRITTEN REPRESENTATION 001).

example, it objected to the appropriateness of KPMG acting as Skilled Person for three of the four first-tier banks<sup>532</sup> on the basis that it did not have adequate capacity to do so. As such, KPMG was only permitted to be appointed as Skilled Person for two of the banks.<sup>533</sup> To similar effect, the FSA also limited the use of contractors by Skilled Persons, in that it insisted they "*be very clear up front if they do use contracted resource and for them to explain how they will ensure quality when using this resource*".<sup>534</sup>

23. While the FSA thus played a significant role in determining who would be appointed as the Skilled Person(s) for each of the banks, it was the banks who were required to pay the cost of the Skilled Persons.<sup>535</sup>
24. The whole selection process was carried out very quickly. One of the Skilled Persons involved at the time noted: "*I felt, clearly for an engagement of this scale and complexity, the whole ... decision making process to appoint a skilled person, I would say it was a bit rushed*".<sup>536</sup> They explained that their organisation was given notification on a Thursday and told: "*can you turn up for a presentation on Monday at 8 am and present your ... credentials for this*".<sup>537</sup>

ii) *Requirement Notices*

25. Once the FSA had approved an appointment, it issued a Requirement Notice under section 166(3) FSMA to the relevant bank, setting out the responsibilities of the Skilled Person.<sup>538</sup> The terms of these Requirement Notices were considered first by the IRS

---

<sup>532</sup> See FCA Records, *Email*, 18 July 2012, 294031; FCA Records, *First Trilateral Meeting with FSA/RBS/Skilled Person on IRS*, 8 August 2012, 403032.

<sup>533</sup> It was communicated in early July 2012 to one of those banks that KPMG would not be acting as its Skilled Person on this basis; see FCA Records, *Telephone call with Lloyds Banking Group to discuss Interest Rate Swaps in relation to the GBSU on 27 July 2012*, 30 July 2012, 341329.

<sup>534</sup> FCA Records, *Email*, 20 August 2012, 361512.

<sup>535</sup> See, for example, FCA Records, *Requirement Notice (EY and Lloyds)*, 3 August 2012, FCA-B-0113, p. 1. The Skilled Persons were, however, required to keep the FSA informed of the cost of preparing their report; see FCA Records, *Requirement Notice (EY and Lloyds)*, 3 August 2012, FCA-B-0113, p. 2.

<sup>536</sup> Meeting Transcript ST (P11:L23-25).

<sup>537</sup> Meeting Transcript ST (P12:L9-11).

<sup>538</sup> See, for example: FCA Records, *Requirement Notice (Deloitte and AIB)*, 11 September 2012, 343839; FCA Records, *Requirement Notice (EY and Lloyds)*, 3 August 2012, FCA-B-0113; FCA Records, *Requirement Notice (KPMG and Barclays)*, 24 July 2012, FCA-C-008-0019; FCA Records, *Requirement Notice (Deloitte and Barclays)*, 16 August 2012, 355538;; FCA Records,

Steering Group<sup>539</sup> and then by FCA employee P.<sup>540</sup> According to FCA employee G, they imposed on the Skilled Persons "*real responsibilities...for actually ensuring that the banks did the right thing*".<sup>541</sup> A pro forma of the Requirement Notices for the Skilled Persons was subsequently made public.<sup>542</sup>

26. The decision to conduct the Pilot Review was taken at a very early stage.<sup>543</sup> The Requirement Notices for the first-tier banks' Skilled Persons stipulated the following timeline for completion of the Pilot Review:<sup>544</sup>
- a. Within one week of signing the contract, the bank and Skilled Person were to agree a project plan, including timelines and the methodology to be employed.
  - b. The bank was then required to undertake a review of a sample of sales of Category A, B and C products, in order to test the key aspects of the methodology and its implementation, to include customer classification, case review (where relevant) and determination of redress.
  - c. That review – excluding the review to be conducted by the FSA – was to be completed within one month of agreeing the project plan.

---

*Requirement Notice (Grant Thornton and Co-op Bank)*, 14 September 2012, FCA-B-0059; FCA Records, *Requirement Notice (BLP and NAGE)*, 24 September 2012, 309200; FCA Records, *Requirement Notice (Deloitte and HSBC)*, 25 July 2012, 299175; FCA Records, *Requirement Notice (Promontory and Lloyds)*, 24 August 2012, 449916; FCA Records, *Requirement Notice (KPMG and RBS)*, 25 July 2012, 342543; FCA Records, *Requirement Notice (Macfarlanes and RBS)*, 24 August 2012, 403556; FCA Records, *Requirement Notice (EY and Santander)*, 25 September 2012, 364889.

<sup>539</sup> See, for example, FCA Records, *Cover email and attachments*, 17 July 2012, 358046, 358047 and 358048.

<sup>540</sup> FCA Records, *Email*, 23 July 2012, 320553.

<sup>541</sup> Meeting Transcript G (P37:L13-15).

<sup>542</sup> The Financial Conduct Authority, "*Requirement Notice – Skilled Persons Report*", accessible at <https://www.fca.org.uk/publication/requirement-notices/irhp-s166-requirement-notice.pdf> (ARTICLE 027).

<sup>543</sup> FCA Records, *Email*, 12 July 2012, 291866.

<sup>544</sup> FCA Records, *Email*, 12 July 2012, 291866. See further FCA Records, *Requirement Notice (EY and Lloyds)*, 3 August 2012, FCA-B-0113, p. 4, para. 10.

27. While the Pilot Review took somewhat longer than the envisaged one-month time frame,<sup>545</sup> this still imposed considerable pressure on those involved in implementing it:

a. One Skilled Person explained: "*I think from being appointed whenever it was, end of July/early August against criteria which were set at a pretty high level in the requirements notice and the undertakings, to then get to a documented policy and methodology on which we had to report in a few weeks, three or four weeks after appointment, was tough. And it was tough, and people were really working extraordinarily hard at the time*".<sup>546</sup>

b. As one bank recalled, this reflected the unrealistic time frames imposed by the FSA more generally:

*"They either had unrealistic expectations of how long things took, or they just didn't care and just decided to put pressure on us, on the basis that the more pressure they put us under the quicker whatever it was we were going to do would get done. But from day one I would say an overriding sense was that we were up against unrealistic time pressure, be that to agree the undertaking, be it to get the Pilot done, be it to sign off the methodology, be it to complete the review. It never for one day felt like we were on top of it from that perspective. And it all came from the FCA and the expectations that they had set*".<sup>547</sup>

## **F. Development of methodologies**

28. Before the start of the Pilot Review, the FSA also asked each bank to develop a methodology setting out the policies, processes and procedures it proposed to adopt during the Pilot Review.<sup>548</sup>

---

<sup>545</sup> See, for example, the final report produced by Deloitte for HSBC's Initial Scheme, where it is stated that the Pilot Review took place between 26 September 2012 and 9 November 2012; FCA Records, Initial Scheme Skilled Person report (HSBC), 9 November 2012, 445499, p. 29, para. 3.9. Deloitte's final report for HSBC in relation to the Main Scheme noted the "*pilot phase*" period as being between August 2012 and April 2013; see FCA Records, Skilled Person report (HSBC), 10 November 2016, p. 6, para. 1.3. (REPORT 005).

<sup>546</sup> Meeting Transcript FR (P15:L17-25).

<sup>547</sup> Meeting Transcript CT (P52:L5-18).

<sup>548</sup> See, for example, FCA Records, *Requirement Notice (EY and Lloyds)*, 3 August 2012, FCA-B-0113, pp. 3-4, paras. 3 and 10.

29. The FSA thereby sought to head off methodological issues likely to arise in the course of the Scheme's implementation. FCA employee S described how the IRS Steering Group hoped that by identifying issues and ensuring consistency ahead of the Pilot Review, it would have done the "*work upfront to make sure that the reviews ran as [the FSA] intended, the vision being that we could then be more hands-off*" during the Initial Scheme.<sup>549</sup> Moreover, as FCA employee A explained, the FSA wanted to ensure that there was "*nothing baked into the methodology which would have a negative impact on the potential customer outcome*".<sup>550</sup>
30. The FSA therefore reviewed the various project plans and methodologies submitted by the banks in respect of the Pilot Review and commented on their adequacy.<sup>551</sup> Each methodology would typically go through several iterations, with the FSA repeatedly requesting banks to amend it.<sup>552</sup> Once appointed, the Skilled Persons also considered the adequacy of the methodology devised by "their" bank and reported their findings to the FSA.<sup>553</sup>
31. One bank recalled the significant difficulties involved in this process:<sup>554</sup>

*"... it was a massive challenge to write a methodology. I seem to recall not really knowing what the word "methodology" meant in that context. What do you mean by methodology? Is it an operational guide? Is it a process plan? What do you*

---

<sup>549</sup> Meeting Transcript S (P20:L4-6).

<sup>550</sup> Meeting Transcript A (P56:L10-12).

<sup>551</sup> See, for example, FCA Records, *Email*, 30 July 2012, 360622; FCA Records, *Email*, 31 August 2012, 463480; FCA Records, *Cover email and attachment*, 3 September 2012, 362900 and 362901; FCA Records, *Cover email and attachment*, 5 September 2012, 001736 and 001737; FCA Records, *Email*, 2 August 2012, 304758; FCA Records, *Cover email and attachment*, 21 September 2012, 322473 and 322474; FCA Records, *Cover email and attachment*, 21 September 2012, 364223 and 364224; FCA Records, *Email*, 9 October 2012, 420703.

<sup>552</sup> See, for example, the following comments on HSBC's submitted methodology: FCA Records, *Cover email and attachment*, 6 September 2012, 003164 and 003165; FCA Records, *Email*, 24 August 2012, 319547; FCA Records, *Meeting with Deloitte on IRS 11 September 2012*, 15 September 2012, 447692. For commentary on Lloyds' proposed methodology, see: FCA Records, *Internal Document*, 4 July 2012, 363641; FCA Records, *Email*, 6 September 2012, 306656. Barclays also noted working with the relevant Skilled Person and the FCA to get their methodology to a "*very good position*": see Meeting Transcript MS (P23:L16). See also FCA Records, *Email*, 1 October 2012, 332125.

<sup>553</sup> FCA Records, Skilled Person report (RBS), 19 May 2016, p. 13, para. 1.2.1. (REPORT 010).

<sup>554</sup> Meeting Transcript CT (P29:L18-P30:L17).

*mean? And [the FSA] couldn't really explain it properly but they said: go away, write it, send it to us and we'll send you feedback on it. We would then go and start writing it. And that would cover everything from: how you're going to build the population, how you're going to build a file, what is a file, what's in a file, what's the process for reviewing a file, what's the process for working out what passes and what fails each Sales Standard? We were left on our own to get on with that. So therefore having been set that challenge, as we started moving that forward we would run that past the Skilled Person, who would give us their feedback, such that by the time we'd finished that methodology it was in a shape where we and the Skilled Person jointly were comfortable with it, it would be sent to the FCA, and they would tell us whether they were happy. They didn't really provide guidance, they just told us whether we'd got it right or not. And I think what they were doing was then comparing what all the different banks had sent".*

32. While this process primarily took place between June and September 2012, the methodologies nonetheless remained in draft form as the Pilot Review began. In October 2012, various FCA workstreams for these methodologies were ongoing and there was an expectation within the FSA that each bank's methodology would continue to develop as the Pilot Review progressed.<sup>555</sup> Again, there was criticism of the time frames imposed by the FSA, with one Skilled Person commenting: *"I think all parties realised very quickly that this wasn't something that would be able to be done in those timeframes. I'm sure the FSA must have realised that fairly quickly as well that it was going to take them longer, as indeed of course it turned out".*<sup>556</sup>

#### **G. Practical issues insufficiently addressed by the Initial Agreement**

33. In part as a result of drawing up and reviewing the various methodologies, it soon became clear that there were certain aspects of the Initial Agreement that would need to be refined and supplemented before the banks could begin their Pilot Review. In particular, the banks and Skilled Persons lacked detail on how the Pilot Review would actually operate in practice in a number of key respects.

---

<sup>555</sup> FCA Records, *Email*, 1 October 2012, 332125.

<sup>556</sup> Meeting Transcript PQ (P17:L5-9).

34. The most prominent of these was redress, including the approach as to when and how awards should be made.<sup>557</sup> Customers raised concerns regarding comments by banks about what might constitute "*fair and reasonable redress*", such as in respect of suggestions that redress could be based on substituting a mis-sold IRHP with another, "*simpler*" one.<sup>558</sup> The FSA had not, thus far, reached a conclusion on what would constitute fair and reasonable redress. In August 2012, FCA employee G noted that "*[t]he methodology to be used in assessing sales, determining whether redress may be appropriate and the fair and reasonable nature of any such redress is yet to be finalised and needs to be approved by us. We have communicated this [to] the banks*".<sup>559</sup>
35. Other insufficiently specific aspects of the Initial Scheme included matters such as the approach to drafting customer correspondence<sup>560</sup> and the interest rate to be applied in respect of any redress payments.<sup>561</sup> One Skilled Person gave another example of the practical difficulties arising out of the lack of detail provided in the Initial Agreement in respect of the application of the Sales Standards:<sup>562</sup>

*"I mean, that's only one detail amongst many. The development of practical tests for each of the eight Sales Standards, development of policy around each of the eight Sales Standards. The Sales Standards were an expression of the standard the sale needed to meet, which was all very well in words but they need to be significantly developed from a policy perspective to be able to process cases in a consistent way with a consistent application of the Sales Standards".*

36. In response to these issues, the FSA commenced work on providing further guidance on specific problem areas, such as the principles of redress.<sup>563</sup> It also set up regular trilateral meetings between itself, the banks and the Skilled Persons, as a forum in which difficult

---

<sup>557</sup> See, for example, the proposals put forward by Barclays in respect of cash redress and the exclusion of consequential loss and limitations on break costs as a form of redress: FCA Records, *Cover email and attachments*, 7 August 2012, 356420, 356421 and 356422.

<sup>558</sup> See, for example, FCA Records, *Email*, 15 August 2012, 361094.

<sup>559</sup> FCA Records, *Email*, 15 August 2012, 361094.

<sup>560</sup> See, for example, FCA Records, *Email*, 22 August 2012, 319165.

<sup>561</sup> FCA Records, *Email*, 30 August 2012, 362589.

<sup>562</sup> Meeting Transcript PQ (P18:L18-P19:L1-2).

<sup>563</sup> See, for example, FCA Records, *Internal Document*, 17 August 2012, 319172.

issues could be discussed.<sup>564</sup> These meetings continued during implementation of the Main Scheme.

37. By the end of August 2012, however, nearly two months after the announcement of the Initial Agreement, the FSA was still in the midst of "*brainstorm[ing]*" its approach to carrying out the Pilot Review.<sup>565</sup> As part of that process, FCA employee A prepared a document which attempted to list the various questions and issues that still needed to be considered and resolved.<sup>566</sup> This subsequently formed the basis for the FSA's efforts to continue to develop a more comprehensive plan for how the Initial Scheme, and indeed the Main Scheme, should work in practice.<sup>567</sup>

## H. Remuneration

38. On 9 August 2012, the ESRC met to consider, amongst other matters, whether to take remuneration-related actions in relation to the mis-selling of IRHPs.<sup>568</sup> The ESRC Summary Paper proposed that: (i) all firms found to have mis-sold IRHPs should "*apply malus (i.e. reduce deferred unvested bonuses) on a firm-wide, business unit or (where possible) individual basis*"; (ii) individual employees terminated due to the findings of the investigation should be classed as "*bad leavers*", forfeiting their outstanding deferred awards and not being awarded any discretionary severance pay; and (iii) banks should reflect the impact of the IRHP investigation, including any fines, customer redress and reputational damage, in their 2012 bonus pools.<sup>569</sup> The paper considered "*possible enforcement actions if firms do not comply*", including an OIVOP or financial penalties.<sup>570</sup> The ESRC was presented with proposed actions under the Remuneration Code and "*discussed at length the legal complications in applying malus*" as well as the fairness of such measures and the practical difficulties of implementing them.<sup>571</sup> Following the discussion, it approved all three of the proposed actions targeting

---

<sup>564</sup> See, for example, FCA Records, *Internal Document*, 30 July 2012, 402404; FCA Records, *Internal Document*, 2 August 2012, 430604; FCA Records, *Email*, 14 August 2012, 850371.

<sup>565</sup> FCA Records, *Email*, 24 August 2012, 319881.

<sup>566</sup> FCA Records, *Cover email and attachment*, 24 August 2012, 319881 and 319882.

<sup>567</sup> See, for example, FCA Records, *Email*, 10 October 2012, 003097.

<sup>568</sup> FCA Records, *Internal Document*, 7 August 2012, 823903.

<sup>569</sup> FCA Records, *Internal Document*, 7 August 2012, 823903.

<sup>570</sup> FCA Records, *Internal Document*, 7 August 2012, 823903.

<sup>571</sup> FCA Records, *Draft ESRC Minutes*, 9 August 2012, FCA-B-0048, p. 2.



remuneration, while recognising the "*significant supervisory challenge*" involved.<sup>572</sup> This Review has seen no evidence of whether and how the ESRC's decision on remuneration actions was implemented in relation to IRHPs.<sup>572a</sup>

## I. Role of the FOS

39. Despite the Initial Agreement not providing for any involvement of the FOS, the FSA continued to grapple with whether the FOS should have any role in the Scheme and, if so, what that should be. The different types of potential FOS involvement contemplated at this stage included the FSA making changes to the FOS jurisdiction rules to broaden the definition of "*eligible complaints*" and increasing the award limit, or creating a mandatory or voluntary stand-alone FOS scheme relating to the sale of IRHPs.<sup>573</sup> Discussions between Martin Wheatley and the Chief Ombudsman began on or about 3 July 2012. At first, these centred on how the Scheme might interact with the exercise of FOS decision making.<sup>574</sup> Meanwhile, internally, the FSA continued to weigh the advantages and disadvantages of involving the FOS at all.<sup>575</sup>
40. In August 2012, the FSA again met with the FOS to further discuss possible FOS involvement, in particular the proposal for a stand-alone FOS scheme dealing with IRHPs.<sup>576</sup> In respect of eligibility for such a stand-alone scheme, the FSA's view was that: "*the eligibility criteria should reflect that of our [Past Business Review]. In other words: (a) customers excluded by the firm/skilled person should be able to go to the FOS to have the decision about exclusion reviewed. (b) customers should be able to have their fair and reasonable redress reviewed by the FOS*".<sup>577</sup> FCA employee S, who was involved in these discussions, recalled:<sup>578</sup>

---

<sup>572</sup> FCA Records, *Draft ESRC Minutes*, 9 August 2012, FCA-B-0048, p. 2.

<sup>573</sup> FCA Records, *Cover email and attachment*, 10 July 2012, 004607 and 004608.

<sup>574</sup> FCA Records, *Internal Document*, 3 July 2012, 296924, paras. 5-6.

<sup>575</sup> FCA Records, *Cover email and attachment*, 10 July 2012, 004607 and 004608.

<sup>576</sup> FCA Records, *Cover email and attachment*, 16 August 2012, 352697 and 352698. See also FCA Records, *Internal Document*, 23 August 2012, 1111887.

<sup>577</sup> FCA Records, *Internal Document*, undated, 431065. See also, in respect of a further meeting with the FOS, FCA Records, *Internal Document*, 23 August 2012, 1111887.

<sup>578</sup> Meeting Transcript S (P29:L8-13).

<sup>572a</sup> Since publication, the Review has identified some evidence of steps that were taken by the FSA/FCA to implement remuneration actions. Having considered that documentation, the Review has concluded that it does not alter any of the conclusions under the Terms of Reference.

"we were discussing either what their approach would be to cases that got referred to them and how that would interact then with the main review that the banks and the skilled persons were doing, and there was also some discussion of whether there should be a separate scheme set up".

## Section 2 - September 2012 to October 2012

### A. Continuing external stakeholder engagement

41. As the Pilot Review was about to commence, the FSA sought to keep external stakeholders updated. It published a progress update on its website<sup>579</sup> and sent correspondence to key interlocutors such as Bully-Banks.<sup>580</sup> It also required the banks to keep affected customers informed by sending them regular updates.<sup>581</sup>
42. In September 2012, however, a number of media reports raised customer expectations that they might receive early redress. On 20 September 2012, the Evening Standard stated that the Pilot Review was due to start the next day.<sup>582</sup> The same day, a headline in The Telegraph stated: "*Rate swap victims could get compensation within weeks*".<sup>583</sup> In that article The Telegraph reported that the "*independent reviewers last week started sifting through 50 cases provided by each of Britain's largest banks*", as a prelude to the Main Scheme.<sup>584</sup> Yet, as explained in Chapter 5, the first redress payments to customers were not made until late spring 2013.

---

<sup>579</sup> FCA Records, *Paper to Board*, September 2012, 354590, p. 8.

<sup>580</sup> FCA Records, *Letter*, 3 September 2012, 1266387.

<sup>581</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 9.12

<sup>582</sup> The Evening Standard, "*Banks shouldn't run mis-selling compensation scheme, says small businesses*", 20 September 2012, accessible at <https://www.standard.co.uk/business/business-news/banks-shouldnt-run-mis-selling-compensation-scheme-say-small-businesses-8159195.html> (ARTICLE 011).

<sup>583</sup> The Telegraph, "*Rate swap victims could get compensation within weeks*", 20 September 2012, accessible at <https://www.telegraph.co.uk/finance/rate-swap-scandal/9553976/Rate-swap-victims-could-get-compensation-within-weeks.html> (ARTICLE 033).

<sup>584</sup> The Telegraph, "*Rate swap victims could get compensation within weeks*", 20 September 2012, accessible at <https://www.telegraph.co.uk/finance/rate-swap-scandal/9553976/Rate-swap-victims-could-get-compensation-within-weeks.html> (ARTICLE 033).

43. On 15 October 2012, the FSA took part in a roundtable meeting with representatives of the BBA, BIS, Bully-Banks and the first-tier banks.<sup>585</sup> The meeting was organised and chaired by HMT. HMT official H, who chaired the meeting and gave evidence to this Review, explained that HMT had stepped in to "*help move this forward in a slightly more amicable way...[as] there was a breakdown in communications between the FCA and...the small business community*",<sup>586</sup> and HMT was able to act as a "*slightly neutral party*".<sup>587</sup> Following that roundtable, a newsletter to Bully-Banks members noted that the FSA had indicated there would be a "*six-month programme*" beginning at the end of the Pilot Review, by the end of which "*it is intended that the sale of all 28,000 of the IRSAs sold by these four banks will have been reviewed. Bully-Banks has requested that a clear end date be agreed, made public and that effective, meaningful sanctions be put in place if that end date is not met*".<sup>588</sup>
44. Following the roundtable, the FSA continued to engage with Bully-Banks.<sup>589</sup> The FSA's note of a meeting held on 25 October 2012 records the main issues as "*recent FOS decisions, receiving feedback from Bully Banks, and the FSA outlining the need to strike [a] balance between speed and right outcomes from this review*".<sup>590</sup> As FCA employee M said at the time, the FSA considered it "*important for Bully-Banks to understand [sic] that while speed is paramount it must be appropriately balanced with the need to provide customers with the opportunity to be heard throughout this process and for the review to ultimately deliver the right outcomes*".<sup>591</sup>

---

<sup>585</sup> FCA Records, *Email*, 16 October 2012, FCA-ADD-0311, pp. 65-6.

<sup>586</sup> Meeting Transcript H (P12:L23-24).

<sup>587</sup> Meeting Transcript H (P13:L6).

<sup>588</sup> Bully-Banks' Facebook page, *Newsletter to Members*, 17 October 2012.

<sup>589</sup> FCA Records, *Email*, 10 October 2012, 1266408; FCA Records, *Internal Document*, 25 October 2012, 326867.

<sup>590</sup> FCA Records, *Internal Document*, 25 October 2012, 326867.

<sup>591</sup> FCA Records, *Internal Document*, 25 October 2012, 326867.

## B. Commencement of the Pilot Review

45. During late September and early October 2012, the FSA gave its approval for each of the first-tier banks to begin the Pilot Review.<sup>592</sup> Barclays,<sup>593</sup> HSBC,<sup>594</sup> and Lloyds<sup>595</sup> formally started their Pilot Reviews between 24 and 27 September 2012, with RBS following on 1 October 2012.<sup>596</sup>
46. Initially, the FSA required each of the banks to review a minimum of 30 cases within its Pilot Review.<sup>597</sup> The banks were responsible for selecting the sample population for their reviews,<sup>598</sup> with some guidance provided by the FSA.<sup>599</sup> In the event, each of the banks conducted a Pilot Review of between 10 and 50 cases.<sup>600</sup>

---

<sup>592</sup> See, for example, FCA Records, *Email*, 1 October 2012, 332125, confirming approval for RBS to begin its Pilot Review on 1 October 2012. Lloyds was also approved to begin its Pilot Review on 24 September 2012, with strong caveats in place with regards to the application of the Initial Sophistication Customer Criteria and break costs: see FCA Records, *Email*, 24 September 2012, 290216; FCA Records, *Email*, 27 September 2012, 332174. HSBC was approved on 20 September 2012; see FCA Records, *Email*, 21 September 2012, FCA-B-0062. Barclays was approved on 24 September 2012; FCA Records, *Email*, 24 September 2017, 290216.

<sup>593</sup> FCA Records, Skilled Person report (Barclays), 28 November 2012, 334179, p. 2.

<sup>594</sup> FCA Records, *Email*, 27 September 2012, 332174.

<sup>595</sup> FCA Records, *Email*, 27 September 2012, 332174.

<sup>596</sup> FCA Records, *Email*, 1 October 2012, 332125.

<sup>597</sup> See for example the following documents relating to Barclays: FCA Records, Initial Scheme Skilled Person report (Barclays), 28 November 2012, 334179, p. 2; to HSBC: FCA Records, Initial Scheme Skilled Person report (HSBC), 9 November 2012, 445499, pp. 16-7; FCA Records, Skilled Person report (HSBC), 10 November 2016, p. 6 (REPORT 005); to Lloyds: FCA Records, Initial Scheme Skilled Person report (Lloyds), 15 November 2012, 808273, p. 64; and to RBS: FCA Records, Skilled Person report (RBS), 13 May 2016, para. 3.2 (REPORT 013).

<sup>598</sup> See, for example, FCA Records, Skilled Person report (HSBC), 9 November 2012, 445499, p. 16.

<sup>599</sup> FCA Records, *Email*, 20 September 2012, FCA-B-0062.

<sup>600</sup> FCA Records, *Internal Document*, 12 December 2012, 313858, p. 2. Deloitte's Skilled Person report for HSBC's Main Scheme notes the "*file review and redress calculation against 30 pilot cases*"; see FCA Records, Skilled Person report (HSBC), 10 November 2016, p. 6 (REPORT 005). KPMG's Initial Scheme Skilled Person report for Barclays notes "*the bank committed to complete 31 customer cases*" during the Pilot Review, 21 of which were reviewed by KPMG; see FCA Records, Initial Scheme Skilled Person report (Barclays), 28 November 2012, 334179, p. 2. EY's Initial Scheme Skilled Person report for Lloyds notes that "*46 non sophisticated cases [were] reviewed as part of [the] pilot*"; see FCA Records, Initial Scheme Skilled Person report (Lloyds), 15 November 2012, 808273, p. 5. Macfarlanes, Skilled Person 2 for RBS, noted that "*The First Pilot population comprised a sample of 38 customer files*"; see FCA Records, Skilled Person report (RBS), 13 May 2016, p. 13 (REPORT 013).

## C. FAQs

47. In order to provide guidance on some of the practical issues insufficiently addressed by the Initial Agreement, the FSA prepared a number of compilations of Frequently Asked Questions directed at the Skilled Persons. In its evidence given in Holmcroft, the FCA stated:<sup>601</sup>

*"While understanding the desire of the banks and Skilled Persons for guidance from the FCA, we were conscious that a balance needed to be struck between the banks and the Skilled Person finding their own answers to issues and the FCA providing its assistance. In response to requests from the banks and Skilled Persons on issues of interpretation of the Agreement we produced a number of Frequently Asked Questions (FAQs) directed to the Skilled Persons. These documents set out our expectations on certain issues and were issued to provide consistent responses to issues and questions raised by the Skilled Persons with the FCA .... The FAQs enabled the Skilled Person to help the banks design the methodology in accordance with our expectations, and to understand the standards against which the Skilled Persons were to report on the banks' progress in conducting the IRHP Review".*

48. In total, the FSA produced four sets of FAQs during this period:
- a. The first FAQs document was issued on or about 5 September 2012.<sup>602</sup> Amongst other matters, this set out the FSA's view that the Skilled Persons could not take a sampling approach to the sophistication test, i.e. determining which customers were to be classified as sophisticated.<sup>603</sup>
  - b. The second FAQs document was issued on or about 18 September 2012.<sup>604</sup> It dealt with matters including:

---

<sup>601</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 12.4.

<sup>602</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 12.4.

<sup>603</sup> FCA Records, *Cover email and attachment*, 5 September 2012, FCA-C-003-0006 and 363617.

<sup>604</sup> FCA Records, *Cover email and attachments*, 18 September 2012, 347284 and 347285.

- i. The number of cases to be reviewed as part of the Pilot Review: *"ten cases from each Category A, B and C (where possible) plus a further ten cases deemed to be sophisticated, for a total of 40 cases for the entire pilot exercise"*.<sup>605</sup>
  - ii. A non-exhaustive list of factors to be considered when determining whether there had been adequate disclosure of break costs, i.e. information which was *"comprehensible, clear, fair and not misleading"*. This requirement could be satisfied in a number of ways including by an *"explanation of what a break cost is and how any might apply to the customer [or an] indication of the potential size (or scale) of any applicable break costs"*. It indicated that the latter could be achieved *"by providing an indicative figure relevant to the product sold - or an explanation of how many applicable break costs could be calculated"*.<sup>606</sup>
  - iii. Consequential loss, with the FAQs providing that fair and reasonable redress should *"take into account the potential direct impact and consequences of such impacts (consequential loss) of the mis-sale on the customer and ensure that the customer is no worse off"*.<sup>607</sup>
- c. The third FAQs document was issued on or about 17 October 2012.<sup>608</sup> Amongst others, it clarified the Initial Sophisticated Customer Criteria. The FSA explained that both the "objective" and "subjective" customer criteria could not be applied on

---

<sup>605</sup> FCA Records, *FAQs for Skilled Persons*, 18 September 2012, 347285, p. 1.

<sup>606</sup> FCA Records, *FAQs for Skilled Persons*, 18 September 2012, 347285, p. 1. The full text reads; *"Customers should always be provided with the information they required to enable them to make an informed decision in relation to purchasing the product. This information should be disclosed in a way that is comprehensible, clear, fair and not misleading. In respect of the disclosure of any potential break costs, this requirement could have been satisfied in a number of ways. The following is a non-exhaustive list:*

- *An appropriate (and comprehensible, clear fair and not misleading) explanation of what a break cost is and how any might apply to the customer.*
- *An appropriate (and comprehensible, clear fair and not misleading) indication of the potential size (or scale) of any applicable break costs.*

*The latter could be achieved by providing an indicative figure - relevant to the product sold - or an explanation of how any applicable break costs could be calculated (provided you can evidence that it was reasonable to assume that the customer could complete the necessary calculation)."*

<sup>607</sup> FCA Records, *FAQs for Skilled Persons*, 18 September 2012, 347285, p. 2.

<sup>608</sup> FCA Records, *Cover email and attachment*, 17 October 2012, 324034 and 324035.

a group basis if the customer was part of a group: "*Our requirement to demonstrate that at the time of the sale the customer had the necessary experience and knowledge means that the Skilled Persons cannot rely simply on group structure and/or relationships with associated companies to indicate whether or not the customer is sophisticated*".<sup>609</sup> The FAQs contemplated a situation where a group's "*knowledge and experience*" could flow down to the individual customer.<sup>610</sup>

- d. The fourth FAQs document was issued on or about 16 November 2012.<sup>611</sup> It included the question: "*Does the application of the 'subjective' sophisticated customer criteria exclude knowledge (of interest rate hedging products and their risks) gained during the sales process itself?*" The answer to this was: "*Yes. The fact that the bank informed the customer about derivative products and the associated risks during the sales process is not relevant in determining 'sophistication'. The firm and Skilled Person may, however, consider this fact among other factors when determining whether or not the sale was appropriate. Furthermore, the 'subjective' sophisticated customer criteria require the bank to demonstrate that the customer had the necessary experience and knowledge of derivatives, which means it may be difficult for a customer without prior experience in derivative products to meet this criteria*".<sup>612</sup>

#### **D. Continuing engagement with the FOS**

49. Communications also continued with the FOS. The Chief Ombudsman wrote to Martin Wheatley, to outline the FOS's position on the FSA's request that it establish a way of handling a wider range of cases in respect of IRHPs. They noted the pressures the PPI complaints process had put on the FOS and the concerns of the FOS's board regarding the "*potential impact of the proposed scheme on the work of the ombudsman service*".<sup>613</sup> In the light of this, they asked for "*reassurance about the likely volume of additional cases the scheme would generate*".<sup>614</sup> Aside from the volume issue, however, they

---

<sup>609</sup> FCA Records, *FAQs for Skilled Persons*, 17 October 2012, 324035, p. 1. Original emphasis.

<sup>610</sup> FCA Records, *FAQs for Skilled Persons*, 17 October 2012, 324035, pp. 1-2.

<sup>611</sup> FCA Records, *Cover email and attachment*, 16 November 2012, 329224 and 329225.

<sup>612</sup> FCA Records, *FAQs for Skilled Persons*, 16 November 2012, 329225, p. 1.

<sup>613</sup> FCA Records, *Letter*, 10 October 2012, 326034.

<sup>614</sup> FCA Records, *Letter*, 10 October 2012, 326034.

indicated that *"it looks likely that our teams will be able to agree on the detail of how the scheme could work in practice"* and that they would take a formal proposal to the FOS board at its October 2012 board meeting.<sup>615</sup>

50. On 17 October 2012, the FSA wrote to the first-tier banks inviting comments on a proposal to extend the FOS's voluntary jurisdiction to cover cases where customers remained dissatisfied after their redress determinations.<sup>616</sup> One of the banks responded that any extension of the FOS's jurisdiction proposed by the FSA at the time would be *"at odds with the terms of, and basis on which we entered into"* the Initial Agreement and had the potential to *"undermine"* the PBR.<sup>617</sup>
51. On 9 November 2012, the Chief Ombudsman wrote to the FCA indicating that their board in principle supported the proposal for a stand-alone ombudsman scheme to consider complaints about the sale of IRHPs. They referred to important safeguards in relation to their existing model and to a joint public consultation with the FSA.<sup>618</sup>
52. However, an IRS Steering Group meeting on 12 November 2012 noted that Lloyds would *"likely need encouragement"* to sign up to a voluntary FOS scheme and that RBS was *"firmly against"* such a scheme. Barclays had expressed an interest but *"had a number of concerns that it wished to discuss"*, principally that unfettered access to an appeals process would likely act as an encouragement to claims management companies.<sup>619</sup>

#### **E. Initial lessons learned exercise**

53. Despite the fact that the Pilot Review had only just begun, and several issues were still being considered by the FSA, the banks and Skilled Persons, by on or about 21 September 2012, the FSA's CBU Supervision Oversight Function initiated a "Lessons Learned Review" in respect of the FSA's intervention on IRHPs (the "internal Lessons Learned Review").<sup>620</sup> This internal Lessons Learned Review covered the period between 1 March

---

<sup>615</sup> FCA Records, *Letter*, 10 October 2012, 326034.

<sup>616</sup> FCA Records, *Letter*, 17 October 2012, 1104823.

<sup>617</sup> See, for example, FCA Records, *Letter*, 23 October 2012, 311822; and FCA Records, *Letter*, 24 October 2012, 311802.

<sup>618</sup> FCA Records, *Letter*, 9 November 2012, 328234.

<sup>619</sup> FCA Records, *Email*, 12 November 2012, 329937.

<sup>620</sup> FCA Records, *Email*, 21 September 2012, 437717.



2010 and 30 September 2012 and considered four high-level matters: (i) whether the FSA could have intervened on IRHPs earlier, (ii) whether it was appropriate to intervene on IRHPs over other issues, (iii) whether the approach, extent and timescales for the intervention were appropriate, and (iv) to identify any lessons learned.<sup>621</sup>

54. The internal Lessons Learned Review ended on or about 14 December 2012,<sup>622</sup> albeit the final report was not circulated internally until 27 March 2013. In outline, it concluded:
- a. The FSA could have taken action earlier than March 2012. This was because, for example, the FSA had intelligence from a range of sources raising concerns. The findings noted that there were "*opportunities for the FSA to have identified the growing problem with the sale of IRHPs and taken earlier action if it had "joined the dots"*". A number of factors affected the likelihood of the FSA intervening earlier: SMEs were "*a blind spot*" for the FSA, "*falling between retail conduct and wholesale risk tolerance*", and "*the emphasis on prudential supervision at the expense of further conduct work*".<sup>623</sup> Nonetheless, it determined that "*it was understandable that the FSA did not intervene earlier*" because the FSA had limited resources after the financial crisis; IRHPs were sold alongside products and activities that were not within its perimeter; and the FSA was dealing with other conduct risks affecting millions of customers, such as PPI.<sup>624</sup>
  - b. It was appropriate for the FSA to intervene on IRHPs over other issues in light of the publicity and external pressure, the level of potential consumer detriment and the absence of evidence of any other more important and pressing risks or competing issues.<sup>625</sup>

---

<sup>621</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products – High Level Findings*, 14 December 2012, 491986.

<sup>622</sup> FCA Records, *Email*, 14 December 2012, 491985.

<sup>623</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 3.

<sup>624</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products – High Level Findings*, 14 December 2012, 491986, p. 13.

<sup>625</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products – High Level Findings*, 14 December 2012, 491986, pp. 21-3.

- c. As to the appropriateness of the approach, extent and timescales, it concluded (amongst others):
- i. The initial focus on the four largest banks was appropriate. Adopting the same approach for the smaller firms, without evidence of poor customer outcomes, was not appropriate or proportionate.
  - ii. The cross-departmental team was particularly strong and effective and the intervention reflected the (shortly to come into existence) FCA's new supervisory approach of faster action with lower evidential thresholds and greater focus on consumers.
  - iii. IRHPs were complex products, which were sold as either a condition of, or secondary to, a business loan. While the FSA had focused on achieving fairer and faster redress for consumers, it had not specifically considered whether the root cause of the problem was captured within existing work on root causes.<sup>626</sup>
  - iv. While a great deal had been delivered during a relatively short period of time, particularly in the initial period up to the end of June 2012, *"the initial pace affected the consideration of complex issues, the pace of progress in the longer term, the ability to take a strategic overview of the work and to pause and take stock of the desired outcomes and the governance arrangements for the project, including the recording of decisions taken and the rationale."*<sup>627</sup>
  - v. *"[G]iven the pace and the intensity of the project, there was little time to consider and develop the strategic approach to the intervention... The pace also compromised the ability to step back and to determine our position on*

---

<sup>626</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 6.

<sup>627</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 4.

*specific issues, such as the sophistication test and break costs ... and slowed down the pace of delivery".*<sup>628</sup>

- vi. It questioned "*the approach and rationale for setting timescales over the course of the intervention*", which were "*driven by the management of external stakeholders/press rather than an assessment of the time and resources required to undertake the work*".<sup>629</sup>
- d. It identified the following lessons learned (amongst others):
  - i. The importance of being able to step back from the detail and the pace of delivery to take a strategic, proportionate approach, which "*minimises potential reputational risks.*"
  - ii. The need for "*clarity of understanding of risk appetite in respect of SME customers*". It noted that "*[t]he FSA's risk tolerance for SMEs was not clear or adequately articulated either internally or externally prior to March 2012. While some members of FSA Senior Management consider that SMEs were arguably within the FSA's risk tolerance, it is clear that this view was not shared, communicated or understood throughout the organisation as a whole*".<sup>630</sup>
  - iii. The FSA "*lack[ed] ... an effective central process or function to collate and disseminate intelligence, both across the FSA and Supervisory Teams*".<sup>631</sup>
  - iv. While a project oversight board with formal reporting requirements would have slowed the pace of intervention, its absence meant that "*the governance arrangements did not always provide the necessary strategic oversight, record and rationale for decisions*", particularly in the early stages of the

---

<sup>628</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products – High Level Findings*, 14 December 2012, 491986, p. 25.

<sup>629</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products – High Level Findings*, 14 December 2012, 491986, p. 25.

<sup>630</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 6.

<sup>631</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products – High Level Findings*, 14 December 2012, 491986, p. 12.

intervention where there were short deadlines and during negotiations with the four major banks.<sup>632</sup>

55. The internal Lessons Learned Review identified a number of specific recommendations. These included that:
- a. CBU and FSA senior management should decide whether its risk tolerance had changed in relation to SMEs and other categories of consumers or products that previously were not an FSA focus. That decision should be communicated internally to remove any perceived lack of clarity.
  - b. CBU and FSA senior management should consider the strategy for future interventions to ensure sufficient strategic oversight and put in place appropriate governance arrangements, including an "*audit trail of decisions*".
  - c. Supervisory Heads of Department should ensure, in addition to securing faster and fairer redress, that the work on IRHPs included consideration of whether the underlying root causes of the issues found in the sale of these products (both firm-specific and on a thematic basis) was captured within the existing work on root causes or whether further work needed to be completed in this respect.<sup>633</sup>

#### **F. FSA Board meeting on 31 October 2012**

56. At its meeting on 31 October 2012, the Board was updated on the IRS Steering Group's proposed next steps. In particular, it was informed that the Main Scheme was expected to last six months.<sup>634</sup>

### **Section 3 - The review of the Pilot Review: November 2012 to January 2013**

57. The first-tier banks concluded their respective Pilot Reviews during November 2012.<sup>635</sup> Each Skilled Person then produced a report on its findings from the Pilot Review from 9

---

<sup>632</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 6.

<sup>633</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425.

<sup>634</sup> FCA Records, *Internal Document*, 14 May 2013, 371428.

<sup>635</sup> See, for example, FCA Records, Skilled Person report (Barclays), 28 November 2012, 334179, pp. 2; FCA Records, Skilled Person report (RBS), 19 May 2016, pp. 13-14, para. 1.2.2 (REPORT

to 28 November 2012,<sup>636</sup> save for the Skilled Person for RBS issuing a report later, in January 2013.<sup>637</sup>

58. The FSA considered and reviewed each of these reports and fed back its conclusions to each bank during the course of several meetings.<sup>638</sup> For example, Pilot Review feedback meetings were held with Deloitte (Skilled Person for HSBC),<sup>639</sup> Lloyds,<sup>640</sup> RBS<sup>641</sup> and Barclays.<sup>642</sup> One FSA employee involved in the review of Pilot Review cases recalled there were "25, 30, maybe more people in the tower of Canary Wharf [conducting the review of the pilot files]".<sup>643</sup>
59. During a meeting on 2 November 2012, Barclays informed the FSA of its concerns in relation to the application of the Initial Sophisticated Customer Criteria. Barclays asked whether its approach of applying the quantitative sophistication test followed by consideration of whether sophisticated customers should be reclassified as non-sophisticated had been adopted by the other banks. The bank also indicated that it was difficult to evidence the flow-through of knowledge and experience within group structures and suggested that the objective sophistication test should be applied at group level where applicable.<sup>644</sup> In addition to evidence of widespread mis-selling, the results highlighted the need to reconsider certain elements of the design of the Initial Scheme. Between mid-November 2012 and January 2013, the FSA therefore focused on:
- a. continuing to review the cases submitted by the banks as part of the Pilot Review and reporting the findings;

---

010); FCA Records, Skilled Person report (Lloyds), 15 November 2012, 808273; and FCA Records, Skilled Person report (HSBC), 10 November 2012 (REPORT 005).

<sup>636</sup> See FCA Records, Skilled Person report (Barclays), 28 November 2012, 334179; FCA Records, Skilled Person report (HSBC), 9 November 2012, 445499; FCA Records, Skilled Person report (Lloyds), 15 November 2012, 808273.

<sup>637</sup> See FCA Records, Skilled Person report (RBS), 19 May 2016, p. 14, para. 1.2.3. (REPORT 010).

<sup>638</sup> FCA Records, *Email*, 20 November 2012, 328118.

<sup>639</sup> FCA Records, *Minutes of FSA and Deloitte meeting*, 14 November 2012, 312943.

<sup>640</sup> FCA Records, *Minutes of FSA and Lloyds meeting*, 30 November 2012, 321560. Note that the relevant meeting took place on 29 November 2012.

<sup>641</sup> FCA Records, *Minutes of FSA and RBS meeting*, 20 December 2012, 293223. Note that the relevant meeting took place on 17 December 2012.

<sup>642</sup> FCA Records, *Minutes of FSA and Barclays meeting*, 17 January 2013, 336194.

<sup>643</sup> Meeting Transcript E (P25:L18-19).

<sup>644</sup> FCA Records, *Email*, 5 November 2012, 361227.

- b. considering whether amendments or adjustments should be made to the terms of the Initial Written Undertaking for the purposes of the Scheme; and
  - c. negotiating and finalising the Supplemental Agreement with the banks to commence the Scheme.
60. On 23 November 2012, Clive Adamson wrote a letter to IRHP customers providing information about the Initial Scheme. He informed customers that the Pilot Review had been set up with independent oversight and with the need for prompt resolution in mind.<sup>645</sup> The letter stated: "*We will not allow the main review to begin until we are satisfied that fair and reasonable outcomes will be delivered for you and the other customers affected*".<sup>646</sup> The initiative was welcomed by Greg Clark MP and Vince Cable MP at BIS, who wrote jointly to Martin Wheatley, saying: "*We particularly welcome the decision taken by the FSA to write to every business that will have a [sic] products reviewed... This is a positive step in ensuring that businesses have confidence in the independence of the scheme you have put in place*".<sup>647</sup>
61. In the period to January 2013, the FSA developed proposals for potential changes to the Initial Scheme. It discussed these, along with the timetable and structure of the Pilot Review, with the banks, the Skilled Persons, HMT, consumer groups, and other stakeholders, such as the APPG and Guto Bebb MP.<sup>648</sup> The contemplated changes included modifications to the Initial Sophisticated Customer Criteria, the development of detailed principles of redress, and an option to recover consequential losses under the Scheme. The FSA also revisited its interpretation of the Sales Standards, in particular regarding the disclosure of break costs (Sales Standard 2).<sup>649</sup>

---

<sup>645</sup> FCA Records, *Letter and attachment*, 23 November, FCA-A-0009, p. 1.

<sup>646</sup> FCA Records, *Letter and attachment*, 23 November, FCA-A-0009, p. 1.

<sup>647</sup> FCA Records, *Letter*, 13 November 2012, 1110394, p. 1.

<sup>648</sup> See for example FCA Records, *Memorandum – suggested points for Clive Adamson meeting with Guto Bebb MP*, 6 November 2012, 330639; FCA Records, *Email*, 7 November 2012, 355219; FCA Records, *Minutes of FSA and Deloitte meeting*, 14 November 2012, 312943; FCA Records, *Memorandum – briefing for Martin Wheatley meeting with Ed Miliband MP*, 21 November 2012, 297074 and further correspondence, FCA Records, *Letter*, 22 November 2012, 329898; FCA Records, *Minutes of FSA and Barclays meeting*, 17 January 2013, 336194.

<sup>649</sup> FCA Records, *Internal Document*, 5 December 2012, 290665.

62. The FSA emphasised that "*We want to ensure that small businesses continue to have a voice as the review progresses. We will carry on communicating with you directly, but we want to ensure that both the FSA and the banks can benefit from the experience of as many different customers as practical*".<sup>650</sup> The FSA considered this was being achieved by HMT setting up a regular meeting with the FSA, the banks, the FSB and Bully-Banks. It did not, however, undertake any formal public consultation process on the various material amendments, additions and refinements to the Initial Scheme being considered.
63. On the FSA's side, this period was shaped by three CSRC meetings in December 2012 and January 2013, which considered the issues arising from the Pilot Review.

#### **A. The issues arising out of the Pilot Review**

64. As preliminary findings of the Pilot Review began to emerge, three key issues arose:
- a. the parameters of the Initial Sophisticated Customer Criteria;
  - b. disclosure of break costs; and
  - c. consistency of redress.
65. First, in respect of the Initial Sophisticated Customer Criteria:
- a. The FSA realised that, as FCA employee A put it, the "*sophistication test didn't work in the way we anticipated. The Sales Standards were too open-ended and didn't necessarily drive the level of consistency we needed and ... on redress we needed to give more clarity*".<sup>651</sup>
  - b. Similar concerns had been raised previously by some of the banks.<sup>652</sup> One bank commented that "*it was absolutely clear that the [sophistication] tests were not going to give effect to what we believed was originally agreed of redressing only non-sophisticated customers. So the application of the objective test by balance sheet size, turnover, employees, was leading to manifestly sophisticated customers*

---

<sup>650</sup> FCA Records, *Letter*, 23 November, FCA-A-0009, p. 2.

<sup>651</sup> Meeting Transcript A (P66:L22-P67:L1).

<sup>652</sup> FCA Records, *Email*, 18 September 2012, 002688; FCA Records, *Cover email and attachment*, 21 September 2012, 322473 and 322474.

*being classed as unsophisticated ... So that was a key learning and certainly led to us having detailed conversations with the FCA about what the final sophistication tests should look like, so that we could give effect to what we believe everybody agreed, which was: unsophisticated customers should get this scheme. And others would have a right to redress and complaints against the Group anyway but they could come against us as a professional counterparty".*<sup>653</sup>

- c. Further, the FSA identified what it described as "*potential weaknesses*" in the Initial Sophisticated Customer Criteria.<sup>654</sup> As Clive Adamson explained, "*there were still flaws ... particularly in relation to certain [SME] customers who ... because of the nature of their business effectively were deemed sophisticated but in fact were unsophisticated*".<sup>655</sup> They were therefore ineligible under the Initial Scheme; "*vice versa, some were included as unsophisticated that should be regarded as sophisticated*".<sup>656</sup>

66. In an attempt to address such concerns, the FSA began considering various legal definitions of "groups" that might be included in the Sophisticated Customer Criteria for the Scheme.<sup>657</sup> It then sought the views of the banks on how the Initial Sophisticated Customer Criteria could be improved, to ensure they captured only the subset of SME customers intended to be the target of the Scheme.

67. In essence, the FSA proposed two options:

- a. replacing the objective test in the Initial Written Undertaking with an entirely new test based on the value of the notional loan made to the customer, with loans over a certain value resulting in that customer being deemed sophisticated; and
- b. retaining the objective test in the Initial Written Undertaking, with one key change: stipulating that, for any customer who was a wholly owned subsidiary of another

---

<sup>653</sup> Meeting Transcript DX (P24:L6-12) and (P25:L2-9).

<sup>654</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089.

<sup>655</sup> Meeting Transcript Adamson (P37:L22-P38:L2).

<sup>656</sup> Meeting Transcript Adamson (P38:L2-4).

<sup>657</sup> See, for example, FCA Records, *Email attachment*, 30 November 2012, 291068.



company, the proposed Sophisticated Customer Criteria would be applied to the parent company, not just the customer.<sup>658</sup>

68. The FSA does not appear to have carried out any detailed impact assessments in respect of the proposed options.<sup>659</sup> Neither was there any adequate analysis of the underlying rationale why certain groups should or should not be excluded from the scope of the Scheme. Rather, much of the debate was shaped by the desire to include certain types of businesses (such as farms and bed & breakfasts) but exclude others (such as SPVs). The banks responded to these proposals with a range of different proposals.<sup>660</sup> One bank noted that "*whatever threshold is chosen is in fact an arbitrary decision*".<sup>661</sup>
69. The second key issue to arise out of the Pilot Review was what constituted adequate disclosure of break costs.
70. The FSA's preliminary view from its review of the Pilot Review cases was that there had been inadequate disclosure of break costs across the board.<sup>662</sup> As FCA employee E put it, "*we realised that this was as we thought ... there was going to be widespread findings of "mis-selling"*".<sup>663</sup>
71. In contrast, the banks' view, advanced in particular by RBS, was that the FSA was judging the adequacy of disclosure of break costs by retrospectively imposing current best practices instead of the standards applied across the market at the time when the

---

<sup>658</sup> See email from FSA to Lloyds, FCA Records, *Email*, 6 December 2012, 321758; email from FSA to Barclays, FCA Records, *Email*, 10 December 2012, 293175; and email from HSBC to FSA, FCA Records, *Email*, 18 December 2012, 357095. For an overview of all banks' responses, see FCA Records, *Internal Document*, 9 January 2013, 356576.

<sup>659</sup> FCA employee G remarked that "*there were some impact assessments at some stage. I just can't recall what document they're in but I remember that there is an analysis. Perhaps it's later on, perhaps it's in the December area where we were talking about the nature of the sophisticated criteria, there were some analysis there about changes to the sophisticated*". Meeting Transcript G (P60:L8-14). I have not, however, seen any such assessments in the course of this Review.

<sup>660</sup> See for example FCA Records, *Cover email and attachment*, 13 December 2012, 300356 and 300357; FCA Records, *Email*, 14 December 2012, 293077.

<sup>661</sup> FCA Records, *Cover email and attachment*, 14 December 2012, 293077 and 293078.

<sup>662</sup> FCA Records, *Internal Document*, 20 November 2012, 329904, slide 2.

<sup>663</sup> Meeting Transcript E (P18:L17-19).

respective IRHPs were sold.<sup>664</sup> RBS maintained that its approach at the time was within the law, that there had never been any suggestion by the FSA that it was not good enough, and that the FOS had ruled in RBS's favour in 20 out of 20 cases.<sup>665</sup> RBS recalled discussing this issue with the FSA:<sup>666</sup>

*"that point was made unequivocally out of the Pilot: "You've [the Banks] got this wrong, you're applying your own processes from the time. We're [the FSA] telling you your processes for the time weren't good enough, you should have done more. This is what you should have done, and if you didn't do that that's not good enough." To which we said: "Well you're asking us to test against a standard that wasn't in place at the time, so of course we're going to fail." And they said: "Well that's why you're doing this review".*

72. The FSA, however, insisted that under its Principles for Businesses, banks had to pay attention to the information needs of customers who should have sufficient information about the product, its features, and its advantages and disadvantages, in order to make an informed decision.<sup>667</sup> FCA employee S elaborated that, in the FSA's view, *"for customers to really fully understand the risks that they were taking with the product, they needed to not just understand there was a break cost ... [but] needed to have some sense of scale"*.<sup>668</sup> They acknowledged that *"our Conduct of Business rules were designed to be high level, and are high level, and so they are not prescriptive in that regard. ... what we were wrangling with was, was that a reasonable expectation based on the rules that were in place at the time?"*<sup>669</sup>

---

<sup>664</sup> See for example FCA Records, *Letter*, 19 November 2012, 347442; FCA Records, *Minutes of FSA and RBS meeting*, 11 December 2012, 321011. Note that the relevant meeting took place on 3 December 2012.

Lloyds raised similar issues in relation to break cost disclosure, complaining that the Skilled Persons were applying a current-day lens to assess the quality of disclosure made in relation to historical sales; see FCA Records, *Letter*, 6 December 2012, 292220.

<sup>665</sup> FCA Records, *Letter*, 19 November 2012, 347442.

<sup>666</sup> Meeting Transcript RBS (P25:L24-P26:L8).

<sup>667</sup> See, for example, FCA Records, *Minutes of FSA and RBS meeting*, 11 December 2012, 321011. Note that the relevant meeting took place on 3 December 2012.

<sup>668</sup> Meeting Transcript S (P63:L6-11).

<sup>669</sup> Meeting Transcript S (P63:L14-25).

73. Thirdly, the Pilot Review showed that the banks were taking different approaches in determining what they considered constituted fair and reasonable redress.<sup>670</sup> In response, the FSA began formulating a process for banks to base decisions on whether the IRHP(s) in a given case fell within Category A, Category B or Category C, and identifying various potential appropriate alternative products.<sup>671</sup>
74. Further, the FSA also continued to consider a stand-alone FOS scheme as a potential addition to the Scheme. To this effect, Martin Wheatley met with the Chief Ombudsman on 6 December 2012.<sup>672</sup> An FSA briefing note, however, recorded the banks' concerns, namely:
- a. that such a scheme would duplicate the banks' and Skilled Persons' work; and
  - b. that consumers may refer cases to the FOS in order to obtain more favourable redress.
75. These concerns appear to have been fuelled in part by the banks' view that the FOS would apply different standards to those agreed with the FSA.<sup>673</sup> Employee ZP of RBS recalled the bank's opposition to this proposal: "*We said, look, either you use the FOS as the place a customer can go, or we pay for a Skilled Person, but we don't need both. But they said, no, you can't stop people going to FOS. ... if you're going to have a Skilled Person, you have a [Skilled Person] review every decision. You don't have anything else as well*".<sup>674</sup>
76. Shortly before the CSRC meeting on 18 December 2012, the FSA prepared a paper outlining various options and considering the impact of the banks' likely opposition to the establishment of an "add-on" FOS scheme of this nature. The paper noted the possibility of exerting "*supervisory leverage*" to obtain the banks' agreement.<sup>675</sup> The FSA

---

<sup>670</sup> FCA Records, *Cover email and attachment*, 4 December 2012, 001245 and 452942, paras. 2-3 and Appendices 1-4.

<sup>671</sup> FCA Records, *Cover email and attachment*, 4 December 2012, 001245 and 452942.

<sup>672</sup> FCA Records, *Memorandum – Notes for meeting with Natalie Ceeney*, 5 December 2012, 326624. Note that the relevant meeting took place on 6 December 2012.

<sup>673</sup> FCA Records, *Memorandum – Notes for meeting with Natalie Ceeney*, 5 December 2012, 326624, p. 3. Note that the relevant meeting took place on 6 December 2012.

<sup>674</sup> Meeting Transcript RBS (P91:L17-24).

<sup>675</sup> FCA Records, *Internal Document*, 18 December 2012, 349204, p. 2.

requested comments from the banks by 13 December 2012. The banks' responses once more identified divergent views and approaches between the different banks.<sup>676</sup>

77. Throughout, the FSA also continued to engage with external stakeholders,<sup>677</sup> including HMT.<sup>678</sup>

## **B. CSRC meeting on 18 December 2012**

78. On 18 December 2012, the CSRC was briefed on the initial findings of the Pilot Review as well as the specific issues identified above. The supporting CSRC Summary Paper noted that "*the banks found significant non-compliance with the provisions of our Handbook, ranging from 38% (RBS) to 95% (LBG)*" and that the FCA's own "*review of the pilot exercise found that over 90% of sales across all four banks were non-compliant with our Principles, rules and guidance*".<sup>679</sup>
79. It then identified the three aforementioned "*significant issues*" which the FSA still needed to "*resolve*",<sup>680</sup> with the annexes to the paper providing detailed information on each of these. The CSRC Summary Paper made clear that "*Our overall view, based on preliminary pilot findings, is that the existing process is the right approach and that we should look to sharpen up the current design to ensure that fair and reasonable redress will be provided, where appropriate*".<sup>681</sup> As such, the CSRC Summary Paper stated that its purpose was only to "*update [the] CSRC on the progress made*" and that "*[n]o decision is sought at this stage*".<sup>682</sup>

---

<sup>676</sup> See, for example, respective emails from Lloyds, Clydesdale and Barclays: FCA Records, *Cover email and attachment*, 13 December 2012, 300356 and 300357; FCA Records, *Email*, 13 December 2012, 811169; and FCA Records, *Cover email and attachment*, 14 December 2012, 293077 and 293078.

<sup>677</sup> See references to various scheduled meetings: FCA Records, *Email attachment*, 12 December 2012, 291522, p. 5.

<sup>678</sup> An HMT roundtable was held on 12 December 2012. See FCA Records, *Email*, 19 December 2012, 1136534.

<sup>679</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, p. 1, para. 2.

<sup>680</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, pp. 1-2, para. 4. The three issues were described as "*a. Ensuring that the sophistication test includes the customers that we believe should be in scope, and excluding those that should be out; b. Finalising our house view on sufficient break cost disclosure; and c. Ensuring that the banks agree the key elements of the approach to fair and reasonable redress.*"

<sup>681</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, p. 2, para. 6.

<sup>682</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, p. 2, para. 1.

80. Addressing the issue of "*sophistication*", the more detailed report set out in Annex 1 to the CSRC Summary Paper noted that "[t]he issue of whether or not customers are deemed to be sophisticated is sensitive and has attracted the attention of a range of stakeholders".<sup>683</sup> These included, on the one hand, "*small business groups such as Bully Banks, and various politicians [who] claim certain customers have been wrongfully excluded from the review ... such as farms, care homes and B&Bs*"<sup>684</sup> and, on the other hand, "*HM Treasury and the banks [who] have raised concerns that the current sophistication criteria artificially include within the review businesses that should actually be classed as sophisticated ... [such as] SPVs created by much larger companies to hold assets*".<sup>685</sup> Annex 1 of the CSRC Summary Paper then set out a number of potential amendments to the Initial Sophisticated Customer Criteria:<sup>686</sup>
- a. "*Amending the Objective Test so that a sophisticated customer would instead be anyone who had taken out an underlying loan of £10m or more;*
  - b. "*Retaining the existing Objective Test but classing as sophisticated any customer that is a 100% owned subsidiary of an entity that does meet the Objective Test; and/or*
  - c. "*Defining a 'group' more widely, including common control or common partners, and then aggregating the turnover, balance sheet, and number of employees of companies or entities in a group for the purposes of the Objective Test*".
81. FCA employee M, who was involved in the design of these proposals, explained that "*there was a significant amount of toing and froing on this and what we were trying to do was to come up with the best answer we could... making sure we included who we believed to be the right set of customers*".<sup>687</sup> FCA employee E elaborated on the notion of the "*right set of customers*", which did not include "*more sophisticated entities that*

---

<sup>683</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, p. 5, para. 14.

<sup>684</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, p. 5, para. 14.

<sup>685</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, p. 5, para. 15.

<sup>686</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, pp. 5-6, paras. 16-7.

<sup>687</sup> Meeting Transcript M (P53:L14-19).

*quite easily could have taken professional advice and chose not to*", in respect of whom the FSA *"took the view they ought not to be in the scope of the review"*.<sup>688</sup>

82. The Summary Paper recited advice given by the GCD, which stated that the FSA would need to ensure that any change to the Initial Sophisticated Customer Criteria was *"reasonable and rational"*. It further noted that:
- a. Any decision to do so *"will need to be capable of justification and based on sufficient evidence of the advantages, disadvantages and potential impacts on both customers and the banks"*.<sup>689</sup>
  - b. Customers who, as a result of changes to the Initial Sophisticated Customer Criteria, now fell outside the Scheme, *"may seek to challenge such a decision based on legitimate expectation,"* although it considered that such claims *"are very difficult to successfully bring"*.<sup>690</sup>
83. In relation to the issues of disclosure of break costs and consistency of redress, the CSRC Summary Paper summarised the concerns that had arisen and noted that work was in progress to present it with recommendations on these issues. As to the latter, both the GCD and the substantive working team expressed the view that what constituted fair and reasonable redress was *"very subjective"* and that the FSA could consider providing *"guidance"* to the banks to assist in achieving a degree of harmonisation.<sup>691</sup>

#### **C. The events leading to the 15 January 2013 CSRC meeting**

84. Following the 18 December 2012 CSRC meeting, the FSA continued to refine its position on each of the three key issues raised at that same meeting, with the IRS Technical Group

---

<sup>688</sup> Meeting Transcript E (P56:L18-23).

<sup>689</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, p. 2.

<sup>690</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, p. 2.

<sup>691</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084, p. 3.

and IRS Steering Group both considering various aspects of the Scheme.<sup>692</sup> In parallel, the FSA continued to engage with a range of external stakeholders.<sup>693</sup>

85. On 21 December 2012, the High Court handed down judgment in Green and Rowley,<sup>694</sup> a case concerning the alleged mis-selling of an IRHP. The High Court found in favour of RBS. On the facts,<sup>695</sup> it held that, inter alia, RBS's disclosure in respect of break costs had been adequate (in that there had been no misstatement)<sup>696</sup> and that there had been no breach of the COB applicable at the time.<sup>697</sup>
86. RBS considered that Green and Rowley was a "*landmark legal judgement*",<sup>698</sup> which supported its approach on break costs vis-à-vis the FSA, and that it confirmed the adequacy of its historical processes and the various FOS findings in its favour.<sup>699</sup> Other banks raised similar concerns.<sup>700</sup> Although the judgment was to be appealed,<sup>701</sup> FCA employee P recalled that the banks received the "*Green and Rowley judgment on Christmas Eve and they were waving it around and saying, 'We've been right all along. You're trying to retrospectively introduce standards which didn't apply at the time'*",<sup>702</sup> which caused the FSA concern "*about how sustainable our views on break costs would be before the agreements were then signed*".<sup>703</sup>

---

<sup>692</sup> See, for example, the discussion paper prepared by FCA employee Y, FCA employee UT and FCA employee E, which considered the standards relevant to the selection of alternative products: FCA Records, *Cover email and attachment*, 7 January 2013, 357097 and 357098. Note the attachment is dated 4 January 2013.

<sup>693</sup> See, for example, FCA Records, *Email*, 23 December 2012, 757848; FCA Records, *Letter*, 18 December 2012, 758032; FCA Records, *Memorandum – Briefing note for meeting with Vince Cable MP*, 14 December 2012, 822962. Note that the relevant meeting was due to take place on 19 December 2012. See also, for example, the following communications with Lloyds and RBS respectively on this matter: FCA Records, *Email*, 18 December 2012, 810633; FCA Records, *Email*, 19 December 2012, 353998.

<sup>694</sup> [2012] EWHC 3661 (QB).

<sup>695</sup> [2012] EWHC 3661 (QB), 21.

<sup>696</sup> [2012] EWHC 3661 (QB), 40-41 and 83.

<sup>697</sup> [2012] EWHC 3661 (QB), 85-86.

<sup>698</sup> FCA Records, *Email*, 22 December 2012, 757374.

<sup>699</sup> FCA Records, *Email*, 22 December 2012, 757374; see also FCA Records, *Email*, 14 January 2013, 757305; FCA Records, *Email*, 15 January 2013, 318357.

<sup>700</sup> Meeting Transcript P (P46:L15-21).

<sup>701</sup> The Court of Appeal subsequently dismissed the claimants' appeal in July 2013: Green and Rowley -v- Royal Bank of Scotland Plc [2013] EWCA Civ 1197.

<sup>702</sup> Meeting Transcript P (P46:L17-20).

<sup>703</sup> Meeting Transcript P (P47:L1-4).

87. The FSA sought urgent legal advice on the potential impact of the decision.<sup>704</sup> The advice from leading counsel was that Green and Rowley was decided on its facts and, as such, did not have wider application.<sup>705</sup> There were differing views within the FSA on how much reassurance this advice provided but, overall, it appears to have alleviated the CSRC's concerns.<sup>706</sup> In light of this, Clive Adamson responded to RBS, explaining that the FSA considered Green and Rowley was decided on "*issues of fact, not law and as such could not be considered [a] landmark [ruling]*".<sup>707</sup>
88. The IRS Technical Group and IRS Steering Group continued to consider various aspects of the Scheme before returning to the CSRC on 15 January 2013. The IRS working teams' proposal was to add a "value overlay" where only the balance sheet limb and employee limb of the Companies Act 2006 objective test was satisfied. It proposed that the "*current objective sophistication test should be amended to include a £7.5m notional hedge value overlay*". This additional overlay would be applied in all cases where limbs (ii) and (iii) (balance sheet and employees, respectively) are the only factors relied upon when determining the customer is sophisticated under the above test. The "*£7.5m notional hedge overlay*" results in these customers with a notional hedge value equal to or less than £7.5m being deemed non-sophisticated."<sup>708</sup>
89. Some data had previously been provided to the IRS Steering Group regarding the likely impact that the inclusion of the overlay would have on various customer populations. The data indicated that, for Lloyds, applying a notional value test (not an overlay) would exclude 35 per cent more customers using a £5 million notional amount threshold and 24 per cent more customers using a £10 million notional amount. However, Lloyds' data also included a large percentage of unverified customers.<sup>709</sup>

---

<sup>704</sup> FCA Records, *Cover email and attachments*, 27 December 2012, 000419, 000420, 000421, 000422, 000423 and 000424.

<sup>705</sup> Meeting Transcript Adamson (P56:L1-4).

<sup>706</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, pp. 15-16, 21. Note that this paper is dated 15 January 2012; see also FCA Records, *Email*, 21 January 2013, 334745.

<sup>707</sup> FCA Records, *Email*, 15 January 2013, 318357.

<sup>708</sup> FCA Records, *Cover email and attachments*, 14 January 2013, FCA-B-0210., 356571 and 356576.

<sup>709</sup> FCA Records, *Cover email and attachments*, 9 January 2013, 357007, 357008 and 357009.



90. Prior to the next CSRC meeting, the IRS Steering Group met again to agree its approach and, in respect of changes to the Initial Sophisticated Customer Criteria, decided that:<sup>710</sup>
- a. a notional hedge value would be used as the basis for "*the additional sophistication test*", considering the hedges themselves rather than the underlying loans, with negotiations to start at £10 million, "*to be potentially negotiated downward*"; and
  - b. a clause was to be included in the Supplemental Agreement "*underlining that no clients previously contained within the review population will be removed as a consequence of changes in the sophistication test*". In the event, that clause was not included in the Scheme Terms.

#### **D. CSRC meeting on 15 January 2013**

91. The next CSRC meeting took place on 15 January 2013. The CSRC was provided with a Summary Paper of the same date,<sup>711</sup> along with detailed annexes.<sup>712</sup> It was asked to make three policy decisions: on the changes to the Initial Sophisticated Customer Criteria, break costs and redress.<sup>713</sup>
92. The CSRC was also provided with options for the FSA in the event that there was a "no-go" decision, i.e. if the FSA and the banks could not agree on the various "*issues of interpretation*" that were still outstanding at this stage.<sup>714</sup> The FSA was committed to provide the first-tier banks with a go/no-go decision by 31 January 2013. This was, at least partly, as a result of "*an external perception...[that] the pilot had come to an end...[and] an expectation that banks should move on to the full scheme as soon as possible*".<sup>715</sup> It acknowledged that "*we could adapt our position on certain issues (e.g.*

---

<sup>710</sup> FCA Records, *Minutes of IRS Steering Group meeting*, 15 January 2013, 315192.

<sup>711</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089.

<sup>712</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089. Note the following annexures to the Summary Paper: Annex 1: Main Report; Annex 2: Sophistication Test; Annex 3: Break Costs; Annex 4: Redress; Annex 5: HSBC settlement offer; Annex 6: Moratorium on payments; Annex 7: Allegations of fraudulent conduct by banks; and Annex 8: Criteria for Go/No-Go decision.

<sup>713</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, pp. 1-2.

<sup>714</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 44.

<sup>715</sup> Meeting Transcript Adamson (P57:L5-9).

*the sophistication and break cost thresholds) to allow us to negotiate back to the positions set out in this paper".<sup>716</sup>*

93. In respect of amendments to the Initial Sophisticated Customer Criteria, the CSRC was informed about three "*potential weaknesses*" with the Initial Sophisticated Customer Criteria. The Summary Paper states:<sup>717</sup>

- i. *"Customers falling outside the review, by virtue of having large fixed assets and employing seasonal workers, who we think should be within the review because neither of those factors reliably denotes their financial sophistication. This typically includes farms, care homes and schools who have high value fixed assets (e.g. land, buildings, machinery etc) and may employ a large number of seasonal workers...*
- ii. *Firms have insufficient details about their customers to determine whether the current objective sophistication test is met without seeking further information from the customer...*
- iii. *Customers falling within the review, under the current objective sophistication test, who are part of a large group or part of a complex structure, which indicates a high level of financial sophistication, and we think should be outside of the review".*

94. Commenting on the third of these weaknesses, FCA employee G noted that "*[w]e had received a lot of evidence and information from the banks about the unintended consequences of the nature of the test which was that it was catching these SPVs and it was catching connected groups. ... they raised powerful arguments*".<sup>718</sup>

95. To address these concerns, three proposals for new "tests" were put to the CSRC:

- a. "Test 1" entailed amending the existing objective test to include a "*£7.5m[illion] notional hedge value overlay*", described at paragraph 88 above.<sup>719</sup> In the meeting,

---

<sup>716</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 3.

<sup>717</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, pp. 9-10.

<sup>718</sup> Meeting Transcript G (P92:L10-14).

<sup>719</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 12.

the CSRC asked how this £7.5 million figure was arrived at. In response, it was apparently provided with a mathematical explanation and debated whether this was appropriate.<sup>720</sup> This Review has been unable to find any record explaining how that figure was arrived at and has heard no adequate explanation for this.<sup>721</sup>

- b. "Test 2" allowed the banks to use the notional hedge amount of £7.5 million or less as a basis for determining sophistication in cases where they had insufficient information to conclude whether the criteria used in the existing objective test were met.<sup>722</sup> FCA employee P recalled that the *"introduction of the £7.5 million was to create a bright line ... for those banks that didn't actually have very good records ... they had no way of working out who was within the scope of the review"*.<sup>723</sup> The CSRC was informed that this would exclude some customers who might otherwise have expected to be included in the Scheme. The FSA envisaged this could pose reputational risks to it and potentially result in poor customer outcomes. To counteract that, it was suggested that, where Test 2 was relied upon to determine a customer's sophistication, and that customer was consequently excluded from the Scheme, any appeal or complaint by the customer: *"should take into account the customer[']s circumstances at the time of the trade, including (but not limited to) whether the customer met the original objective test"*.<sup>724</sup> This concept became articulated in the form of the "feedback loop", which was an exception that fell away by the time of the Supplemental Agreement (see paragraphs 129 and 133 below).
- c. "Test 3" permitted the banks to decide a customer's sophistication based on a group aggregated basis (as defined under the Companies Act), rather than looking at the individual customer entity in isolation. An exception was included to protect customers who only formed part of a "small group" based on the thresholds set out

---

<sup>720</sup> FCA Records, *CSRC Minutes*, 15 January 2013, FCA-B-0090, p. 2.

<sup>721</sup> Meeting Transcript A, (P71:L9-P73:L24) and (P87:L19-25).

<sup>722</sup> In particular under the Companies Act employee test, there was often insufficient evidence to determine whether workers were full time or not; see FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 9.

<sup>723</sup> Meeting Transcript P, (P45:L25-P46:L4).

<sup>724</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 12. This subsequently evolved into the 'feedback loop', discussed at para. 108a below).

in section 383 Companies Act at the time ("Small Group").<sup>725</sup> In addition, Test 3 also envisaged that there should be a *"firm and Skilled Person subjective overlay to ensure the aggregated group accounts are calculated appropriately (according to the definitions in Companies Act), and to ensure that the customer truly is functioning as part of a group"*.

96. The application of Test 1, as it was then formulated, would potentially result in more customers falling within the scope of the Scheme; applying Test 2 could both include or exclude customers. The application of Test 3 would operate only to exclude customers from the scope of the Scheme.
97. The CSRC was provided with only minimal data regarding the likely practical impact of these changes. Specifically, it was provided with information on the potential impact of these amendments on a representative sample from Barclays' customer population (1,427 customers). By applying Test 1, 54 more customers of that sample population were said to be included in the Scheme. The figures did not consider the impact of the two additional proposed amendments. Applying Test 2 to the same sample population indicated that 78 more customers would be included in the Scheme, and applying Test 3 indicated 91 additional customers from the sample population would be excluded from the Scheme by applying this proposed amendment.<sup>726</sup>
98. The GCD's assessment at the time was that it understood that of the three tests set out in the CSRC Summary Paper, Tests 2 and 3 were likely to remove previously eligible customers and that *"[a] disgruntled customer may challenge a change to the sophistication tests under normal public law grounds or on the basis of a legitimate expectation claim. Whilst it is generally difficult to bring legitimate expectation claims, a decision to change the tests would need to be rational, reasonable and capable of objective justification including a consideration of the likely impact of the change"*.<sup>727</sup>

---

<sup>725</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 13. A customer was deemed to be part of a Small Group where the group of which it was a part met two or more of the following thresholds (together, the "Small Group Thresholds"): (i) aggregate turnover of not more than £6,500,000 net (or £7,800,000 gross); (ii) aggregate balance sheet total of not more than £3,260,000 net (or £3,900,000 gross); and (iii) aggregate employees of not more than 50.

<sup>726</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 13.

<sup>727</sup> The GCD also reiterated the risk of legal challenges: see FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 10.

As discussed in Chapter 5, the changes led to a significant number of customers being excluded from the scope of the Scheme, in circumstances where they would previously have been eligible.

99. The CSRC agreed with the proposed changes to the Initial Sophisticated Customer Criteria. The meeting minutes record:<sup>728</sup>

***"Decision: CSRC agreed that the current objective sophistication test should be amended to include a £7.5 million notional hedge overlay, which would result in those customers with a notional hedge value equal or greater than £7.5m being deemed sophisticated.***

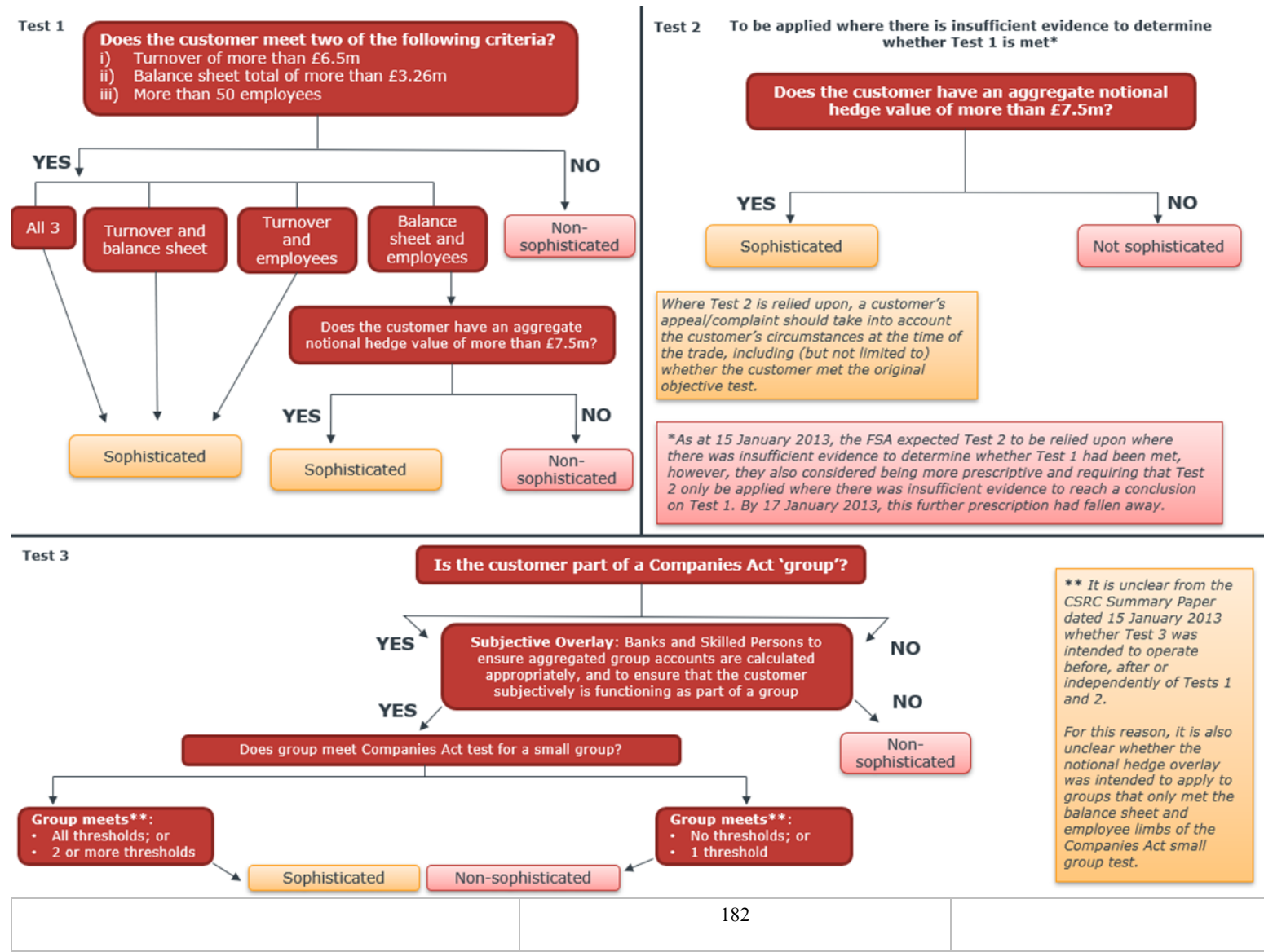
***Decision: CSRC agreed that firms should be allowed to determine sophistication based on group accounts rather than on the entity under dispute in isolation".***

100. The flowchart below (Figure 2) illustrates how the Sophisticated Customer Criteria was expected to be applied as at 15 January 2013.

---

<sup>728</sup> FCA Records, *CSRC Minutes*, 15 January 2013, FCA-B-0090, p. 3. Original emphasis.

Figure 2:



101. Regarding the disclosure of break costs, the CSRC was apprised of the developments in respect of Green and Rowley and agreed<sup>729</sup> with the recommendation that the FSA should maintain its position, as set out in the FAQs addressed to the Skilled Persons (see paragraph 48.b above).<sup>730</sup>
102. As for the redress principles, the CSRC also accepted<sup>731</sup> the recommendation set out in the Summary Paper (and Annex 4), for it: "*To accept the redress principles highlighted here as a fair and reasonable "baseline" for redress determinations in the review*".<sup>732</sup> The key principle for redress was "*to put the Customer back into the position they would have been in had the breach of the Regulatory Requirements not occurred*".<sup>733</sup>
103. The starting point for determining whether redress was payable was to determine which category of product the customer had purchased:<sup>734</sup>
- a. Category A: banks had to provide fair and reasonable redress to all non-sophisticated customers; or
  - b. Category B and C: banks had to assess compliance of the sale of IRHPs with the Regulatory Requirements taking into account, in particular, the Sales Standards. Banks had to consider whether there had been a "*non-compliant sale*". The customer would be entitled to fair and reasonable redress if they suffered loss and the loss was caused by a breach of the Regulatory Requirements.
104. For Category B and C products, a customer who had a non-compliant sale would receive no redress if they either suffered no loss, or, if it were not for the breach of Regulatory

---

<sup>729</sup> FCA Records, *CSRC Minutes*, 15 January 2013, FCA-B-0090, pp. 2 and 4.

<sup>730</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089. See also the FAQs addressed to the Skilled Persons: FCA Records, *Email attachment*, 18 September 2012, 347285, p. 1.

<sup>731</sup> FCA Minutes, *CSRC Minutes*, 15 January 2013, FCA-B-0090, p. 3.

<sup>732</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 22.

<sup>733</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 22.

<sup>734</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 22.

Requirements, the evidence suggested the customer would have purchased the same IRHP(s).<sup>735</sup>

105. The Annex then provided detail on the fair and reasonable redress, which essentially included two broad types of redress:<sup>736</sup>
- a. Full tear-up: exit from the IRHP at no charge, and a refund of all historical cash flows deriving from the IRHP (plus interest) including, where appropriate, any break costs previously paid.
  - b. Alternative product: an alternative IRHP would be considered fair and reasonable where the customer would have purchased alternative interest rate protection. The customer would also be entitled to a refund of the difference in cash-flows between the actual product purchased and the alternative product selected. Further information was provided to the CSRC, which would be used to consider what alternative product would be fair and reasonable including, for example: (i) taking into account the customer's individual circumstances; (ii) that a customer acting with full knowledge would have purchased a simple product without any extendable or callable elements; and (iii) that it is unlikely that a customer would have purchased a product with break costs that, under pessimistic but plausible interest rate scenarios, exceeded 7.5 per cent of the notional value of the IRHP. In practice, this would mean that no alternative product should exceed the maximum term (as defined) as calculated from the date of the original sale.
106. The principles also included a section on consequential loss, which stated that, in the context of the Scheme, it may be fair and reasonable to consider consequential loss by applying the general legal principles relevant to cases involving breaches of the FSA's rules.<sup>737</sup>

---

<sup>735</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 22. As set out in Chapter 4, Section 3 para. 105 below, customers with non-compliant sales who suffered a loss would otherwise receive full tear-up or an alternative product.

<sup>736</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, pp. 23-25.

<sup>737</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 26. It added that "*the test for redress under the Review is what is fair and reasonable in the circumstances of the case and is therefore not limited to claims that a court would accept. Each claim for consequential loss will need to be assessed on its own merits.*"



107. As for the various options available to the FSA in the event of a "no-go" decision, finally, six possible "*Enforcement-type*" options were put to the CSRC, although the Summary Paper warned that "*this is a fast moving situation and we have had relatively little time to explore these options in any depth*".<sup>738</sup> The Summary Paper concluded that the "[u]se of OIVOP powers to require bank(s) to adopt the view of its Skilled Person, or alternatively to accept and pay for a full Skilled Person review of customer files (as opposed to the current position of Skilled Person oversight of the bank's review)"<sup>739</sup> was the option with the "*most merit*" and would be "*a reasonable and proportionate use of [the FSA's] powers*".<sup>740</sup>
108. Following the CSRC meeting, on 17 January 2013 the FSA communicated its proposed amendments to the Scheme to the first-tier banks. A draft Supplemental Agreement and a draft letter was provided to the banks setting out its position on and refinements to the Scheme. These covered the proposed Initial Sophisticated Customer Criteria, Sales Standards, redress, consequential loss, the moratorium on payments, and offsetting.<sup>741</sup> It sought confirmation by 23 January 2013 that the banks would make the necessary changes to enable them to conduct the Scheme.<sup>742</sup> The proposals were substantially similar to those outlined and approved by the CSRC, save for the following further changes:
- a. The Test 2 "*feedback loop*" was amended so that the customer would feed back into the Scheme where they could demonstrate that they would not have met at least two of the turnover, balance sheet and employee limbs. Additionally, the criteria for applying that test were more flexible than in the 15 January 2013 version. The letter described that "*Banks can choose to apply this test on a case by case*

---

<sup>738</sup> See FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, pp. 44-48.

<sup>739</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 46. The remaining options were: Option 1: Use of OIVOP powers to require bank(s) to adopt the FSA's interpretation of disclosure of break costs; Option 2: use of OIVOP powers to require bank(s) to adopt the FSA's interpretation of redress generally; Option 4: enforcement to bring a Principle 11 disciplinary case against bank(s) for breach of the Initial Agreement; Option 5: enforcement to bring a Principle 11 disciplinary case against banks' CEO for breach of the CEO attestation in the Initial Agreement; Option 6: enforcement to bring a Principle 6 disciplinary case against bank(s) for mis-selling IRHPs.

<sup>740</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 44.

<sup>741</sup> See, for example, FCA Records, *Letter*, 17 January 2013, FCA-B-0091, p. 2.

<sup>742</sup> See, for example, FCA Records, *Letter*, 17 January 2013, FCA-B-0091, p. 4.

*basis, but we only expect them to use this test where there is insufficient information to determine whether [Test 1 is met]"*.<sup>743</sup>

- b. In relation to Test 3, if a group met any one of the three Small Group thresholds (rather than two, as envisaged in the 15 January 2013 version), that was sufficient for a customer to qualify.<sup>744</sup>

109. On the same day, the Board was updated regarding the outcomes of the Pilot Review and the issues it had thrown up. The Board paper stated that the FSA's review of the Pilot Review cases had confirmed the initial findings of mis-selling, that the FSA would be implementing a full redress programme, which was likely to cost the banks between £3 and £5 billion, and that it intended to publish the results of the Pilot Review by the end of January 2013. The minutes of the Board meeting record that the Board paper was presented to the Board, but they do not record any discussion of it amongst the Board members, which might have been expected given the imminence of the publication of the results and the commencement of the Scheme. Moreover, it was left to the Executive to make the further significant changes described below without further formal communication of the decisions to the Board.<sup>745</sup>

#### **Section 4 - 17 January 2013 to 28 January 2013**

110. Given the FSA's self-imposed end of January deadline for the publication of the results of the Pilot Review, the timeline for reaching agreement with the banks was very tight. The two weeks following 17 January 2013 were thus marked by intensive discussions with the first-tier banks and other stakeholders, such as the BBA and HMT. A Sky News story on 27 January 2013 reported that "*Britain's major banks have mounted a coruscating attack on their new regulator as they brace for the outcome of a new mis-selling probe*".<sup>746</sup>

---

<sup>743</sup> See, for example, FCA Records, *Letter*, 17 January 2013, FCA-B-0091.

<sup>744</sup> See for example, FCA Records, *Letter*, 17 January 2013, FCA-B-0091.

<sup>745</sup> FCA Records, *Memorandum – paper to the FSA Board*, 17 January 2013, 354398. See also FCA Records, *FSA Board Minutes*, 17 January 2013, 815087.

<sup>746</sup> Sky News, "*Exclusive: Banks' Fury At Mis-Selling Probe*", 27 January 2013, accessible at <https://news.sky.com/story/exclusive-banks-fury-at-mis-selling-probe-10456561> (ARTICLE 009).

111. In this period, material modifications were made to customer eligibility. These consisted of changes to the scope of those who would be entitled to participate in the Scheme and those who would be excluded from the Scheme on the basis of being sophisticated.

112. Following the FSA's provision of the draft Supplemental Agreement and letter of 17 January 2013, it quickly became apparent that the "*banks didn't like...[the] changes that had been made to the objective sophistication criterion*" nor the proposed £7.5 million notional hedge overlay.<sup>747</sup> As FCA employee A recalled:

*"each of the [banks]... came back in quite a lot of detail about their proposals. That followed in the same mechanism. Are we capturing group level loans sufficiently? Have we got SPVs accounted for? Does the test allow for us to do that? Are we looking at the right notional value?"*<sup>748</sup>

113. The FSA summarised the concerns raised by the banks in a draft paper dated 24 January 2013, which set out its proposals to address these. These introduced several important further changes to the Initial Scheme, particularly in respect of eligibility. In outline, the FSA's additional proposed changes were:<sup>749</sup>

- a. those customers with hedges of less than £7.5 million would be deemed non-sophisticated;
- b. those with hedges between £7.5 million and £10 million would be deemed sophisticated unless the bank and/or customer could demonstrate the customer would be deemed non-sophisticated under the original objective test;
- c. those with hedges of more than £10 million would be deemed sophisticated; and
- d. in respect of SPVs and common ownership groups, the banks could define a "group" using the BIPRU definition of "groups of connected clients" in addition to the group company Test 3.

---

<sup>747</sup> Meeting Transcript P, (P43:L6-8).

<sup>748</sup> Meeting Transcript A, (P86:L13-18).

<sup>749</sup> FCA Records, *Internal Document*, 24 January 2013, 461392.

114. For example, Lloyds raised concerns in relation to the proposed amendments to the Initial Sophisticated Customer Criteria and in particular the "feedback loop". It believed that these should be capped at a certain amount.<sup>750</sup> It also considered that consequential loss should be dealt with outside the scope of the PBR.<sup>751</sup>
115. To similar effect, RBS also raised questions about the proposed Sophisticated Customer Criteria. It queried why the threshold of £7.5 million was proposed by way of the overlay to the objective test, and how the subjective test should be applied in practice.<sup>752</sup>

#### A. Engagement with HMT

116. In light of the CSRC's action point that HMT should be kept informed about the FSA's current position,<sup>753</sup> Clive Adamson and a team of other FSA staff met with HMT officials H and U on 24 January 2013.<sup>754</sup> The FSA's minutes of that meeting record HMT official H stating that "*the Treasury had been lobbied hard by the CEOs of the banks, particularly the two state-owned institutions (LBG and RBS). As a result, the Chancellor had come to the opinion that the total redress costs needed to be reduced, and that the purpose of the meeting was for HMT to understand the FSA's proposals in order to find ways to cut the cost*".<sup>755</sup>
117. HMT official H is recorded acknowledging this may be seen as a "*volte face*", given HMT's previously adopted position: "*i.e. that HMT fully supported small businesses and that the FSA needed to build a robust review and redress exercise*".<sup>756</sup> However, "*the desire of ministers to limit the cost of this exercise over-rode HMT's previous position*".<sup>757</sup> HMT also considered that "*the 31 January deadline was optimistic and should be put back*".<sup>758</sup> In response, Clive Adamson "*explained that the FSA is an independent regulator and not a political body. As the CBU, we are focused on achieving*

---

<sup>750</sup> FCA Records, *FSA and Lloyds Minutes*, 17 January 2013, 374516.

<sup>751</sup> FCA Records, *Email*, 17 January 2013, 333941.

<sup>752</sup> FCA Records, *FSA and RBS Minutes*, 18 January 2013, 819348.

<sup>753</sup> FCA Records, *CSRC Minutes*, 15 January 2013, FCA-B-0090.

<sup>754</sup> FCA Records, *FSA and HMT Minutes*, 24 January 2013, 359870.

<sup>755</sup> FCA Records, *FSA and HMT Minutes*, 24 January 2013, 359870, para. 2.

<sup>756</sup> FCA Records, *FSA and HMT Minutes*, 24 January 2013, 359870, para. 3.

<sup>757</sup> FCA Records, *FSA and HMT Minutes*, 24 January 2013, 359870, para. 3.

<sup>758</sup> FCA Records, *FSA and HMT Minutes*, 24 January 2013, 359870, para. 4.

*fair and reasonable outcomes for consumers. We find it inappropriate for HMT to intervene in this manner given the nature of its involvement in the issue*".<sup>759</sup> The FSA appears to have resisted pressure to use the meeting to look at "*the issues where the banks are lobbying hardest, and try to find ways to cut the cost*".<sup>760</sup> FCA employee G explained that while the FSA was prepared to explain its position more fully it would not engage in such an exercise.<sup>761</sup> Nonetheless, the meeting then covered several issues of detail, including the proposed Sophisticated Customer Criteria, break costs disclosure, and redress, with HMT setting out its views on how these might be used to reduce the overall cost of the Scheme to the banks.<sup>762</sup> The FCA emphasised that it was "*not willing to compromise getting the right outcome for small businesses*".<sup>763</sup>

118. Reflecting on this meeting, Clive Adamson stated in evidence to this Review that: "*The financial crisis... was still continuing and there was still pressure on the financial position of banks including in relation to one in particular which had a large government ownership. So it wouldn't be unusual that there would be lobbying by the banks. ... what was unusual here was a view clearly expressed about [the] desire of ministers to ... question what we were doing and I think it[']s fair to say that we were disappointed in that*".<sup>764</sup>
119. In an internal email written on 24 October 2013, Martin Wheatley also recalled "*the pressure we received from FST*<sup>765</sup> *to go easy on the banks in reaching the agreement*".<sup>766</sup> Giving evidence to the TSC on 10 September 2013, however, Martin Wheatley stated, when asked to give an assurance that there had been no pressure from the Government that could prejudice the independence of the FCA: "*That is right. There is nothing that I*

---

<sup>759</sup> FCA Records, *FSA and HMT Minutes*, 24 January 2013, 359870, para. 5.

<sup>760</sup> FCA Records, *FSA and HMT Minutes*, 24 January 2013, 359870, para. 6.

<sup>761</sup> FCA Records, *FSA and HMT, Minutes* 24 January 2013, 359870, para. 6.

<sup>762</sup> FCA Records, *FSA and HMT, Minutes* 24 January 2013, 359870, paras. 7-13.

<sup>763</sup> FCA Records, *Minutes of FSA and HMT meeting*, 24 January 2013, 359870, para. 15.

<sup>764</sup> Meeting Transcript Adamson (P58:L22-P59:L7).

<sup>765</sup> The Rt. Hon. Sajid Javid MP, then Financial Secretary to the Treasury.

<sup>766</sup> FCA Records, *Email*, 24 October 2013, 004331.

would describe as inappropriate in terms of the relationship or the desire for information".<sup>767</sup>

120. On 24 January 2013, a further meeting took place between Sajid Javid MP (then Financial Secretary to the Treasury), Martin Wheatley, and officials H and F of HMT. The FSA's note of the meeting records that Sajid Javid MP explained his concern about where to "draw the line" in respect of sophistication. Both he and HMT official F pressed the FSA for "flexibility" and challenged the FSA's proposed timeline for redress, which they considered "artificial".<sup>768</sup>
121. HMT official H sent a follow-up email later that evening.<sup>769</sup> In that email, they set out their position that certain key details of the Scheme had not yet been considered or worked through. They said: "*there is still a large gap between the FSA and the banks on the detail. Given that the scheme itself is complicated, then it is the detail that will really make a difference*". In respect of sophistication, they took issue with the feedback loop, which they described as allowing customers to have "*another bite of the cherry through the main test of sophistication*". HMT official H also questioned whether the test could be simplified "*to deal with this complexity*" without having a "*negative impact on banks that don't have records for that period*".<sup>770</sup> They made a number of suggestions about how to achieve that end. FSA records noted that one such suggestion was including an "*additional test to deem any customer with a hedge greater than £3.26m[illion] as sophisticated*". In response, the FSA explained that "*this would remove a large number of customers we believe to be clearly non-sophisticated*".<sup>771</sup>
122. On 26 January 2013, The Sunday Telegraph reported that "*Factions within the Treasury want the [FSA] to "water down" the findings of a review of banks' mis-selling of complex financial products to small businesses ... [there was] [c]oncern within the Government*

---

<sup>767</sup> FCA Records, *Oral evidence taken before Treasury Committee*, 10 September 2013, 1135205, p. 9.

<sup>768</sup> FCA Records, *Email*, 25 January 2013, 756241.

<sup>769</sup> FCA Records, *Email*, 24 January 2013, 461500.

<sup>770</sup> FCA Records, *Email*, 24 January 2013, 461500.

<sup>771</sup> FCA Records, *Note for Record*, 24 January 2013, 359870, para. 8.

*that the scandal could "blow a hole" in the banks' balance sheets has resulted in the pressure on the FSA".*<sup>772</sup>

123. Commenting on the level of access HMT had to the FSA compared to other stakeholders, FCA employee G commented: *"It's a matter of political reality that the CEO of the FCA was appointed by the Treasury, so of course that's a political fact there... the political realities are that not all stakeholders are equal... [but that] does not mean that we were subject to inappropriate influence".*<sup>773</sup> As Clive Adamson put it: *"I think from my experience, and going back to the experience when I was head of what was called MRGD [Major Retail Groups Supervision Division] in the FSA is there were constant calls from Treasury at all hours of the day and night, so that is not unusual. And obviously they had as much access as they wanted to at all levels of the organisation ... I think arguably customer stakeholders might have had less access. But one of the features of the FCA [compared to the FSA] was that we wanted to communicate more directly with all stakeholders, not just the traditional ones".*<sup>774</sup>
124. In their evidence to the Review, HMT official H agreed with the description of HMT's role as that of an *"honest broker"*<sup>775</sup>, facilitating access for other stakeholders and ensuring their views reached the FSA. HMT official H stated: *"[I]n one sense you could say that the FCA perhaps were doing a good job because all sides of the negotiation, the businesses felt like they were getting the rough end of the stick, and so did the banks. So, in a way, everybody felt that they weren't winning that negotiation. Well, the businesses felt shut out, and I think the banks felt that the FCA wasn't listening... certainly one of our roles was to try and make sure that the FCA were properly listening and then coming to a view. That they weren't just dismissing things: that they were actually giving them proper consideration".*<sup>776</sup>

---

<sup>772</sup> The Sunday Telegraph, *"FSA under pressure to 'water down' mis-selling findings"*, 26 January 2013, accessible at <https://www.telegraph.co.uk/finance/rate-swap-scandal/9829396/FSA-under-pressure-to-water-down-mis-selling-findings.html> (ARTICLE 036).

<sup>773</sup> Meeting Transcript G (P99:L19-21, P100:L7-8 and, P99:L24-P100:L1).

<sup>774</sup> Meeting Transcript Adamson (P64:L12-15, and P65:L1-5).

<sup>775</sup> Meeting Transcript H (P13:L7-10).

<sup>776</sup> Meeting Transcript H (P30:L10-22).

## B. CSRC meeting of 28 January 2013

125. The purpose of the next CSRC meeting on 28 January 2013 was "*to decide how best to respond to the banks, so that we can make an announcement on 31 January 2013 about which banks will be progressing to the Main Review*".<sup>777</sup> The CSRC considered various aspects of the Scheme, including in particular: (i) the proposed revisions to the Initial Sophisticated Customer Criteria, (ii) break costs, (iii) principles of redress, (iv) a potential FOS element to the Scheme, (v) whether to extend the Skilled Persons responsibilities to give the FSA an assurance that banks were appropriately considering moratoria on payments, and (vi) possible actions the FSA could take against non-cooperating banks.
126. Regarding what, if any, amendments to make to the proposed Sophisticated Customer Criteria, the CSRC Summary Paper noted that the banks were concerned the proposed criteria would "*still result in large property companies and SPVs or common ownership structures being non-sophisticated (and therefore included within the review)*".<sup>778</sup> It added that "*allowing these type [sic] of customer in the review ... will increase the time it takes to complete the review and typically these customers had larger hedges, so the overall cost of redress would be higher if they are included*".<sup>779</sup> While these concerns had been raised by all of the banks, it was a particular issue for two state-owned banks, Lloyds and RBS, given the profiles of their customer portfolios.
127. The proposal put to the CSRC was that: "*We are persuaded that we should make further substantial changes to the criteria, to exclude more customers from the review which the banks say are sophisticated because they are SPVs or subsidiaries of offshore parents*".<sup>780</sup> The CSRC Summary Paper therefore suggested two changes to the amendments to the Initial Sophisticated Customer Criteria:
- "1. *To remove the feedback loop from Test 2 (the notional hedge test) and set the notional hedge threshold amount at £10 million; and*

---

<sup>777</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 1.

<sup>778</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 2.

<sup>779</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 2.

<sup>780</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 2.



2. *To include a group test to include groups that would meet the definition of "groups of connected clients" as set out in BIPRU (large exposures requirements)".*<sup>781</sup>
128. Subject to that, the materials presented to the CSRC on 28 January 2013 did not mention the further suggested amendments to the Initial Sophisticated Customer Criteria, namely:
- a. The notional hedge would cease to be just an "overlay" on the existing Companies Act size criteria, but would become a new, stand-alone test, and would be applied across both individual customers and aggregated groups; and
  - b. The previous qualification included within Test 3 would be removed. This provided that, when applying that test, the bank and Skilled Person would be required to ensure the consolidated group accounts are calculated appropriately (according to the definitions in the Companies Act) and to ensure that the customer was functioning as part of a group. The minutes do not record that this was discussed during the meeting.<sup>782</sup>
129. While the threshold amount was thus increased to £10 million the other proposed changes would exclude many previously eligible customers from the scope of the Scheme:
- a. The notional hedge threshold would now apply to **all** customers, regardless of whether they met the Balance Sheet limb and the Employee limb of the Sophisticated Customer Criteria. In other words, it ceased to be an "overlay" or safeguard which would only bring customers back into scope of the Scheme, and instead became a free-standing, objective criterion which could itself exclude customers from scope of the Scheme.
  - b. The notional hedge threshold would now also apply to all customers which were part of: (i) a Companies Act Group not being a Small Group or (ii) a BIPRU Group under the expanded group definitions. The notional hedge threshold was then applied to the aggregate hedges of the whole group, regardless of the size of the individual customer's IRHP exposure.

---

<sup>781</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 9; see para. 95b of this Chapter regarding the definition of "feedback loop".

<sup>782</sup> See FCA Records, *CSRC Minutes*, 28 January 2013, 359688.

- c. The final terms omitted the previously proposed Test 2 "feedback loop".
  - d. The final terms also omitted the previous qualification upon Test 3 regarding the application of that test.
130. FSA personnel giving evidence to this Review, who were asked about the changes to the notional hedge test, could not recall specific discussion on this and expressed differing views. Clive Adamson stated that "*the point was to include [unsophisticated customers] not exclude them... the principle was to include as many customers in the scheme who would be regarded as unsophisticated*",<sup>783</sup> whereas FCA employee P said "*I think it was... a concession to the banks.... When I say "concession", it's a negotiation, isn't it*"<sup>784</sup> and FCA employee A suggested it was "*not a case of keeping everyone in, it was about keeping the highest number of the right group of customers and if there was uncertainty making sure we had a strong enough buffer*".<sup>785</sup> In contrast, one bank recalled in respect of the introduction of the £10 million threshold that "*there is no doubt it increased the number of customers who ended up being sophisticated. I seem to recall they introduced a maximum trade value, was it £10 million, which we hadn't asked for nor expected, and that made quite a difference as well*".<sup>786</sup> The materials provided to the CSRC for the meeting did not consider the proposed changes, or their likely impact, in any detail.<sup>787</sup> The CSRC Summary Paper noted "*a risk that the wider definition of groups (i.e. BIPRU) will push lots of customers out of the review*"<sup>788</sup> and that the FSA "*would need to ask the banks for data to truly understand this risk*".<sup>789</sup> The CSRC had seen only indicative data from Lloyds and Barclays about the potential impact of the changes from the Initial

---

<sup>783</sup> Meeting Transcript Adamson (P51:L13-14).

<sup>784</sup> Meeting Transcript P (P53:L5) and (P53:L21).

<sup>785</sup> Meeting Transcript A (P95:L15-18).

<sup>786</sup> Meeting Transcript CT (P41:L5-9).

<sup>787</sup> The minutes record that the CSRC was informed that the introduction of the group of connected clients BIPRU test would result in 20 per cent of Lloyds' customers being excluded from the Scheme and that the increase of the notional hedge threshold from £7.5 million to £10 million and the removal of the feedback loop would reduce the transactions included in scope from about 10,000 to 4,500 for Lloyds. No further data analysis was provided. See FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p.1.

<sup>788</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 9.

<sup>789</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 9.

Sophisticated Customer Criteria to the Sophisticated Customer Criteria.<sup>790</sup> Minutes from the meeting record that "CSRC noted that the "groups of connected clients" test as set out in BIPRU would result in 20% of Lloyds' customers being excluded from the review [...] CSRC also noted that increasing the notional hedge threshold from £7.5 million to £10 million and removing the feedback loop would reduce the number of transactions included in scope from about 10,000 to 4,500 for Lloyds, with smaller impacts for the other banks".<sup>791</sup> To similar effect, the GCD considered it clear that at least some customers would fall out of the Scheme but the "ultimate effect of the changes to the tests is uncertain" and "the potential impact of such a change would seem to be a key piece of information".<sup>792</sup> Nonetheless, the minutes of the CSRC meeting record that CSRC "agreed with the two proposed changes to the sophistication customer criteria".<sup>793</sup> The authors of the Summary Paper hoped to be able to provide a further verbal update at the CSRC meeting.<sup>794</sup>

131. FCA employee I, who played no part in the discussions at the time, later heard from those involved that the £10 million threshold was arrived at through the use of "an Excel spreadsheet containing the entire retail customer population" and the relevant team having "'played with the thresholds' until they were left with a 'reasonable population' that 'felt about right'".<sup>795</sup> FCA employee A confirmed the existence of "a spreadsheet ... that I was using ... to model"<sup>796</sup>, but explained that the FSA "[had] limited data and intelligence and you have to make a decision and you can't quite quantify the lasting impact of that".<sup>797</sup> They considered that the FSA "certainly did not know who would be captured by the objective test. We did not have that level of data or understanding about the potential unskilled population and therefore we were making judgments based upon samples and ... discussions with the firm".<sup>798</sup> Looking back, they concluded that "it's

---

<sup>790</sup> FCA Records, *Memorandum – CSRC Summary Paper – Interest Rate Hedging Products*, 15 January 2013, 394535, p. 10-1; FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p. 1.

<sup>791</sup> FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p.1.

<sup>792</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 7.

<sup>793</sup> FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p. 2.

<sup>794</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 9.

<sup>795</sup> Written Representations I, 16 February 2020, pp. 5-6.

<sup>796</sup> Meeting Transcript A (P80:L6-9).

<sup>797</sup> Meeting Transcript A (P81:L3-5).

<sup>798</sup> Meeting Transcript A (P81:L14-19).

*actually, now I think about it, really bad that we couldn't get more data from the firms on their base to model this. What we were told is they just didn't have it."*<sup>799</sup>

132. The Review asked the FCA for any documents showing the rationale behind the calculation for the £10 million figure and the likely impact at the time it was proposed, including the spreadsheet mentioned above. The documents received did not include a spreadsheet and the Review was unable to locate it elsewhere.<sup>800</sup> In addition, this Review is unaware of material to suggest that the FSA subsequently acquired or considered such data until much later into the implementation phase of the Scheme. It was not until late 2013 that the FSA had an indication of the effect of the changes to the Initial Sophisticated Customer Criteria.<sup>801</sup>
133. Despite the lack of impact analysis, the CSRC approved the two amendments to the Initial Sophisticated Customer Criteria referred to in the CSRC paper and the other changes described at paragraph 129 above.<sup>802</sup> The CSRC's view in respect of the removal of the feedback loop was that: "*those customers who were more sophisticated were more likely to have access to advisers and accountants and therefore would be able to secure appropriate redress, where necessary*".<sup>803</sup> Removal of the feedback loop had the effect of removing customers based on the notional value of hedges alone, without an option to be reconsidered for inclusion in the Scheme.

---

<sup>799</sup> Meeting Transcript A (P82:L9-11).

<sup>800</sup> Request 56 to FCA ("*Please provide any documents showing the rationale behind and the calculation for the £10 million sophistication criteria figure. Please also provide any information available concerning internal discussions or considerations made by the FCA regarding the likely impact of the £10m figure at the time it was proposed – i.e. we understand there may have been a spreadsheet containing the mathematical calculations backing the original £7.5m figure.*"). The FCA responded: "*The change in sophistication criteria was the subject of legal action. Documents provided which explain the rational[e]. Additional documents provided*".

<sup>801</sup> See Chapter 5, Section 1, paras. 16-25.

<sup>802</sup> FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p. 3.

<sup>803</sup> FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p. 2.

134. On the issue of break costs, the CSRC agreed that the FSA should maintain its current position<sup>804</sup> but did not expressly set out the specific requirements in the revised terms agreed in respect of the Scheme.<sup>805</sup>
135. In respect of redress, some of the banks had objected to the maximum term on alternative products.<sup>806</sup> The CSRC decided that the FSA's position on redress should be maintained, noting that "*careful messaging would be needed to ensure that this is not perceived as a policy stance*".<sup>807</sup>
136. The CSRC Summary Paper also referred to concerns raised by the banks in respect of consequential loss. Despite stating that it did not accept these concerns, it proposed that the CSRC "*remove the 'fair and reasonable' aspect of consequential loss as requested by RBS, and limit it to losses that are 'reasonably foreseeable'*".<sup>808</sup> The CSRC agreed with this assessment, again noting "*that this [decision] requires careful messaging*".<sup>809</sup>
137. In relation to the proposed FOS scheme, by 22 January 2013 the CBU Senior Policy Committee had recommended that, given the limited benefits a stand-alone FOS scheme would deliver, the FSA should not proceed with the consultation and establish such a

---

<sup>804</sup> FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p. 3.

<sup>805</sup> The 28 January Summary Paper, at p. 11, suggested that determination of whether a bank had complied with adequate disclosure on break costs would include a "*holistic consideration*" of a range of factors, including "*The size and nature of the Customer; The Customer's knowledge and understanding of these types of products generally and the specific product purchased; The Customer's interaction during the sales process; The complexity of the product; and The information provided during the sales process, particularly the quality and nature of the information provided, when and how it was provided and how long the Customer had to digest and understand it*"; See FCA Records, CSRC Summary Paper, 28 January 2013, FCA-B-0095, p. 11.

<sup>806</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, pp. 2-3.

<sup>807</sup> FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p. 3.

<sup>808</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 13.

<sup>809</sup> FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p. 3.

scheme.<sup>810</sup> Consistent with that determination, the CSRC decided that there should be no amendment to the FOS's jurisdiction.<sup>811</sup>

## Section 5 - Finalising the Supplemental Agreement

138. Following the CSRC meeting, on 28 January 2013, Martin Wheatley informed HMT that the FSA had finalised its views on changes to the Scheme and would be communicating those views to the first-tier banks the following day.<sup>812</sup>
139. On 29 January 2013, the FSA wrote to the first-tier banks, setting out its final position in relation to the terms of the Scheme.<sup>813</sup> A copy of the 29 January 2013 letter is at Appendix 8. The detail of that letter is not repeated here, save to note the following:
- a. The flow chart set out below (Figure 3) illustrates the finalised Sophisticated Customer Criteria.<sup>814</sup>
  - b. The starting point for determining whether a customer was sophisticated (and therefore fell outside the Scheme) had shifted – from both the test outlined in the Initial Written Undertaking agreed in June 2012, and the proposed amendments to the Initial Sophisticated Customer Criteria outlined on 17 January 2013. A speaking note prepared for meetings with the banks on 29 January 2013 described the FSA as having made two "*big concessions*" in relation to the Sophisticated Customer Criteria (particularly for Lloyds), and that it was likely to be unpopular with consumer groups, who had not been consulted on the changes.<sup>815</sup> It outlined

---

<sup>810</sup> In its representations to the Review, the FOS referred to Martin Wheatley's letter to the FOS dated 11 February 2013, which states "*I would like to take this opportunity to record my gratitude to you and your team for assisting us with this piece of work. The feedback that I have received from my team is that the work we undertook on this scheme was a great example of how our two organisations can work flexibly and collaboratively*". Written Representations FOS, 1 September 2021.

<sup>811</sup> FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p. 3.

<sup>812</sup> FCA Records, *Email*, 28 January 2013, 819347.

<sup>813</sup> Letter to RBS: FCA Records, *Letter*, 29 January 2013, 290816; Letter to Barclays: FCA Records, *Letter*, 29 January 2013, FCA-ADD-0099; Letter to HSBC: FCA Records, *Letter*, 29 January 2013, 576499; and Letter to Lloyds: FCA Records, *Letter*, 29 January 2013, 570975.

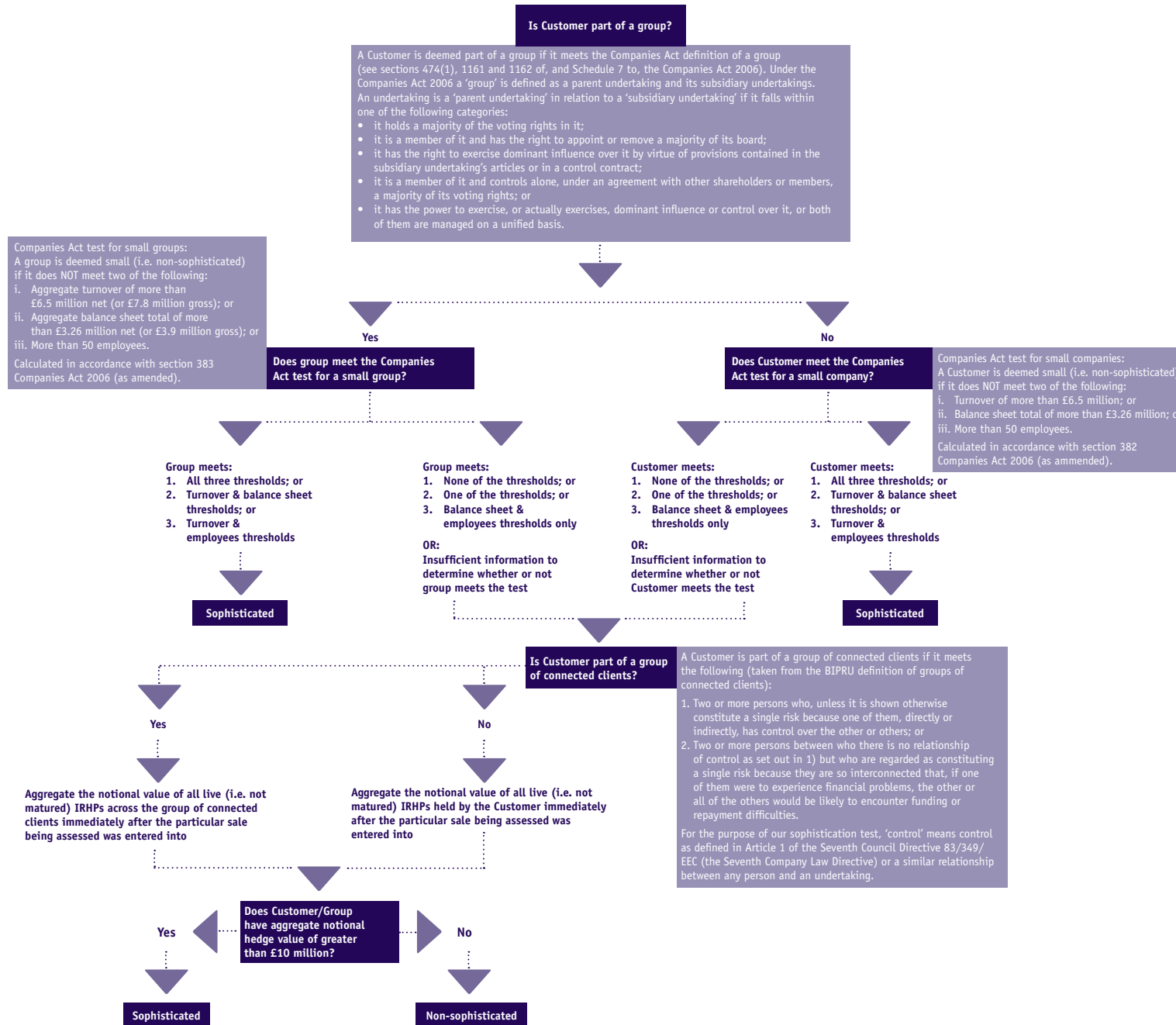
<sup>814</sup> The Financial Services Authority, "*Interest rate hedging products – flowchart*", 1 February 2013 accessible at <https://webarchive.nationalarchives.gov.uk/ukgwa/20130201182900/http://www.fsa.gov.uk/stat%20ic/pubs/other/irs-flowchart-2013.pdf>

<sup>815</sup> FCA Records, *Internal Document*, 29 January 2013, 461441.

that a £10 million notional threshold rather than £7.5 million or £5 million had been selected for a number of reasons. In particular, it stated that the FSA had looked in detail at the types of customers who fell on both sides of an absolute cut-off for notional value. As noted above, however, based on the contemporaneous records and the witness evidence provided to the Review, it does not appear that the FSA undertook such work in any great detail, if at all.

- c. The letter enclosed the FSA's finalised redress principles. These remained largely unchanged from those principles communicated to the banks on 17 January 2013. One notable point of difference, however, was that in the version sent on 17 January 2013, only Category B and Category C customers could be found to have a "no redress" outcome where they either suffered no loss or where it was determined that, even absent the mis-selling, they would have bought the same IRHP. This now applied to all customers, so that there was no longer a right to automatic full tear-up for Category A customers, nor an automatic right to redress, in such circumstances.

Figure 3:





140. The same day, after 10.00 p.m., HMT official H contacted FCA employee M, apologising for the late hour and requesting to "*speak briefly*".<sup>816</sup> M and FCA employee G called them that night. An internal FCA email circulated just before midnight records that HMT official H "*had spoken to all the banks and... wanted to feed back on two key issues which they had raised*" (in particular, RBS) regarding the FSA's position set out in its letter of 29 January 2013.<sup>817</sup> HMT official H explained that their "*impression was that the [banks] were a lot happier overall and in particular on sophistication and the FOS... [Their] impression was that as a result of this, they seem to have shifted their position 'quite a lot'*".<sup>818</sup> FCA employees M and G "*confirmed again that whilst we had moved substantially on sophistication to ensure that the right customers were involved in this exercise, we felt strongly that we should maintain our position on redress*".<sup>819</sup> In the round, they considered that the position arrived at by the FSA represented "*a balanced approach which ensured fair and reasonable outcomes for the small and unsophisticated customers who had been mis-sold and was fair to the banks*". HMT official H "*asked us to keep... [them] informed as issues progressed tomorrow*".<sup>820</sup>
141. Despite their remaining reservations regarding certain aspects of the Scheme, all of the first-tier banks responded to the FSA on 30 January 2013, confirming their agreement in principle to the FSA's terms.<sup>821</sup> The CSRC was informed that unconditional agreement had been received from the first-tier banks.<sup>822</sup>
142. The CSRC agreed that an FSA press release should be published on 31 January 2013,<sup>823</sup> but not the specific terms of the Scheme.<sup>824</sup> In addition, the FSA initiated a wider communications strategy regarding the Scheme, including interviews with Martin

---

<sup>816</sup> FCA Records, *Email*, 29 January 2013, 295332.

<sup>817</sup> FCA Records, *Email*, 29 January 2013, 295332.

<sup>818</sup> FCA Records, *Email*, 29 January 2013, 295332.

<sup>819</sup> FCA Records, *Email*, 29 January 2013, 295332.

<sup>820</sup> FCA Records, *Email*, 29 January 2013, 295332.

<sup>821</sup> Letter from RBS: FCA Records, *Letter*, 30 January 2013, 295425; Letter from HSBC: FCA Records, *Letter*, 30 January 2013, 446939; Letter from Lloyds: FCA Records, *Letter*, 30 January 2013, 816076; and Email from Barclays: FCA Records, *Email*, 30 January 2013, 373155.

<sup>822</sup> FCA Records, *Memorandum – CSRC Summary of Outcomes*, 30 January 2013, 882867.

<sup>823</sup> FCA Records, *CSRC Minutes*, 30 January 2013, 292091.

<sup>824</sup> As to the subsequent discussions on whether to publish the Scheme Terms, see Chapter 5, Section 3, paras. 89-99.

Wheatley, meetings with MPs, engagement with trade associations and consumer bodies, updates on the FSA website, and briefings to the FSA contact centre.<sup>825</sup>

143. On 31 January 2013, the FSA published a report which summarised the work it had undertaken in respect of the Pilot Review and the various amendments to the Scheme.<sup>826</sup> The report noted the FSA's expectation that the banks should aim to complete their reviews within six months (with some banks with larger review populations taking up to 12 months). The priority being the delivery of fair and reasonable outcomes for customers. As described in further detail in Chapter 5, this report was updated in March 2013.<sup>827</sup>
144. There was significant press coverage following the announcement of the Supplemental Agreement. The Telegraph wrote "*More than 90 pc of complex interest rate derivatives sold by the banks to small businesses could have been mis-sold, according to the findings of a review*".<sup>828</sup> Martin Wheatley was quoted as "*accus[ing] lenders of selling businesses 'absurdly complex products'*".<sup>829</sup> Speaking on BBC Radio 4's Today programme, Martin Wheatley said: "*If you're selling financial products, one of the things you are required to do is understand your customer and understand what level of product is appropriate for them*".<sup>830</sup>

---

<sup>825</sup> Letter to Andrew Tyrie MP: FCA Records, *Letter*, 31 January 2013, 301328; Letter to Vince Cable MP: FCA Records, *Letter*, 31 January 2013, 299047; Letter to Greg Clark MP: FCA Records, *Letter*, 31 January 2013, 299043; Letter to Sajid Javid MP: FCA Records, *Letter*, 31 January 2013, 299055; Letter to Ed Miliband MP: FCA Records, *Letter*, 31 January 2013, 301352; Letter to Guto Bebb MP: FCA Records, *Letter*, 31 January 2013, 299917; and Letter to George Osborne MP: FCA Records, *Letter*, 31 January 2013, 298896. Each letter outlines the agreement reached with the four banks.

<sup>826</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, January 2013, FCA-ADD-0267.

<sup>827</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, March 2013, FCA-A-0011.

<sup>828</sup> The Telegraph, "*Banks mis-sold more than 90 per cent of rate swaps, says FSA*", 31 January 2013, FCA-A-0043, p. 1.

<sup>829</sup> The Telegraph, "*Banks mis-sold more than 90 per cent of rate swaps, says FSA*", 31 January 2013, FCA-A-0043, p. 1.

<sup>830</sup> BBC Radio 4, *The Today Programme*, 31 January 2013.

## Chapter 5

### Implementation of the Scheme

#### Introduction

1. The implementation of the Scheme, which is the subject of this Chapter, began in February 2013 after the banks had agreed to the Scheme Terms, as amended by the Supplemental Agreement and the Exchange of Letters. At the time, the FSA estimated and expected that the implementation process would take approximately six to twelve months depending on the review population of each respective bank.<sup>831</sup>
2. As this Chapter outlines, it took years and not months from the end of January 2013 for all eligible customers to receive redress.<sup>832</sup>
3. Throughout the period from 2013 to 2016, the FCA periodically released figures updating the public as to the progress of the Scheme. It was not until 30 September 2016 that this update recorded that all eligibility, compliance and basic redress outcomes had been assessed and communicated to customers.<sup>833</sup>
4. Indeed the scale of the redress programme and the complexity of the redress mechanism, even when limited to those eligible, meant that timely resolution of all cases was always unlikely, despite the ambitions at the outset that this Scheme was to be "*an opportunity to distinguish the FCA from the FSA and that was to be characterised by speed, moving from analysis to action quickly*".<sup>834</sup>

---

<sup>831</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, January 2013, FCA-ADD-0267, p. 4.

<sup>832</sup> The Scheme continued beyond 31 December 2018, the end date for this Review, and indeed EY did not submit its final report on Lloyds until September 2019; see FCA Records, Skilled Person report (Lloyds), 9 September 2019 (REPORT 006).

<sup>833</sup> At 30 June 2016 two alternative product basic redress outcomes were still to be communicated; see FCA Records *Progress of sales through stages of the review as at 30 June 2016 – All banks*, 3 October 2016, 772259. By 30 September 2016 these final two cases had been determined and communicated; see The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf> (ARTICLE 026).

<sup>834</sup> Meeting Transcript C (P18:L2-4).

5. This Chapter outlines the FCA's role and steps taken and the key events in the implementation of the Scheme.

6. The remainder of the Chapter is structured as follows:

a. Section One – The early stages of implementation

Section One describes the issues that emerged after the Scheme Terms were agreed, and which needed to be resolved by the FCA before the banks and Skilled Persons could commence their reviews.

b. Section Two – The respective roles of the FCA, the banks and Skilled Persons during implementation

Section Two considers the banks' and Skilled Persons' respective functions in the Scheme. It also addresses the FCA's role in overseeing the Scheme as well as the specific issues to which it needed to respond.

c. Section Three – The FCA's oversight of specific issues during the Scheme's implementation

Section Three considers the complications that emerged while the Scheme was being implemented and the FCA's response in each instance.

d. Section Four - Conclusion of the Scheme

This final section considers the FCA's actions during the latter part of the Scheme's implementation once redress outcomes had been determined for the majority of customers.

## **Section 1 – The early stages of implementing the Scheme**

7. The early months of 2013 were characterised by continuing negotiations and discussions as the banks and Skilled Persons responded to the FSA's feedback from the Pilot Review and worked through the detail of how to implement what had been agreed, while building the necessary teams, systems and governance processes to be able to begin reviewing thousands of files at speed. Meanwhile, the FSA itself was undergoing the final stages of a major organisational change from which the FCA and PRA were created.

8. This Section One details the various points that needed to be resolved before banks and Skilled Persons could commence their reviews. These points can broadly be categorised as follows:
  - a. appointment of additional Skilled Persons and managing potential conflicts;
  - b. agreeing a methodology to carry out the PBR exercise and redress;
  - c. establishing the number of in-scope customers; and
  - d. outstanding technical points to be resolved by the FCA.

**A. Skilled Persons and managing potential conflicts**

9. Before the Scheme could be implemented, the FCA needed to ensure that banks signed up to the Scheme Terms and were engaging suitable Skilled Persons. By 31 January 2013, the first-tier banks had agreed to sign the Supplemental Agreement, which differed in several key respects from the Initial Agreement, as set out in Chapter 4. The Skilled Persons appointed by each bank are set out in Table 1 below. Some of them had already been involved in the Pilot Review with their respective banks.<sup>835</sup> As an FCA Summary Paper noted: "*It was necessary to ensure consistency in the selection and appointment of multiple skilled persons and to manage use of the same skilled persons by different banks*".<sup>836</sup>
10. As described at Chapter 4, Section 1, paragraph 15, the FSA, and later the FCA, sought to minimise the risk of conflicts by supporting and overseeing the appointment of second (and, in one instance, third) Skilled Persons, in circumstances where the first, or primary, Skilled Person was conflicted as regards a particular IRHP customer. Additionally, this Review has seen evidence that, where customers and other stakeholders raised concerns

---

<sup>835</sup> FCA Records, *Memorandum – Interest Rate Hedging Products (IRHP) – March 2013 Board update*, 6 March 2013, 450153. AIB confirmed its agreement on 12 February 2013: FCA Records, *Letter*, 12 February 2013, 820269. Bank of Ireland confirmed its agreement on 13 February 2013: FCA Records, *Letter*, 13 February 2013, 822193. NAGE confirmed its agreement on 13 February 2013; FCA Records, *Signed Supplemental Agreement*, 13 February 2013, 816939; FCA Records, *Email*, 13 and 14 February 2013, 821237. Santander confirmed its agreement on 14 February 2013: FCA Records, *Signed Supplemental Agreement*, 14 February 2013, FCA-B-0106. Co-op Bank confirmed its agreement on 12 February 2013: FCA Records, *Signed Supplemental Agreement*, 12 February 2013, FCA-B-0104.

<sup>836</sup> FCA Records, *Internal Document*, January 2014, 419354, p.6, para.7.11.

about employees at Skilled Persons possibly being conflicted by previously working for one of the banks, the FCA investigated these claims.<sup>837</sup> As KPMG, Skilled Person 1 for Barclays, noted, "*the issue of conflicts and any conflicts that the firm might have was something that the FCA was interested in and I think it was particularly important that the individuals who were put forward on the skilled persons team should be as free of conflicts as possible with the bank*".<sup>838</sup>

11. Table 1 below lists each bank and its respective final Skilled Person appointments.

<b>Bank</b>	<b>Skilled Person(s)</b>
<b>Barclays</b>	1. KPMG  2. Deloitte  3. Macfarlanes
<b>HSBC</b>	1. Deloitte  2. SJ Berwin/KWM  Consequential loss: SJ Berwin/ KWM/ Osborne Clarke <sup>839</sup>
<b>Lloyds</b>	1. EY  2. Promontory
<b>RBS</b>	1. KPMG

---

<sup>837</sup> FCA Records, *Email*, 27 January 2014, 473459. Separately, in a further example of the oversight of conflicts, Deloitte (Skilled Person 1 for AIB) was appointed AIB's statutory auditor while its IRHP Skilled Person appointment was ongoing, and customers were contacted to explain how this could create a perceived conflict of interests and were given the choice of an alternative Skilled Person to carry out their file review. Grant Thornton was appointed as AIB's second Skilled Person in August 2013 for this purpose; see FCA Records, Skilled Person report (AIB), 12 August 2016 (REPORT 008).

<sup>838</sup> Meeting Transcript KPMG (P9:L10-16).

<sup>839</sup> As set out in more detail at Chapter 5, Section 3 para. 140, Deloitte and HSBC agreed for consequential loss claims to be considered by an additional Skilled Person.

<b>Bank</b>	<b>Skilled Person(s)</b>
	2. Macfarlanes
<b>Santander</b>	EY
<b>AIB</b>	1. Deloitte 2. Grant Thornton
<b>Bank of Ireland</b>	EY
<b>Co-op Bank</b>	Grant Thornton
<b>Clydesdale/NAGE</b>	BLP

## **B. Agreeing a methodology**

12. Once each Skilled Person was in place, the bank and its respective Skilled Person needed to agree a methodology for the purposes of carrying out the Scheme. This was mandated under the Requirement Notices and a bank could not commence its review until this was finalised. These methodologies were prepared by each bank and, on occasion, ran to hundreds of pages.<sup>840</sup> The purpose of these documents was to act as a reference manual to encourage consistency across review teams within each bank when undertaking eligibility, compliance and redress reviews.
13. Unlike in the Pilot Review, the FSA decided that it "*should not be reviewing revised methodologies, as the onus is on the Skilled Person in attesting to the changes.*"<sup>841</sup> It therefore did not review or comment on the final methodology of each bank,<sup>842</sup> but instead required each bank and Skilled Person to attest that the methodology was suitably updated to take account of the Supplemental Agreement and the Exchange of Letters.<sup>843</sup>

---

<sup>840</sup> See, for example, FCA Records, *SME Derivates End to End Methodology*, 13 November 2012, 819799.

<sup>841</sup> FCA Records, *Cover email and attachment*, 18 February 2013, 371505.

<sup>842</sup> See, for example, FCA Records, *Cover email and attachment*, 18 February 2013, 371505.

<sup>843</sup> FCA Records, *Meeting Note*, 14 February 2013, 819262.

These Skilled Person attestations were often brief and provided little detail as to the nature and significance of the changes that had been made as a result of the Supplemental Agreement and the Exchange of Letters.<sup>844</sup> Some attestations contained language disclaiming the extent to which the FSA could rely on the Skilled Person's opinion. For instance, KPMG, Skilled Person 1 for Barclays, stated in its attestation that it has "*applied its understanding of the FSA's requirements and used its skills and experience from other reviews*" but notes that "*[i]n preparing this assessment, KPMG has not conducted an audit and does not provide the same level of assurance as an audit ... there cannot be any guarantee that our review will always accord with those of the FCA*".<sup>845</sup> Additionally, some of the points covered in the methodology updates were of considerable significance to the Scheme. Among the methodology updates was the requirement to take into account the amended Sophisticated Customer Criteria.<sup>846</sup> To that extent, the FSA and later the FCA may have been unaware at that time whether the methodologies, as designed and amended to reflect the provisions in the Supplemental Agreement and the Exchange of Letters, including in relation to eligibility, were consistent across firms.

### **C. Establishing the number of in-scope customers**

14. As set out in Chapter 4, the FSA made changes to the eligibility criteria in January 2013, but did not fully understand the impact of these changes at the time. Following a request by the IRS Steering Group, the banks were asked to compare the numbers of customers who would have been included under the Initial Sophisticated Customer Criteria used in the Initial Scheme, and the Sophisticated Customer Criteria. The banks were asked to provide this information by no later than 1 March 2013.<sup>847</sup> In order to establish this, they needed to assess exactly which customers fell within the scope of the Scheme. This entailed sorting those customers into two groups: sophisticated and non-sophisticated.

---

<sup>844</sup> See, for example, FCA Records, *Cover email and attachment*, 26 April 2013, 378049 and 378050. See also, for example, FCA Records, *Email*, 19 April 2013, 379237.

<sup>845</sup> FCA Records, *Cover email and attachment*, 22 April 2013, 378002 and 378003.

<sup>846</sup> See, for example, FCA Records, *Letter*, 29 January 2013, 290816.

<sup>847</sup> FCA Records, *IRS Steering Group Note of Meeting and attachment*, 18 February 2013, 371505 and 371508. The request was sent to the following banks: Lloyds, see FCA Records, *Email*, 18 February 2013, 818780; RBS, see FCA Records, *Email*, 18 February 2013, 821443; NAGE, see FCA Records, *Email*, 18 February 2013, 818228; AIB, see FCA Records, *Email*, 18 February 2013, 820261; Co-op Bank, see FCA Records, *Email*, 18 February 2013, 823224; and Barclays, see FCA Records, *Email*, 20 February 2013, 371866.



Only those who fell within the non-sophisticated group were eligible to have their cases reviewed under the Scheme.

15. This Review has found no evidence that the FSA considered making any further changes to the test at this point, or subsequently as a result of the information provided. Rather, it seems that this request to the banks was for the purpose of the FSA's information only.

*i) FSA and FCA's understanding*

16. As discussed at paragraphs 14 and 15 above, the evidence suggests that the impact of the changes to the eligibility criteria on the number of in-scope customers was not properly understood by the FSA at the time. In January 2013, the CSRC had seen only indicative data from Lloyds and Barclays about the potential impact of the changes from the Initial Sophisticated Customer Criteria to the Sophisticated Customer Criteria.<sup>848</sup> Minutes from a 28 January 2013 meeting record that "*CSRC noted that the "groups of connected clients" test as set out in BIPRU would result in 20% of Lloyds' customers being excluded from the review [...] CSRC also noted that increasing the notional hedge threshold from £7.5 million to £10 million and removing the feedback loop would reduce the number of transactions included in scope from about 10,000 to 4,500 for Lloyds, with smaller impacts for the other banks*".<sup>849</sup>
17. This Review has considered the responses provided by some of the banks. In each case, the banks confirmed that the net effect of the Sophisticated Customer Criteria was to reduce the in-scope population to a greater or lesser extent. By way of example,<sup>850</sup> the banks' responses estimated that the number of non-sophisticated customers had fallen from: 4,024 to 2,848 (Lloyds);<sup>851</sup> 3,133 to 2,933 (Barclays);<sup>852</sup> 403 to 297 (AIB);<sup>853</sup> and 91 to 63 (Co-op Bank).<sup>854</sup>

---

<sup>848</sup> FCA Records, *Memorandum - CSRC Summary Paper – Interest Rate Hedging Products*, 15 January 2013, 394535, p. 10-11; FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p. 1.

<sup>849</sup> FCA Records, *CSRC Minutes*, 28 January 2013, 359688, p.1.

<sup>850</sup> The Review has not seen responses from RBS and HSBC to this request.

<sup>851</sup> FCA Records, *Email*, 1 March 2013, 822329.

<sup>852</sup> FCA Records, *Email*, 1 March 2013, 371179.

<sup>853</sup> FCA Records, *Email*, 1 March 2013, 826830.

<sup>854</sup> FCA Records, *Email*, 27 February 2013, 823224.

ii) *Transparency*

18. In the Pilot Findings Paper, the FSA stated that "*the new sophistication test will provide a greater level of assurance that the review will be focused on those small businesses that were unlikely to have had the expertise and skills needed to understand the risks associated with these [IRHP] products*".<sup>855</sup> However, the manner and detail in which this change was communicated to the public was problematic and lacked transparency. For example, the Pilot Findings Paper provided no indication of the impact that the changes to eligibility would have upon the banks' liabilities for mis-selling.
19. Additionally, the Pilot Findings Paper contained several discrepancies and inaccurate statements. Firstly, in both the January and March versions, the FSA stated that: "*We have had rules in place governing the sales of IRHPs to 'non sophisticated' customers for the whole period of this review*". In a footnote, the FSA defined "non-sophisticated customers" as: "*'private customers' (in respect of sales made between 1 December 2001 and 31 October 2007) [i.e. before MiFID came into force] or 'retail clients' (in respect of sales made since November 1 2007) [i.e. after MiFID]*".<sup>856</sup> However, this was not the applicable test under the Scheme. Elsewhere in this paper, the FSA did more accurately define 'non-sophisticated' for these purposes: "*a customer will be considered 'non-sophisticated' in cases where the customer does not meet the 'sophistication test'*".<sup>857</sup>
20. The details given on pages 11 and 12 of the Pilot Findings Paper, under the heading "Findings on the original sophistication test", referred to the £10 million notional limit only in the context of: (a) "*customers who meet (only) the balance sheet and employee number criteria are included in the review where the total value of their 'live' IRHPs is equal to or less than £10m*", i.e. as part of a new test bringing customers back into the Scheme who were previously outside the scope of the Scheme; and (b) "*SPV customers that are constituted in a way that falls outside the Companies Act 2006 definition of a*

---

<sup>855</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, January 2013, FCA-ADD-0267, p. 12.

<sup>856</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, January 2013, FCA-ADD-0267, p. 12, footnote 5. See also FCA Records, *Interest Rate Hedging Products – Pilot Findings*, March 2013, FCA-A-0011, p. 12, footnote 8.

<sup>857</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, January 2013, FCA-ADD-0267, p. 5, footnote 3.

*group but are nevertheless connected entities...*".<sup>858</sup> It did not refer to the fact that as a result of the changes in the Supplemental Agreement<sup>859</sup> all customers (or groups of which the customer was a member) that had a total value of live IRHPs at the point of sale of £10 million or more were now ineligible under the Scheme Terms. Rather than including the details of the Sophisticated Customer Criteria, the January version of the Pilot Findings Paper instead pointed readers to a flowchart in the following terms: "*Further information on how the new sophistication test works in respect of groups or connected entities can be found on our website: [www.fsa.gov.uk/static/pubs/other/irs-flowchart-2013.pdf](http://www.fsa.gov.uk/static/pubs/other/irs-flowchart-2013.pdf)*".<sup>860</sup> That statement was removed in March 2013 since the new £10 million notional test applied to all customers; not just to groups or connected entities.

21. Even the flowchart did not assist in every case. At least one customer wrote to the FSA shortly after the publication of the report asking for clarification. This customer, who was not part of a group of companies, satisfied the Companies Act Small Group Exclusions, but was not clear whether the £10 million notional test at the end of the flowchart excluded them from the Scheme given the apparently contradictory statements made in the written explanation.<sup>861</sup> For customers who had previously been eligible, but now fell outside the revised criteria, the communication of this change was frustrating and elicited a complaint to the FCA: "*for such a major move to be hidden in the small print is outrageous... the [£10m notional] cap has no basis in determining sophistication*".<sup>862</sup> In March 2013, the FSA published a further flowchart that set out the Sophisticated Customer Criteria in greater detail.<sup>863</sup>
22. At the time, the Independent newspaper picked up on the lack of transparency surrounding the disclosure of this figure or any justification for it, reporting on its front

---

<sup>858</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, March 2013, FCA-A-0011, pp. 11-2.

<sup>859</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, March 2013, FCA-A-0011, pp. 11-2.

<sup>860</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, March 2013, FCA-A-0011, p. 12.

<sup>861</sup> FCA Records, *Email*, 14 February 2013, 373448.

<sup>862</sup> FCA Records, *Email*, 8 February 2013, 373450.

<sup>863</sup> The Financial Conduct Authority, "*Interest rate swaps flowchart*", 6 March 2013, accessible at <https://webarchive.nationalarchives.gov.uk/20140902060442/http://www.fca.org.uk/your-fca/documents/fsa-irs-flowchart> (ARTICLE 021).

page, that there "was no mention of the figure in the watchdog's press release or in a detailed larger document. It was accessible only through study of a complicated flow chart. While the £10 million figure looks substantial, experts said it was conceivable that some relatively small enterprises, and many medium-size firms, could be excluded from the process as a result".<sup>864</sup>

23. As part of this Review, a member of the Supervision division who contributed to the drafting of that paper was asked whether they could explain this discrepancy between the information in the flowchart and the information highlighted in the Pilot Findings Paper. The employee's response was "[w]hy does this [Pilot Findings Paper] not say in capital letters the £10 million test now applies. I agree that would have been clearer. The reality is... that the FCA or the FSA was trying to present this in the best light possible. That I'm sure is the answer. Without misleading anybody, because the flowchart is there but the headlines were the ones that we wanted to be favourable I suspect is the answer".<sup>865</sup>
24. Later in 2013, the IRS Steering Group considered again the number of customers excluded by the eligibility criteria. An IRS Steering Group memorandum dated 10 October 2013 examined external stakeholders' concern that approximately 40 per cent of private/retail IRHP customers had been excluded from the Scheme as a result of the Sophisticated Customer Criteria. The paper, prepared by FCA employee I, noted that "*the number of customers dropping out of the review is probably higher than expected*" but that "*[t]he intention of the sophistication test is to identify those customers likely to be sophisticated. There is no target number of customers who should be in or out of the review and therefore we do not agree that the number can be considered too high*".<sup>866</sup>
25. Figure 4 compares the total number of IRHP trades per bank with the total number of eligible trades at the conclusion of the Scheme.<sup>867</sup> Based on the data in the Skilled Persons reports, it is clear that the proportion of customers who were excluded by the

---

<sup>864</sup> The Independent, "Mis-selling scandal: banks let off the hook", 2 February 2013, accessible at <https://www.independent.co.uk/news/uk/home-news/mis-selling-scandal-banks-let-hook-8477891.html> (ARTICLE 029).

<sup>865</sup> Meeting Transcript E, (P67:L20-P68:L3).

<sup>866</sup> FCA Records, *Memorandum - Update from IRHP Project Steering Group*, 10 October 2013, 1324117.

<sup>867</sup> Compiled information of redress outcomes from Skilled Person reports prepared by this Review, 18 September 2020 (REPORT 015).

Sophisticated Customer Criteria varied from bank to bank. Lloyds in particular found the majority of its IRHP sales were to customers who, as a result of the revised Sophisticated Customer Criteria, were ineligible for review. The evidence in the reports of the Skilled Persons indicate that the first-tier banks applied the Sophisticated Customer Criteria in an appropriate manner that was consistent with the approach prescribed by the FSA/FCA.<sup>868</sup>

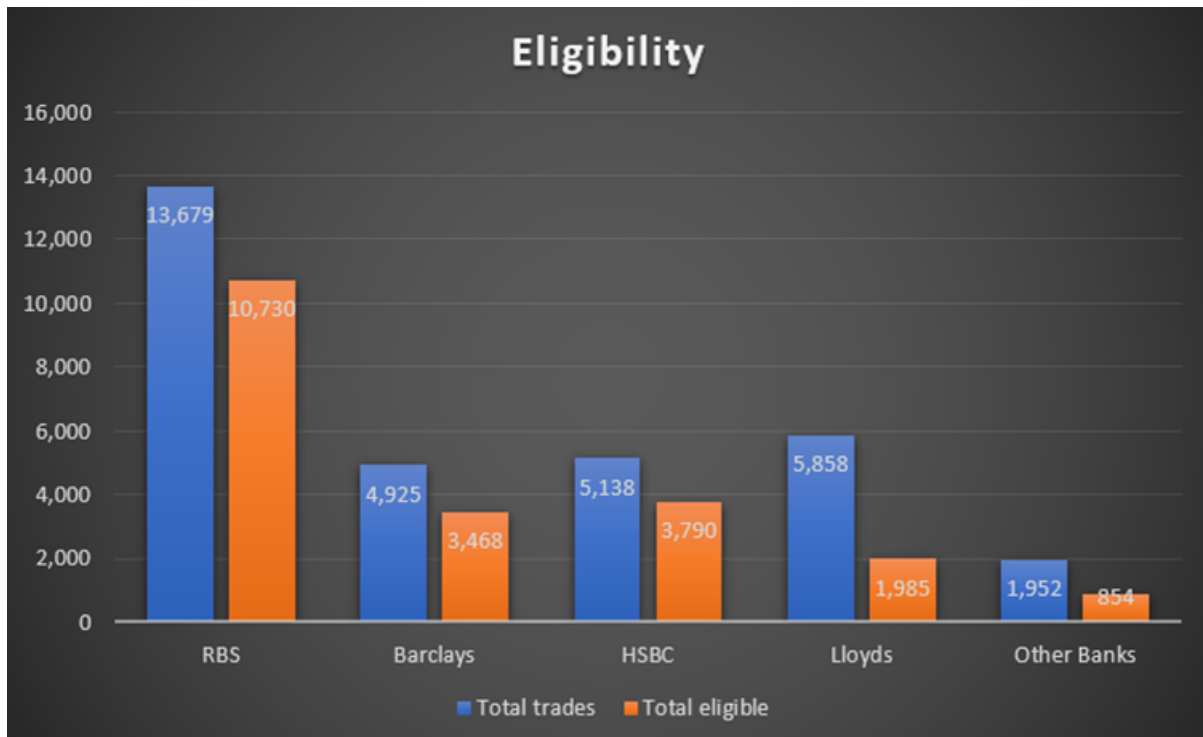


Figure 4 – Total number of trades per bank that fell to be assessed for eligibility, and the total number of trades found to be eligible

<sup>868</sup> For instance, KPMG, Skilled Person 1 for RBS, concluded that "*SP1 considers that the Bank's classification of customers as sophisticated was appropriate and consistent with the approach prescribed by the FCA*"; see FCA Records, Skilled Person report (RBS), 19 May 2016, p. 108, para. 10.5.5 (REPORT 010). In instances where a Skilled Person challenged a bank's initial sophistication assessment, evidence in the Skilled Person reports suggests that either the bank would subsequently agree with the Skilled Person's assessment or alternatively the assessment would be reworked until the Skilled Person was satisfied that the outcome was appropriate. For instance, Deloitte, Skilled Person 1 for HSBC, noted that "*Based on the procedures we have undertaken, we concluded that the Bank's sophistication methodology has been applied consistently in the great majority of instances. In the 30 sales where our assessment differed from the Bank's assessment as a result of inconsistent application of the Methodology, the Bank agreed with our assessment*"; see FCA Records, Skilled Person report (HSBC), 10 November 2016, p. 66, para. 8.4.6(REPORT 005).

**D. Outstanding technical points to be resolved by the FCA.**

26. The remainder of this Section One sets out the technical issues which emerged after the Scheme Terms were agreed and which needed to be resolved by the FCA before the banks and Skilled Persons could commence their review.
27. Indeed, when the Supplemental Agreements were signed by each of the banks, several technical issues relating to redress principles remained outstanding and needed to be resolved. While many more issues would arise once the job of implementing the Scheme had begun, the attestation given by each of the banks bound them to create methodologies under which they would review sales of IRHPs in accordance with the Scheme Terms. However, certain points required resolution so that the banks and Skilled Persons could finalise their methodologies, thereby enabling them to begin their file reviews.
28. Contrary to the estimated timescales outlined by the FCA publicly, the number and variety of these unresolved issues led to the Scheme's implementation being delayed. The FSA announcement on 31 January 2013, accompanying the publication of the Pilot Findings Paper, had clearly suggested that the reviews were to begin imminently and would be completed by January 2014 at the latest: "*[w]e expect the banks to aim to complete their review within six months, although the priority must be delivering fair and reasonable outcomes for customers. We accept that for banks with larger review populations this may take up to 12 months*".<sup>869</sup> However, given the number of outstanding issues of design and detail, the majority of the reviews did not begin until May 2013. This was not made clear to customers and their representatives until later in 2013.
29. Sajid Javid MP (then Financial Secretary to the Treasury) later expressed his frustration with this further delay: "*As we have heard today, the FCA said in January this year that the full process would begin, but it has since confirmed that the full process did not start until May this year. That delay has been disappointing, and the FCA should have been*

---

<sup>869</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, January 2013, FCA-ADD-0267, p. 4. With regard to the press release, see The Financial Conduct Authority, "*FSA confirms start of full review of interest rate swap mis-selling*", 31 March 2013, accessible at: <https://www.fca.org.uk/news/press-releases/fsa-confirms-start-full-review-interest-rate-swap-mis-selling> (ARTICLE 013). See also FCA Records, *Interest Rate Hedging Product Questions*, 15 February 2013, 1019636.

*much clearer about exactly when this full review actually started.*"<sup>870</sup> For customers who had been expecting redress to follow swiftly from the FSA's June 2012 announcement, the slow start to the Scheme was another unwelcome and unforeseen delay on their journey to receiving redress. This is particularly striking given that internal documents reveal that one of the FCA supervisors for a first-tier bank was asked, back in November 2012, whether it was realistic for the FCA to have announced that the banks would complete their PBRs within six to nine months. The supervisor replied that it was "[c]ompletely unrealistic". When asked whether there was any methodology for calculating the proposed timescales, the supervisor answered: "*No. We just wanted it done quickly... [but] it creates an expectation that it'll be done by May [2013]... we are already off target, we'll never get close to it*".<sup>871</sup>

30. During February and March 2013, a few of the small team of FSA employees who had been primarily responsible for designing and negotiating the Initial and Supplemental Agreements with the banks continued to engage with the banks on technical issues. Some of these issues were relevant to the methodology and therefore an approach needed to be agreed before the banks could commence their reviews. This Review considers that the key outstanding issues that caused this delay were as follows:
- a. break costs and assessing the counterfactual that a customer would not accept a break cost of greater than 7.5 per cent, referred to as the 7.5% Rule;
  - b. the suitability of substitution of the IRHP with a fixed rate loan as an alternative product;
  - c. whether it was suitable to allow a "roll-over" when the alternative product had a shorter tenor than the original (mis-sold) product and the bank is able to conclude

---

<sup>870</sup> House of Commons Debate, "*Interest Rate Swap Derivatives*", 24 October 2013, Hansard volume 569, col. 503, accessible at <https://publications.parliament.uk/pa/cm201314/cmhansrd/cm131024/debtext/131024-0003.htm#13102453000788>. See also, FCA Records, *Email*, 24 October 2013, 440098 and FCA Records, *Memorandum – Martin Wheatley – briefing ahead of IRHP Meeting 09.00, 28 October 2013*, 25 October 2013, 1102320, p. 4.

<sup>871</sup> FCA Records, *Memorandum - Lessons Learned Review of Interest Rate Hedging Products Discovery: HSBC Wrap Up*, 29 November 2012, 995904, p. 8.

that the customer would have purchased a second alternative product after expiry of the shorter alternative product;

- d. how to deal with IRHP trades that had been novated between banks, where a customer had taken out an IRHP with one bank within the period of the IRHP review and had then subsequently switched banking providers and moved the product to a new bank; and
- e. how to deal with dissolved entities and companies in financial distress.

i) *Method of calculation under the 7.5% Rule*

31. As set out at Chapter 4, Section 3, paragraph 105, the FCA required the banks to consider the following rebuttable presumption when assessing the counterfactual: "*that the customer would not have taken an IRHP with a potential break cost greater than 7.5% of the notional value of the IRHP in a pessimistic but plausible scenario. This means that the tenor of the product should not exceed the maximum term. The calculation of the maximum term is done by shocking the interest curve by a pessimistic but plausible amount (2 standard deviations)*".<sup>872</sup> While the Pilot Findings Paper referred to this, it did not describe how this "*pessimistic but plausible scenario*" was to be calculated or understood.<sup>873</sup> Therefore, having agreed to this principle, the FSA/FCA, banks and Skilled Persons now needed to agree how this was to be achieved in practice.

32. On 11 February 2013, the IRS Steering Group met and discussed how the 7.5% Rule should be modelled and calculated. The notes of the meeting record that the banks had expressed a strong desire to undertake the modelling themselves, on the grounds of speed, availability of resource and their existing modelling frameworks. However, the IRS Steering Group's preference was to present modelling criteria to the banks at a joint meeting.<sup>874</sup> Having considered the banks' suggestions of how each would devise its own interest rate curves for the purposes of discounting future cash flows in the context of calculating break costs under the 7.5% Rule, in late March 2013, the FSA concluded that, as a result of the risk of inconsistency in customer outcomes, the FSA would provide

---

<sup>872</sup> FCA Records, *Letter*, 29 January 2013, 456629, p. 14, Annex 3, paras. 52-53.

<sup>873</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, March 2013, FCA-A-0011.

<sup>874</sup> FCA Records, *Email*, 12 February 2012, 370438.



curves to be used by all of the banks.<sup>875</sup> The standardised curves were "*based on the average of the data provided by a number of banks*"<sup>876</sup> with Skilled Persons then verifying the calculations used for their respective banks.<sup>877</sup>

33. The Skilled Persons subsequently requested further guidance on how to apply the 7.5% Rule in practice, as they were concerned "*about the risk of inconsistent outcomes, given the subjective nature of this assessment*".<sup>878</sup> The need for clarification and guidance continued throughout 2013 as the banks and Skilled Persons struggled to interpret the 7.5% Rule in the context of the counterfactual analysis, as required by the Scheme Terms. For instance, an FCA employee tried to clarify to a Skilled Person how to apply the 7.5% Rule, which they described as "*an artificial construct which has been formulated for the purpose of the IRHP review*". They asked the Skilled Person to consider whether fair, clear and not misleading information about break costs, at the point of sale, would have changed a customer's mind about the product. The Skilled Person responded: "*The answer to your question, as with any question relating to the counterfactual, is that the Bank would never know for sure whether fair, clear and not misleading disclosure of break costs would have changed a customer's mind*".<sup>879</sup> The Skilled Person later commented to the FCA: "*I have never seen anything as complex and judgemental in terms of a redress approach than that required under the current IRHP review*".<sup>880</sup> The FCA consequently provided further guidance to the banks and Skilled Persons in December 2013.<sup>881</sup>
34. Evidence considered during this Review suggests that customers similarly struggled to understand this rule. Having received an explanation of the rule by the FCA's experts,

---

<sup>875</sup> FCA Records, *Email*, 3 May 2013, 384480.

<sup>876</sup> For AIB, see FCA Records, *Email*, 28 March 2013, 372485; for RBS, see FCA Records, *Email*, 28 March 2013, 378274; for HSBC, see FCA Records, *Email*, 28 March 2013, 378584; for Lloyds, see FCA Records, *Email*, 28 March 2013, 379117; for Santander, see FCA Records, *Email*, 28 March 2013, 388909; for Bank of Ireland, see FCA Records, *Email*, 28 March 2013, 382744; for NAGE, see FCA Records, *Email*, 28 March 2013, 377328.

<sup>877</sup> FCA Records, *Memorandum – IRHP review – Steering update 14 October 2015*, 14 October 2015, 1173712, p. 19.

<sup>878</sup> FCA Records, *Memorandum – Skilled Persons' request for additional guidance on rebuttal of maximum term and 3rd party costs*, 16 May 2013, 1143945, p. 1.

<sup>879</sup> FCA Records, *Email*, 24 November 2013, 588638.

<sup>880</sup> FCA Records, *Email*, 1 December 2013, 427767.

<sup>881</sup> See, for example, FCA Records, *Email*, 3 December 2013, 423198.

Bully-Banks wrote to the FCA saying: "*We are confident that not one of Bully-Banks' members has understood the 7.5% Rule as it was explained by the FCA. We very much doubt whether any MP has understood the 7.5% Rule as it was explained by the FCA*". In their view, the "*natural interpretation of the principle is that it means what it says, i.e. that victims of mis-selling whose redress takes the form of an alternative product will face a maximum loss of 7.5% of the amount hedged*". Further, Bully-Banks wrote: "*We find it extraordinary that the FSA should give information to the banks about the meaning of this term [pessimistic but plausible interest rate scenarios] and yet fail to provide those who have been mis-sold the IRSAs with any information about the meaning of this term*".<sup>882</sup>

ii) *Fixed rate loans as alternative products*

35. A further issue that remained outstanding at the point of signing the Supplemental Agreements was whether it was suitable to substitute an IRHP with a fixed rate loan that has MTM break costs.<sup>883</sup> In February 2013, the FSA considered the proposals put forward by some of the banks. The FSA commented that the proposals: (i) "*were at odds with our principle that a customer would not have purchased a product with break costs greater than 7.5% of the notional value of the IRHP in a plausible but pessimistic scenario*"; (ii) could have a disproportionate effect on financially distressed/vulnerable customers; and (iii) were undermined by a sense that the proposals were based on an attempt by the banks to limit the cost of redress.<sup>884</sup> The FSA also considered that a decision to include or exclude fixed rate loans was likely to have a significant impact on the total redress received by customers.<sup>885</sup>
36. The FSA subsequently decided to allow fixed-rate loans as an acceptable alternative product, so long as the loan complied with the 7.5% Rule and various other criteria, including a commitment from the banks to refinance when the alternative fixed-rate loan expired. This position was communicated to banks on 28 March 2013,<sup>886</sup> albeit one bank,

---

<sup>882</sup> FCA Records, *Letter and attachment*, 27 June 2013, 405073 and 405074.

<sup>883</sup> FCA Records, *CSRC Minutes Extract*, 30 January 2013, 394520.

<sup>884</sup> FCA Records, *Internal Document*, 18 February 2013, 822196.

<sup>885</sup> FCA Records, *Internal Document*, 18 February 2013, 822196.

<sup>886</sup> For AIB, see FCA Records, *Email*, 28 March 2013, 372485; For RBS, see FCA Records, *Email*, 28 March 2013, 378274; For HSBC, see FCA Records, *Email*, 28 March 2013, 378584; For

RBS, did not accept the FCA's proposition regarding fixed-rate loans, and so did not offer them by way of redress.<sup>887</sup>

iii) *Roll-over*

37. In February 2013, a further outstanding issue was considered by the IRS Steering Group, namely the concept of "roll-overs" and whether the banks should be allowed to "roll over" alternative products, that is, when the alternative product had a shorter tenor than the original (mis-sold) product, should the bank be permitted to conclude that the customer would have purchased a second alternative product after expiry of the first, shorter alternative product.<sup>888</sup> The recommendation (which was agreed by the IRS Steering Group) was that this should not be permitted.<sup>889</sup> However, the IRS Steering Group subsequently agreed that a second alternative product was permissible where it was fair and reasonable to do so, subject to a number of criteria.<sup>890</sup>

iv) *Novations*

38. Another issue that the FSA had considered, but not resolved prior to 31 January 2013, was how to deal with IRHP trades that had been novated between banks: where a customer had taken out an IRHP with one bank within the Relevant Period and had then subsequently switched banking providers and moved the product to a new bank. In the days after the first-tier banks signed the Supplemental Agreements, one of the FSA Supervisors of a first-tier bank tried to encourage this being brought to a resolution and

---

Lloyds, see FCA Records, *Email*, 28 March 2013, 379117; For Santander, see FCA Records, *Email*, 28 March 2013, 388909; For Bank of Ireland see FCA, Records, *Email*, 28 March 2013, 382744; For NAGE, see FCA Records, *Email*, 28 March 2013, 377328.

<sup>887</sup> For RBS's resistance to the FCA's proposition on fixed rate loans, see FCA Records, *Email*, 09 April 2013, 378259. Additionally, KPMG's Skilled Person report for RBS notes that "*Under RBS policy at the time, the customers in this Review would not have qualified for a fixed rate loan unless their debt requirement was below £0.5m*"; see FCA Records, Skilled Person report (RBS), 19 May 2016, p. 64 (REPORT 010).

<sup>888</sup> FCA Records, *Email*, 25 February 2013, 819860; FCA Records, *Memorandum– Alternative Products: Purchase of a second IRHP*, 22 February 2013, 819862.

<sup>889</sup> FCA Records, *Email*, 25 February 2013, 819860.

<sup>890</sup> FCA Records, *Internal Document*, 20 March 2013, 370560. See also, for AIB, FCA Records, *Email*, 28 March 2013, 372485; for RBS see FCA Records, *Email*, 28 March 2013, 378274; for HSBC see FCA Records, *Email*, 28 March 2013, 378584; for Lloyds see FCA Records, *Email*, 28 March 2013, 379117; for Santander see FCA Records, *Email*, 28 March 2013, 388909; for Bank of Ireland see FCA Records, *Email*, 28 March 2013, 382744; for NAGE see FCA Records, *Email*, 28 March 2013, 377328.

communicated to other members of Supervision : "*The novations issue I understand needs to be looked at soon as it helps banks determine which clients they are to review and if they do not adopt a consistent approach the danger is that some customers may be excluded (as they may believe it is the responsibility of another bank to review and the other bank adopts a different stance)*".<sup>891</sup> By November 2013, an agreement was reached between the banks, the BBA, and the FCA, that the original provider of the loan and IRHP would be responsible for the customer's redress.<sup>892</sup>

v) *Dissolved entities and companies in financial distress*

39. Another issue that had not been resolved prior to signing the Supplemental Agreements was how to treat companies who had been mis-sold IRHPs but were subsequently dissolved. In other words, there was no longer any legal entity to whom redress could be paid. The IRS Technical Group considered this matter in the spring of 2013. To give an indication of the relative size of this issue, dissolved companies accounted for approximately three per cent of Lloyds' review population.<sup>893</sup> The FSA considered that it would be unfair for the banks to take no action, as this could be regarded as giving the banks a windfall. The discussion paper prepared by the FSA on this topic for the IRS Technical Group noted:

*"There would appear to be good arguments to support requiring the banks to calculate redress and, where possible, to notify any former liquidator, director or other interested party from the dissolved company of which they are aware of the potential payment to which the former company would have been entitled. The relevant party could then decide whether it was worthwhile restoring the company to the Register in order to enable distribution of the redress monies. It is recognised, however, that in practice, many companies that have been wound up will have significant debts which may mean that restoration does not make financial sense".<sup>894</sup>*

---

<sup>891</sup> FCA Records, *Email*, 8 February 2013, 818563.

<sup>892</sup> FCA Records, "*British Bankers' Association: Principles on Novated Interest Rate Hedging Products (IRHPs)*", 4 November 2013, 005603.

<sup>893</sup> FCA Records, Skilled Person report (Lloyds), 9 September 2019, p. 18 (REPORT 006).

<sup>894</sup> FCA Records, *Cover email and attachment*, 20 February 2013, 822377 and 822378.

40. The FSA presented to the banks some options as to how to deal with such customers and asked for feedback.<sup>895</sup> After receiving feedback, the FCA was later chased for a decision by one of the banks and responded on 9 May 2013 saying that "*we are working through the final practicalities and will then issue guidance. I would guess it's a couple of weeks away*".<sup>896</sup> A series of options on how the banks should approach dissolved companies was presented to the IRS Steering Group on 17 May 2013. The FCA concluded that the banks should review files of Category A customers, but also proactively contact interested parties of dissolved Category B customers. A 23 May 2013 FAQs prepared for Skilled Persons contained FCA guidance on this approach.<sup>897</sup>
41. Public guidance was subsequently published on the FCA's website on 4 September 2013 and largely followed the review procedure for active companies, albeit for Category A and Category B companies the banks would need to make reasonable efforts to identify and contact the principal interested parties (usually, the former directors and/or shareholders, or insolvency practitioners). For those sold Category C products, the interested party would need to contact the bank.<sup>898</sup> The interested party could then decide whether to restore the company to the Register of Companies and, if restored, the company was treated as if it had continued in existence and not been "*dissolved or struck off*".<sup>899</sup> Where companies were not restored to the Register of Companies, and therefore the redress funds had no legal owner, the redress amounts were paid to the Crown (HMT) as "*bona vacantia*".<sup>900</sup>

---

<sup>895</sup> For RBS, see FCA Records, *Cover email and attachment*, 1 March 2013, 821376 and 821377; for Lloyds, see FCA Records, *Email*, 27 February 2013, 824458; for Barclays, see FCA Records, *Email*, 19 March 2013, 372229.

<sup>896</sup> FCA Records, *Email*, 9 May 2013, 375498.

<sup>897</sup> FCA Records, *IRHP Reviews – FAQs for Skilled Persons*, 23 May 2013, 387259, p. 1.

<sup>898</sup> The Financial Conduct Authority, "*Businesses in financial distress*", 4 September 2013, accessible at <https://webarchive.nationalarchives.gov.uk/20130904094641/http://www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products/businesses-in-financial-distress>.

<sup>899</sup> FCA Records, *Email*, 11 September 2013, 1310654; FCA Records, *Email*, 11 September 2013, 1323986.

<sup>900</sup> "Bona Vacantia" means vacant goods and is the name given to ownerless property, which by law passes to the Crown, see the Government's website for more information: <https://www.gov.uk/government/organisations/bona-vacantia>.

42. Although this Review has not seen evidence of the final decision taken by the FCA recorded in meeting notes,<sup>901</sup> it is clear from the documents and Skilled Persons reports that, despite the banks' feedback on some of the complications that might arise from seeking to pay redress to dissolved companies, the FCA's guidance was ultimately the approach followed in the Scheme.<sup>902</sup>
43. For IRHP customers that remained in business but were in a state of financial distress, the FCA took two steps following the Supplemental Agreement and the Exchange of Letters to address the burden of ongoing IRHP payments upon customers pending the implementation of the Scheme.
44. Around March 2013, the FSA began issuing revised Requirement Notices to each of the banks.<sup>903</sup> Most significantly, these revised Requirement Notices, at Annex 1, expressly added two further requirements on banks:
- a. First, each bank *"will not (except in exceptional circumstances) foreclose on or adversely vary the existing lending facilities of Customers without giving prior notice to the relevant Customer and obtaining their prior consent, until the Firm has issued a final redress determination and, if relevant provided redress to the*

---

<sup>901</sup> Evidence from the final reports of the Skilled Persons for the first-tier banks does however generally indicate that the banks took appropriate steps to implement this approach. For instance, EY, Skilled Person 1 for Lloyds, notes that *"The Firm developed the Dissolved Companies Customer Treatment Strategy to deal with Customers in liquidation or who had been dissolved"*; see FCA Records, Skilled Person report (Lloyds), 9 September 2019, p. 58 (REPORT 006). KPMG, Skilled Person 1 for Barclays, notes that *"The Bank developed and implemented appropriate procedures with respect to dissolved entities"*; see FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 59 (REPORT 009).

<sup>902</sup> See, for example, FCA Records, Skilled Person report (AIB), 12 August 2016, para. 10.8 (REPORT 008); FCA Records, Skilled Person report (Barclays), 11 April 2016, para. 6.2.4 (REPORT 009); FCA Records, Skilled Person report (Barclays), March 2016, 688117, section 5.3 (REPORT 004); FCA Records, Skilled Person report (HSBC), 10 November 2016, sections 6.4, 8.9.3 and 10 (REPORT 005); FCA Records, Skilled Person report (HSBC), 20 December 2016, sections D.5.4, D.8 and F.1 (REPORT 011); and FCA Records, Skilled Person report (Lloyds), 9 September 2019, p. 58 (REPORT 006).

<sup>903</sup> A pro forma version was finalised in February 2013; see FCA Records, *Requirement Notice*, 28 February 2013, 446160. This revised requirement notice was then circulated to the banks in March 2013. See, for example, FCA Records, *Requirement Notice*, 5 March 2013, 822094; and FCA Records, *Requirement Notice*, 1 March 2013, 821489.

*Customer*".<sup>904</sup> This wording reflected the banks' CEO attestations that formed part of the Initial Agreement.<sup>905</sup>

b. Second, each bank "*will consider on a case by case basis whether to suspend the payments payable by a Customer under an [IRHP] pending the outcome of the review of the sale to the Customer, where the Firm determines financial distress to be present*". This new requirement is sometimes known as the "moratorium".<sup>906</sup> As the BBA announced in December 2012, the banks had already agreed to consider whether to apply a moratorium of IRHP payments on a case-by-case basis.<sup>907</sup> However, the FSA considered that the express addition of moratoria was now required due to concerns expressed by "*the consumer groups that not all banks are adequately applying such a moratorium*".<sup>908</sup>

45. Additionally, not only were the banks' responsibilities expressly extended to include foreclosures and moratoria as described above, the scope of the Skilled Persons' responsibilities were also extended to include oversight of the banks in this regard.<sup>909</sup> Consequently, the Skilled Persons were required to: (i) "*provide independent oversight*" of the banks' approach to the undertakings they had given in relation to not foreclosing in certain circumstances,<sup>910</sup> and (ii) "*ensure the appropriateness of the [banks'] procedures*" for considering on a case-by-case basis whether a moratorium was appropriate.<sup>911</sup>

---

<sup>904</sup> FCA Records, *Requirement Notice*, 5 March 2013, 822094, p. 3.

<sup>905</sup> See FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 7.

<sup>906</sup> Further revisions of the Requirement Notices followed to address specific issues, such as to reflect the split in responsibility across two Skilled Persons reporting on the same bank, see for example, FCA Records, *Requirement Notice*, 12 March 2014, 541110.

<sup>907</sup> BBA, "*Interest Rate Swaps: Businesses in Financial Distress (major banks review process)*", 11 December 2012, accessible at <https://www.bba.org.uk/news/statistics/sme-statistics/interest-rate-swaps-businesses-in-financial-distress-major-banks-review-process/#.XtIdgIVKiUk> (ARTICLE 038).

<sup>908</sup> See, for example, for HSBC, FCA Records, *Letter*, 29 January 2013, 822085; for RBS see FCA Records, *Letter*, 29 January 2013, 003568, p. 2; for Barclays see FCA Records, *Letter*, 29 January 2013, FCA-ADD-0099, p. 2.

<sup>909</sup> This Review has seen evidence that, by November 2012, the FCA was asking Skilled Persons to review any 'exceptional cases' before a foreclosure decision was made. See, for example, FCA Records, *Email*, 16 November 2012, 338969.

<sup>910</sup> See, for example, FCA Records, *Requirement Notice*, 5 March 2013, 822094, p. 4.

<sup>911</sup> See, for example, FCA Records, *Requirement Notice*, 5 March 2013, 822094, p. 4.

46. As a result of these additions, the banks adopted processes to handle foreclosure cases, which the Skilled Persons then reviewed. For instance, Barclays "*prepared a document which detailed its approach to 'exceptional circumstances' cases*".<sup>912</sup> Among other things, this included an approval mechanism within the bank for sanctioning adverse variance and foreclosure as well as definitions of what constituted "*exceptional circumstances*", adverse variance and foreclosure.<sup>913</sup>
47. Evidence from the final Skilled Persons reports suggests that foreclosure was considered in a small number of cases:
- a. RBS escalated "*nine cases of exceptional circumstances*" to KPMG, its primary Skilled Person;<sup>914</sup>
  - b. Lloyds presented only one possible foreclosure case to EY, its primary Skilled Person;<sup>915</sup> and
  - c. Barclays "*formally presented*" KPMG, its primary Skilled Person, "*with eight potential exceptional circumstances cases*".<sup>916</sup>
48. The Skilled Person reports generally indicate that the first-tier banks put in place appropriate measures.<sup>917</sup> However, this Review has seen evidence that one bank, HSBC, "*did not maintain an appropriate system to ensure that it was in compliance at all times with the terms of its Original Undertaking with the FSA, in respect of customers subject to foreclosure action*".<sup>918</sup>

---

<sup>912</sup> FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 107 (REPORT 009).

<sup>913</sup> Similarly, RBS set out its approach to assessing and managing exceptional circumstances in its "Overview of GRG actions in relation to the FCA Undertaking" document; see FCA Records, Skilled Person report (RBS), 19 May 2016, p. 88 (REPORT 010).

<sup>914</sup> FCA Records, Skilled Person report (RBS), 19 May 2016, p. 88, section 7.3.6 (REPORT 010).

<sup>915</sup> FCA Records, Skilled Person report (Lloyds), 9 September 2019, p. 7 (REPORT 006).

<sup>916</sup> FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 107, section 15.2 (REPORT 009).

<sup>917</sup> For instance, EY, Skilled Person 1 for Lloyds, concluded that "*Overall the Firm's treatment was considered appropriate*"; See FCA Records, Skilled Person report (Lloyds), 9 September 2019, p. 7 (REPORT 006).

<sup>918</sup> FCA Records, Skilled Person report (HSBC), 10 November 2016, p. 110 (REPORT 005).



49. In relation to moratoria, they were either proactively offered by the banks to customers in financial difficulty or were requested by customers.<sup>919</sup> KPMG's final Skilled Person report for Barclays provides an example of how Barclays implemented this measure: the *"temporary suspension of payments was offered until completion of the Customer's review and implementation of redress (if any). Customers remained liable for the suspended payments. The Bank did not charge interest on the suspended payments"*.<sup>920</sup>
50. Evidence from the final Skilled Persons' reports for the first-tier banks suggests that the moratorium provision was more frequently utilised and provided relief to a greater number of SMEs than the restriction on foreclosure. For instance:
- a. as at April 2014, the FCA records suggest that more than 1,500 customers had their payments *"suspended"*, which represented 82 per cent of cases where customers had requested a suspension;<sup>921</sup>
  - b. KPMG, Skilled Person 1 for RBS, found that *"[a]s at June 2015, the Bank had suspended or agreed to suspend payments for 405 trades and had declined to suspend payments for 153 trades"*;<sup>922</sup> and
  - c. Deloitte, Skilled Person 1 for HSBC, identified that a moratorium was granted in 28 out of a total of 56 cases.<sup>923</sup>
51. The final Skilled Person reports indicate that the first-tier banks largely implemented the moratorium successfully. EY, Skilled Person 1 for Lloyds, concluded that *"[o]verall the Firm's treatment was considered appropriate"*.<sup>924</sup>

---

<sup>919</sup> For instance, Deloitte, Skilled Person 1 for HSBC, notes that *"In seven cases the customer requested a suspension of payments which was subsequently granted. In the remaining three cases, whilst there was no evidence available of a customer requesting a suspension of IRHP payments, the Bank appears to have proactively offered a moratorium to the customer due to the customer being in financial difficulty"*; see FCA Records, Skilled Person report (HSBC), 10 November 2016, p. 102 (REPORT 005).

<sup>920</sup> FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 57, section 6.2.2 (REPORT 009).

<sup>921</sup> FCA Records, *Internal Document*, 15 April 2014, FCA-C-009-0013, p. 3.

<sup>922</sup> FCA Records, Skilled Person report (RBS), 19 May 2016, p. 90, para. 7.4.8 (REPORT 010).

<sup>923</sup> FCA Records, Skilled Person report (HSBC), 10 November 2016, p. 102 (REPORT 005).

<sup>924</sup> FCA Records, Skilled Person report (Lloyds), 9 September 2019, p. 7 (REPORT 006). In a further example, KPMG, Skilled Person 1 for Barclays, reviewed the bank's procedures for considering

52. However, this Review has seen evidence that one bank did not implement appropriate procedures. Deloitte, Skilled Person 1 for HSBC, found that "*the Bank did not have a sufficient process in place for identifying, assessing and recording customer requests for a suspension of existing IRHP payments in accordance with the agreement it had made with the FSA under the BBA initiative*".<sup>925</sup>

## **Section 2 - The respective roles of the FCA, the banks and Skilled Persons during implementation**

53. By early May 2013, an agreed approach was reached with the banks on the technical issues outlined above.<sup>926</sup> With methodologies agreed, the banks and Skilled Persons were able to commence their file reviews in earnest.<sup>927</sup> This Section Two will now explore in more detail the respective roles of the FCA, the banks and the Skilled Persons in implementing the Scheme.

### **A. The role of the FCA in the implementation of the Scheme**

#### *i) The FCA's role*

54. The Scheme designed by the FSA meant that, once oversight passed to the newly-established FCA, the expectation was that its role would be one of overseeing the Scheme. In brief, it had assigned to the banks and Skilled Persons responsibility for determining the outcome in individual cases, without requiring recourse to the FCA. In evidence given to this Review, the FCA confirmed that: "*The FCA's role in the IRHP Review was one of providing oversight of the banks and the independent reviewers, to ensure that they were*

---

whether to suspend payments payable under IRHP, considering the procedures to be appropriate; See FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 10, para. 2.2 (REPORT 009).

<sup>925</sup> FCA Records, Skilled Person report (HSBC), 10 November 2016, p. 106, para. 10.6 (REPORT 005).

<sup>926</sup> Further practical issues later emerged in relation to some of these points. For instance, the FCA consequently provided further guidance on the 7.5% Rule to the banks and Skilled Persons in December 2013; see, for example, FCA Records, *Email*, 3 December 2013, 423198.

<sup>927</sup> Note, however, the comment in Deloitte's Skilled Person's report for AIB, noting that the FCA's "*final decision and guidance on intra-month interest rate curves for the purpose of maximum term calculations [was] issued to banks*" on 12 July 2013; see FCA Records, Skilled Person report (AIB), 29 June 2016, p. 37 (REPORT 002).

*conducting their reviews in a way that was fair, reasonable and consistent with the arrangements for the IRHP Scheme".*<sup>928</sup>

55. To facilitate its oversight, the FSA formulated the contents of the section 166 FSMA arrangements and approved the appointment of each Skilled Person. Chapter 2, Section 3, paragraphs 72-74 describes how section 166 FSMA arrangements are commonly formulated by the FSA/FCA. The primary function of a section 166 report is to provide a report to the FSA/FCA either as a diagnostic tool, for monitoring purposes, preventative action or for remedial action in relation to the matters that gave rise to the appointment in the first instances. It is an investigative and information-gathering power and the skilled person is required to report to the FSA/FCA. As concerns the Scheme Terms, however, the FSA/FCA's role was that of a facilitator, helping the banks and the Skilled Persons in their management of the Scheme. Firstly, the FSA/FCA was not a party to these agreements, which were entered into between the banks and the Skilled Persons.<sup>929</sup> Secondly, the FSA/FCA did not maintain any public law accountability for the decisions of the banks; a matter later confirmed by the Court of Appeal in Holmcroft, ruling that IRHP customers could not challenge the Skilled Persons (or, indirectly, the FCA) in this way. The Court of Appeal held that while the customer would have had no means of redress in public law, customers would be free to reject their redress offer and their legal remedies against the bank for the mis-selling would be unaffected.<sup>930</sup> The section 166 FSMA agreements created a relationship between the banks and Skilled Persons that was governed by private law. As such, the banks and the Skilled Persons were responsible for providing customers with fair and reasonable redress, while the FCA would provide guidance on unforeseen issues and consider the Skilled Person reports that it received.

---

<sup>928</sup> Confidential work package 5, 4 September 2020, p. 1, para. 2 (WORK PACKAGE 005).

<sup>929</sup> The FCA only obtained this power to directly appoint a Skilled Person in 2013, with it being noted: "*At the time of the IRHP reviews, our powers to appoint a Skilled Person required the Firms to appoint a skilled person...subject to our formal approval of the skilled person...Since that time, in 2013 we gained additional powers, to allow the FCA to appoint the Skilled Person directly*"; See Confidential work package 5, 4 September 2020, p. 2, paras. 9-10 (WORK PACKAGE 005).

<sup>930</sup> [2016] EWHC 323 (Admin) paras. 53-55. As discussed in Section 4 of Chapter 2, customers who claimed to have been mis-sold IRHPs were often unsuccessful in the civil courts. In addition, in CGL Group Limited And Others -v- The Royal Bank Of Scotland Plc, National Westminster Bank Plc And Barclays Bank Plc [2017] EWCA Civ 1073, it was held that it would not be fair, just and reasonable to impose a duty of care on the banks to carry out reviews under the Scheme with reasonable care and skill.

An FCA employee involved in implementing the Scheme gave evidence to this effect: "*it was unclear what our role would be ... [e]very aspect of the redress scheme, including every individual case, would be overseen by independent skilled persons (the skilled person costs would ultimately cost the banks more than £300m)*".<sup>931</sup>

56. The FSA had reminded the first-tier banks that it was expecting the implementation to provide "*fair outcomes for consumers sold IRHPs*" and that each case would be assessed by a Skilled Person.<sup>932</sup> Whilst these expectations were a strong signal to the banks that they were under clear and enforceable duties to comply with the Scheme Terms, certain instances nonetheless emerged where the FCA was unable to exert control over the Scheme's implementation. For example, the FCA's ability to ensure that redress flowed quickly to customers was limited in practice. As FCA employee T (who was involved in the implementation phase of the Scheme) commented in evidence as part of this Review, other than applying "*moral pressure*" and "*giving them [the banks] guidance in a timely fashion, it's very difficult for us otherwise to influence*" the timing of redress payments.<sup>933</sup> Nor could it, without the agreement of all the banks, unilaterally modify the Scheme Terms so as to reduce its complexity, which might have allowed for speedier implementation.<sup>934</sup> The Scheme was the only means for those eligible to obtain redress,

---

<sup>931</sup> Written Representations I, 16 February 2020, p. 43, para.2.24.

<sup>932</sup> See for HSBC, FCA Records, *Letter*, 29 January 2013, 822085; for RBS, see FCA Records, *Letter*, 29 January 2013, 003568; for Barclays, see FCA Records, *Letter*, 29 January 2013, FCA-ADD-0099; and for Lloyds see FCA Records, *Draft letter*, 29 January 2013, 290818.

<sup>933</sup> Meeting Transcript T, (P40:L:15-19).

<sup>934</sup> Notwithstanding this, individual agreements were negotiated between the FCA and individual banks to speed up redress in certain instances by defaulting to the most generous customer outcome in lieu of a full file review. For instance, KPMG's final Skilled Person report for RBS notes that following the November 2013 recalibration (explained at paragraph 116-122), RBS agreed with the FCA to introduce an expedited outcome process thereby simplifying the file review for customers who met specified criteria; see FCA Records, Skilled Person report (RBS), 19 May 2016, p. 33, para. 2.5.20 (REPORT 010). KPMG's final report for Barclays noted that through interaction with the FCA, Barclays was able to establish procedures, processes and controls to expedite decision making for "low lens" customers and Category A trades; see FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 18, para. 2.4.8 and p. 25, para. 3.2.1.1 (REPORT 009). HSBC also suggested to the FCA (and the FCA agreed) that in circumstances where the bank had concluded the sale was not compliant and the customer was entitled to a full tear-up (in other words, the best possible outcome from the customer's point of view), there was no need for the Skilled Person to review the file again in detail; see FCA Records, *Letter*, 8 November 2013, 462366, p. 2; and FCA Records, *Emails*, 26 November 2013, 423504.

unless they opted out and sought redress through the courts; a matter addressed in Chapter 2.<sup>935</sup>

57. Additionally, the FSA/FCA neither reserved to itself, nor exercised, any official appellate jurisdiction under the Scheme, and it had decided, after consideration, against any expanded role for the FOS to provide an avenue of appeal under the Scheme.<sup>936</sup> One of the reasons given by the FCA to the FOS for deciding against a stand-alone FOS appeal scheme was that "*the skilled persons already provide sufficient independent oversight to ensure the banks conduct their reviews appropriately and provide fair and reasonable redress where appropriate*".<sup>937</sup> Internally, however, the FCA also noted an additional key factor against pursuing a stand-alone FOS appeal scheme: the difficulty of retrospectively extending the jurisdiction of the FOS to resolve the "*significant mismatch between businesses who purchased IRHPs (broadly, non-sophisticated retail clients) and those customers who are ordinarily eligible to complain to the Ombudsman*" either compulsorily, or voluntarily (with the agreement of the banks).<sup>938</sup> As a result, the FCA had no power to overrule a decision of the banks on any particular case, and only those micro-enterprises eligible under the existing FOS jurisdiction could challenge the outcome proposed by their banks without having to resort to litigation. Customers were informed through the FCA's website of their ability to challenge redress outcomes as follows:

*"The IRHP review scheme has an in-built appeal mechanism. For customers to make an informed decision as to whether to accept a redress offer, banks are required to clearly explain how they have reached their determination, including what facts they have relied on. Redress offer letters set out the basis of banks' decisions at a relatively high level. In addition, customers will be offered a face to face meeting, during which they can obtain a more detailed explanation, ask questions and, if appropriate, challenge the outcome. The banks and independent*

---

<sup>935</sup> See also footnote 930.

<sup>936</sup> FCA Records, *Letter*, 28 June 2013, 423832.

<sup>937</sup> FCA Records, *Letter*, 28 June 2013, 423832. The letter further notes that the FCA also now has "*data that indicates that a number of customers are already likely to be eligible to complain to the Ombudsman under the existing jurisdiction.*"

<sup>938</sup> FCA Records, *Memorandum – Widening access to the FOS*, 28 June 2013, 389638.

*reviewers will carefully consider any points raised by customers and, if necessary, will review their decision.*"<sup>939</sup>

58. Reflecting on customers' lack of ability to appeal against final redress determinations, the FCA has noted in evidence to this Review that "*[o]ne of the lessons from the IRHP scheme is that we would now generally consider that an independent appeal element is important in a redress scheme (not just a review by a Skilled Person), whether that appeal be provided through the FOS (where the customer is eligible) or some other mechanism*".<sup>940</sup>

ii) *The FCA's need to respond to specific issues*

59. Certain issues emerged in relation to the interpretation and application of the Scheme Terms which required specific attention from the FCA in order to promote the objectives of the Scheme. FCA employee I, who was involved in implementing the Scheme, gave evidence to this Review that while in early 2013 "*it was unclear what our role would be ... it quickly became clear that the redress scheme had significant issues which needed to be addressed*".<sup>941</sup> Likewise, FCA employee T (who was involved in the implementation of the Scheme but had not been involved in its design or negotiation) commented in evidence to this Review: "*At the time what I was thinking was: why [was] so much detail left for me?*"<sup>942</sup> The apparent frustration arose from the fact that: "*It [the Scheme Terms] didn't say: if this happens, that's what you have to do by way of redress. Or, that's the alternative product that you have to offer. Or, you have to terminate the swap and match the term of the loan. We didn't have this sort of specific guidance on the general agreement*".<sup>943</sup>

60. In an effort to ensure that banks were complying with their obligations under the Scheme Terms, during June 2013 the FCA reviewed the first ten files in which banks proposed

---

<sup>939</sup> The Financial Conduct Authority, "*Interest rate hedging product review - FAQs*", archived on 1 September 2014, accessible at <https://webarchive.nationalarchives.gov.uk/20140901210429/http://www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products/questions>.

<sup>940</sup> Confidential work package 5, 4 September 2020, p. 4, para. 17 (WORK PACKAGE 005).

<sup>941</sup> Written Representations I, 16 February 2020, p. 43, para. 2.2-2.3.

<sup>942</sup> Meeting Transcript T (P44:L5-6).

<sup>943</sup> Meeting Transcript T (P32:L4-9).

an alternative product by way of redress outcome to determine whether they were compliant with the methodology agreed between the FCA and the banks.<sup>944</sup> In relation to two of the first-tier banks, the FCA considered that most files passed but noted that it "*purely test[ed] calculation[s]*".<sup>945</sup> In relation to the first five files put forward by one of the other first-tier banks, the FCA's assessment was that "*2 were ok, 1 alternative product offered was actually detrimental to the customer, 2 failed the calculation test*".<sup>946</sup> The meeting note also referred to a meeting between the FCA and one of the Skilled Persons "*to provide them with feedback (we are not satisfied they are providing sufficient challenge)*".<sup>947</sup> As set out in more detail at paragraph 161 below, the FCA cited a lack of "*sufficient resources*" as the reason for not reviewing more files.<sup>948</sup>

61. As the implementation of the Scheme continued, so did the need for the FCA to provide additional guidance to the banks and Skilled Persons, not least to seek to ensure a consistent implementation between banks. For example:
  - a. It held bilateral and multilateral meetings with the banks and Skilled Persons, and forums for all Skilled Persons to discuss issues as they arose. These meetings were occasionally used to influence the banks' and/or Skilled Persons' handling of individual cases through its reaction to representations made directly to the FCA by customers.<sup>949</sup>
  - b. The FCA also employed the aggregate data it collected in respect of the Scheme to recommend a change to a bank's and/or Skilled Person's processes. For instance, in November 2013, the FCA identified that the alternative products being offered by one bank were "*significantly more expensive for the customer than other banks*". Reporting on a meeting with this bank and its Skilled Person, an FCA employee noted that as a result of the FCA's intervention the bank "*now recognise[s] that*

---

<sup>944</sup> FCA Records, *Email*, 7 May 2013, 659055. See also FCA Records, *Email*, 27 June 2016, 382607.

<sup>945</sup> FCA Records, *Internal Document*, 27 June 2016, 382607, p.4.

<sup>946</sup> FCA Records, *Internal Document*, 27 June 2016, 382607, p.4.

<sup>947</sup> FCA Records, *Internal Document*, 27 June 2016, 382607, p.4.

<sup>948</sup> Chapter 5, Section 3, para. 161.

<sup>949</sup> FCA Records, *Cover email and attachment*, 11 December 2013, 465521 and 465522.

*they are an outlier (at least on their cap products), and will consider reviewing their pricing process in light of this given the potential for poor publicity".*<sup>950</sup>

62. In relation to issues falling outside the strict language of the Scheme Terms, the FCA used a form of "nudge" to persuade a bank to conform with good practice. For instance, in relation to sending out additional mailing to Category C customers, the FCA was able to persuade a bank to align its position to that of the other eight banks by noting that "*the other banks have confirmed they will be writing to their cap customers*". In response, this bank noted that "*while an additional mailing goes beyond the requirements of the formal agreement, in the interests of promoting consistency of approach for all customers in the review, we would confirm our agreement to conduct this final mailing*".<sup>951</sup>
63. Based on the evidence reviewed, it appears that the FCA had to use its judgement and discretion on an ad hoc basis as to the nature and scale of its oversight. For example:
- a. In internal email correspondence, an FCA employee recommended not engaging with a customer who was unhappy with their redress outcome and instead advocated leaving the Skilled Person to address the customer's concern, stating "*I am mindful that we should not be seen providing an arbitration service for customers who disagree with their outcome*".<sup>952</sup>
  - b. On other occasions, where the FCA considered intervention necessary and related to a point of principle or process, the FCA would inform the relevant banks and Skilled Persons that it was concerned that a fair procedure consistent with the agreed process may not have been followed and/or that the customer may not have been treated fairly or reasonably. In such situations, the FCA asked the bank and Skilled Person to consider the matter further. For instance, following its challenge to one bank about the number of redress outcomes that were based on a replacement swap, the bank committed to re-review a large number of cases, resulting in the number of outcomes of no redress or alternative products dropping from around 44 per cent to 25 per cent "*which is much more in line with its peers*".<sup>953</sup> Another

---

<sup>950</sup> FCA Records, *Email*, 12 November 2013, 1275858.

<sup>951</sup> FCA Records, *Emails*, 21-22 January 2015, 584727.

<sup>952</sup> FCA Records, *Email*, 15 May 2013, 382749.

<sup>953</sup> FCA Records, *Email*, 3 October 2014, 1268886.



Skilled Person who was generally perceived by the FCA to be performing at a high level, responded to specific FCA feedback on "*four or five issues... [and] had taken them on board.*"<sup>954</sup> The evidence provided to this Review by FCA employee M would suggest that this approach was successful as they noted that one of the Skilled Persons' "*performance significantly improved as a result of our intervention on it*".<sup>955</sup>

- c. Certain customers requested an update directly from the FCA. On a number of these occasions, the FCA would enquire directly with the banks, on behalf of the customer, to ascertain the status of that customer's file review and provide the customer with an update.<sup>956</sup>

64. Nonetheless, there was a tension between the FCA's desire to influence the decisions made by banks and Skilled Persons and its role under the Scheme. For example, in a meeting between the FCA, one of the first-tier banks and its Skilled Persons in February 2014, the Skilled Person declined to change its mind on a particular case outcome, despite the FCA's attempt to persuade them of an alternative interpretation. The Skilled Person sought to ensure each party's role (as defined and decided by the FCA in 2012 and January 2013) remained clear: "*Your approach is not helping. I'm the Skilled Person*".<sup>957</sup> A similar point had previously been raised by the same Skilled Person in June 2013, following additional feedback provided by the FCA on cases that had been previously discussed and agreed with the FCA: "*Whilst we all understand that the FCA is keen to ensure the review is robust and effective, we do need to reach a point where we can proceed without such iterations of views and challenges... this is about how we can get a review of thousands of cases done in a sensible time frame.*"<sup>958</sup>

---

<sup>954</sup> Meeting Transcript M, (P67:L11-14).

<sup>955</sup> Meeting Transcript M, (P67:L10-11).

<sup>956</sup> Confidential work package 5, 4 September 2020, p. 3, para. 15 (WORK PACKAGE 005).

<sup>957</sup> FCA Records, *Meeting minutes*, 4 February 2014, 460473, p. 3. The meeting was between FCA, RBS, KPMG and Macfarlanes.

<sup>958</sup> FCA Records, *Email*, 13 June 2013, 371116.

iii) *The Board's role in respect of the Scheme between 2013 and 2015*<sup>959</sup>

65. This section briefly sets out the Board's role in respect of the Scheme. The Board in this context was that of the FSA during the period from 2012 to 31 March 2013 and that of the FCA for the remainder of the Review Period. It is clear from the contemporary documentation relating to the role of the Board that it had a number of critical functions reserved to it.<sup>960</sup> The FCA has made representations to the Review that the Scheme was not a matter reserved to the Board and as such was "*delegated by the Board to the CEO. The CEO is then able to sub-delegate the authority granted from the Board to one or more individuals or committees.*"<sup>961</sup> The FCA also noted: "*At relevant times decisions were escalated to ExCo and the Board as necessary. As the IRHP Redress Scheme was*

---

<sup>959</sup> This Review has seen Board papers beyond 2015. These provided factual updates covering how customer cases were progressing. See, for instance, FCA Records, *Board Paper*, 21 April 2016, 722625, p. 2.

<sup>960</sup> The following matters were, inter alia, reserved to the Board: (i) "**Strategy and management...** 7. *Oversee the discharge of FSA's operations by executive management ensuring: a) competent and prudent management; b) sound planning; c) adequate accounting and other records; and d) compliance with statutory obligations*"; and (ii) "**Internal controls and risk management...** 13. *Ensure maintenance of a sound system of internal controls and internal risk management including: a) receiving reports on and reviewing the effectiveness of the FSA's internal risk and controls processes to support its strategy and objectives, (Audit Committee)\*; ... 14. Ensure the maintenance of an effective risk management system which both identifies and, where feasible seeks to mitigate risks to the FSA's statutory objectives. (Risk Committee)\*...*". The Financial Services Authority, "*Schedule of Matters Reserved to the Board as at 24 June 2010*", accessible at [https://webarchive.nationalarchives.gov.uk/ukgwa/20120302222133mp\\_/http://www.fsa.gov.uk/pubs/other/som.pdf](https://webarchive.nationalarchives.gov.uk/ukgwa/20120302222133mp_/http://www.fsa.gov.uk/pubs/other/som.pdf).

See also "*Governance of the Authority*", adopted by resolution of the Board on 28 June 2012, which states: (i) that the Board's role includes: "2c) *overseeing the discharge by the executive management of the day-to-day business of the Authority... f) taking specific decisions which the Board or executive management consider to be of such significance as to require to be taken by the Board.... h) providing an accountability mechanism for decisions of committees of the Board and executive management, through periodic reporting*" and (ii) that "*In accordance with the Turnbull Report, the Board's deliberations in the management of risks to the Authority's objectives will include consideration of: a) the nature and extent of the risk facing the Authority; b) the extent and categories of risk which it regards as reasonable for the Authority to accept; c) the likelihood of the risks concerned materialising; d) the Authority's ability to reduce the incidence and impact on its objectives of risks that do materialise; and e) the costs of operating particular controls relative to the benefit thereby obtained in managing the related risks.*" The Financial Services Authority, "*Governance of the Authority*", 28 June 2012, accessible at [https://webarchive.nationalarchives.gov.uk/ukgwa/20121210021633mp\\_/http://www.fsa.gov.uk/pubs/other/gov\\_memo.pdf](https://webarchive.nationalarchives.gov.uk/ukgwa/20121210021633mp_/http://www.fsa.gov.uk/pubs/other/gov_memo.pdf).

These responsibilities included dealing with reputational risk; see Meeting Transcript Griffith-Jones (P21:L2-16).

<sup>961</sup> Confidential work package 1, 16 September 2020, p. 2, para. 1.4 (WORK PACKAGE 001).

*a significant project, regular updates were provided to the Board via the CEO's report".*<sup>962</sup> Nevertheless the delegation to which the FCA referred in its representations does not supplant the Board's powers and responsibilities.<sup>963</sup>

66. This Review has considered the regular updates given to the Board via the CEO's report, covering the progress of the implementation of the Scheme, including the number of customer cases decided. These updates were largely similar in substance to those placed in the public domain via the FCA's website.<sup>964</sup>
67. For example, the Board was told that the FCA was close to achieving targets that were then subsequently revised. For example:
- a. An update on 20 March 2013 noted the intention that the first offers of redress would begin to be sent out "*towards the end of March [2013]*".<sup>965</sup>
  - b. An update during April 2013 noted that the banks continued to revise their methodologies "*to bring them in line with our published principles*".
  - c. Similarly, in June 2014, the Board was informed that all banks (save for two) were expected to complete their reviews in May 2014 and the final two would complete their reviews in June 2014.
  - d. However, by July 2014, the Board was informed that the revised expectation was for the Scheme to continue to run until the end of the year, to allow for outstanding basic redress and consequential loss claims to be resolved.<sup>966</sup>
68. In addition to setting out how customer cases were progressing, these updates would occasionally cover topics such as stakeholder concerns, contemplation of enforcement action and ongoing legal issues relating to IRHPs. For instance, in June 2013, the Board was updated more comprehensively in respect of ongoing litigation related to IRHPs and

---

<sup>962</sup> Confidential work package 1, 16 September 2020, p. 9, para. 5.1 (WORK PACKAGE 001).

<sup>963</sup> See footnote 960.

<sup>964</sup> See, for example, the updates of FCA Records, *Board Paper*, 27 June 2013, 376649, pp. 1 and 16; FCA Records, *Board Paper*, 25 July 2013, 392116, pp. 2 and 21; FCA Records, *Board Paper*, 26 September 2013, 531391, pp. 2-3, 6, and 26.

<sup>965</sup> FCA Records, *Board Paper*, 20 March 2013, 376240, p. 6, para. 3.3.2.

<sup>966</sup> FCA Records, *Board Paper*, 24 July 2014, 531100, pp. 2 and 25.

related legal issues.<sup>967</sup> Following this meeting, Martin Wheatley noted to ExCo that the ensuing discussion: "*took us to a better understanding with the Board of the issues that we have faced but also a question from the Board as to whether this sort of discussion ought to occur at the start of us embarking on a major new intervention rather than reporting at the end. Interestingly we did not, I think, take the Board through our approach on Interest Rate Swaps at an early stage*".<sup>968</sup>

69. The Review's conclusions on whether and to what extent the Board could and should have been more involved in "*this sort of discussion*" are covered in Chapters 7 and 8 of the Report.
70. During a Parliamentary debate in the House of Commons on 4 December 2014 on the FCA's intervention on the mis-selling of IRHPs, there was serious criticism by MPs of the FCA's conduct. The Board was informed on 26 February 2015 that the FCA was considering with HMT whether to set up a full independent inquiry into the FCA's conduct in relation to the Scheme, or whether a review by a non-executive director of the FCA would "*sufficiently satisfy the public interest that appears to be growing around this issue*".<sup>969</sup> In March 2015, the Board requested a review to be undertaken by the FCA's Risk and Compliance Oversight Division of the handling of IRHP correspondence received by the FCA.<sup>970</sup> It appears that this was because the Board saw these events as giving rise to serious reputational risk and thereby falling within the scope of the Board's responsibilities.<sup>971</sup>
71. The report that was prepared for the Board noted that all IRHP correspondence was passed to the "*IRHP team (in effect one person) for response*"<sup>972</sup> and flagged a risk that the "*audit trail between [the] subject of correspondence and follow-up with [the] bank [was] not always clear*".<sup>973</sup> Given the team had apparently dwindled by this stage to one person, and in order to expedite the handling of customer complaints, by mid-2014, the

---

<sup>967</sup> FCA Records, *Board Paper*, 24 June 2013, 006557.

<sup>968</sup> FCA Records, *Email*, 5 June 2013, 456244.

<sup>969</sup> FCA Records, *Board Paper*, 26 February 2015, 562151, p.1, para. 1.1.

<sup>970</sup> FCA Records, *Board Paper*, 24 March 2015, 599393, p. 3, para. 6.2.

<sup>971</sup> Meeting Transcript Griffith-Jones (P21:L2-16); see further footnote 960 above.

<sup>972</sup> FCA Records, *Internal Document*, 23 March 2015, 574059, p. 4.

<sup>973</sup> FCA Records, *Internal Document*, 23 March 2015, 574059, p. 10.

FCA had developed a set of standard responses covering no fewer than 31 different issues, many of which would be familiar to critics of the Scheme, for example: the Scheme being too slow, Sophisticated Customer Criteria, independence of Skilled Persons and the "secret agreement" with the banks.<sup>974</sup> Nonetheless, it was also noted that responding to high volumes of correspondence, complaints and freedom of information requests (from customers, MPs, and other customer representatives) was taking a toll on the ability of the FCA to achieve its oversight objective: "*Correspondence volumes could impact [our] ability to carry out [our] primary oversight role...due to limited resource*".<sup>975</sup>

72. The following meeting of the Board, on 24 March 2015, was dedicated to the "*Supervisory Intervention on Interest Rate Hedging Products*".<sup>976</sup> This is in contrast to many of the previous Board meetings where the topic formed just part of a very broad agenda of multiple items. At this meeting, the Board "*noted that it would be appropriate to wait*" until ongoing/potential legal actions related to the Scheme were completed prior to continuing with any independent review or lessons learned related to the FCA's intervention.<sup>977</sup> Accordingly, "*the Board requested the Executive Committee to consider the next steps and provide a proposal to the Non-Executive Directors for the form and timing of any review, which they would oversee*".<sup>978</sup> In turn this led to the appointment of the Independent Reviewer in June 2019. Chapters 7 and 8 below return to the issue of the Board's involvement in the FSA/FCA's supervisory intervention and its relevance to any of the issues in the ToR relating to the efficacy of that intervention.

iv) *The responsibilities of the banks*

73. The ToR focus on the FCA's conduct and accordingly only a brief summary of the banks' role during this period follows. It is, nonetheless, important to note that under the Scheme, which one bank described as "*an extremely complex way of trying to get redress to customers*", a very significant amount of work was required on the part of the banks in

---

<sup>974</sup> FCA Records, *Internal Document*, 15 April 2014, 495984.

<sup>975</sup> FCA Records, *Internal Document*, 23 March 2015, 574059, p. 10.

<sup>976</sup> FCA Records, *Board Paper*, 24 March 2015, 599393.

<sup>977</sup> FCA Records, *Minutes of the Board*, 24 March 2015, 706837, p. 3, para. 4.2. These legal actions related to a claim for 'Francovich' damages against the FCA and HMT, Holmcroft and a potential judicial review being brought by Bully-Banks.

<sup>978</sup> FCA Records, *Minutes of the Board*, 24 March 2015, 706837, p. 3, para. 4.2.

order to meet their responsibilities.<sup>979</sup> For instance, in evidence given to this Review, one bank described creating the methodologies as "*a monumental task*",<sup>980</sup> another noted that in mapping out the process from end to end they "*spent a huge amount of time making sure the process was rigorous*"<sup>981</sup> and a further bank commented that assessing consequential loss "*became extremely onerous*."<sup>982</sup>

74. As set out in Chapter 4, the Scheme Terms involved a degree of subjective interpretation as to each of its three principal features:
- a. eligibility, in particular the subjective test;
  - b. compliance, for example, in respect of the assessment of whether one or more of the eight Sales Standards had been breached; and
  - c. redress, in particular the assessment of the counterfactual (i.e. what, in the banks' view, the customer would have done if the product had not been mis-sold).
75. In short, therefore, the role of the bank in each case was to decide whether the customer was eligible for inclusion in the Scheme, whether there had been a compliant sale, and, if it had made a non-compliant sale, whether redress was payable, with full tear-up and repayment of all sums at one end of the spectrum to no redress payable at the other.
76. The banks were all operating under and within a set of rules to which they had committed substantial resource and in respect of which the FCA had secured attestations from their respective Chief Executive Officers that the banks would be responsible for ensuring the Scheme was carried out in accordance with the Scheme Terms.<sup>983</sup>
77. The FCA received regular Management Information ("MI") from the banks during the implementation of the Scheme. During the first year of the Scheme, the MI was generally received fortnightly and then monthly as the Scheme progressed throughout 2013.<sup>984</sup> In its evidence given in Holmcroft, the FCA stated that they "*compare[d] the banks' MI in*

---

<sup>979</sup> Meeting Transcript DX (P69:L14-15).

<sup>980</sup> Meeting Transcript CT (P32:L1-2).

<sup>981</sup> Meeting Transcript MS (P95:L5-7).

<sup>982</sup> Meeting Transcript DX (P71:L11).

<sup>983</sup> See, for example, FCA Records, *Letter*, 23 April 2013, 379599.

<sup>984</sup> FCA Records, *Emails*, 27 September 2013, 1325782.

*order to identify and manage any inconsistencies".*<sup>985</sup> This highlighted to the FCA if, and when, a certain bank had, for example, issued fewer redress outcomes than its peers by a particular point in time, or, if it was proposing a higher than average amount of non-compliant sales, but no, or proportionally fewer, redress outcomes, rather than data relating to individual case outcomes.

v) *The responsibilities of the Skilled Persons*

78. As with the banks' responsibilities, the ToR do not extend to forming judgements on the conduct or performance of the Skilled Persons. As such, the point is briefly considered.
79. As described at paragraph 12 above, the Requirement Notices required Skilled Persons to provide independent oversight of the approach taken by the banks as well as to consider redress for each individual customer on a case-by-case basis. Under their arrangements with the FCA, each Skilled Person was required to submit monthly reports to the FCA and, at the end of its assignment, a final report. All of these reports were provided on conditions of confidentiality. Consequently, none of these have been made public. Each of the reports provides, to a greater or lesser extent, a detailed account of the tasks facing them and of the results.
80. The decisions required to be made by the banks, and reviewed by the Skilled Person, on: (i) eligibility, in particular the subjective test; (ii) compliance, including how much and what kind of information ought to have been provided in respect of the risks of the product including break cost disclosure; and (iii) redress, including the question of what a customer might have done years ago if the sale had been compliant, were all matters on which the banks and the Skilled Persons might come to different conclusions.
81. The question for each Skilled Person, on virtually every case, was whether the bank had reached that decision in accordance with the purposes and conditions of the Scheme Terms agreed with the FCA. That question could only be answered by a rigorous analysis of the evidence relied on by the bank and by testing the bank's provisional conclusions

---

<sup>985</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-009-0001, p. 12, para. 3.11.

against the proper application of the Scheme Terms, which were to be interpreted in a customer-centric manner.

82. The evidence reviewed demonstrates that Skilled Persons robustly challenged the banks:

a. EY, Skilled Person for a number of banks, gave evidence of the protocols they had in place to challenge the banks:

*"I think what was crystal clear to us, pretty much from the word go in these engagements, was the need for process rigour which basically was documented and then if we disagreed we should have clear escalation routes for that, which we did. There is no case in any of these reviews where we have accepted a bank's view on the overall outcome which we sort of disagree with but we've accepted because we don't think it's worth fighting".<sup>986</sup>*

b. Describing how they challenged the banks, KPMG, Skilled Person 1 for RBS, recalled that:

*"we either would go back and say unable to conclude and say it's not well argued so if you want to try again, we'll consider it again. Or we would just disagree and say, I'm sorry but we just don't buy the argument".<sup>987</sup>*

c. Deloitte, Skilled Person 1 for HSBC, recorded in its final report to the FCA dated 10 November 2016 that:

*"Of the 3,725 sales that we reviewed, there were 1,117 sales where the Bank had initially put forward a provisional redress proposal of an Alternative product or No Redress and where, following our review and subsequent discussion, the Bank agreed to revise its initial assessment. In total, the Bank revised its assessment in 73% of the cases where the initial redress proposal was an Alternative product or No Redress".<sup>988</sup>*

---

<sup>986</sup> Meeting Transcript EY, (P65:L18-P66:L1).

<sup>987</sup> Meeting Transcript KPMG, (P68:L15-19).

<sup>988</sup> FCA Records, Skilled Person report (HSBC), 10 November 2016, p.71 (REPORT 005).



83. These were by no means the only examples of a Skilled Person demonstrating robust challenge to a bank, or speaking to the FCA in confidence about issues relating to the conduct of a bank. For example, on another occasion, a Skilled Person expressed a concern to the FCA that the bank was not necessarily carrying out the Scheme in accordance with the "*customer centric approach*" and was, for example, tending to propose redress offers that were cheaper for the bank to provide.<sup>989</sup>
84. In evidence given to this Review, a partner at Skilled Person 1 for Barclays stated that this role was "*pretty all-consuming for the period of time that the engagement was ongoing*".<sup>990</sup> Discussing the need to consider redress on a case-by-case basis, a representative of Skilled Person 1 for RBS was equally candid on the size of the task, noting that "*it was a huge effort to review everything*".<sup>991</sup>
85. Nonetheless, in its evidence given in Holmcroft, the FCA stated there was considerable scope for "*inconsistent outcomes between the banks, in spite of the use of standard methodologies and the involvement of independent reviewers*".<sup>992</sup>
86. The question of consequential loss created further opportunity for divergent views. In giving evidence to this Review, one Skilled Person noted that in respect of calculating consequential loss "*[w]e did have skilled persons forums where we used to talk about certain high-level principles and the sense, and it genuinely is a sense, is that people were applying different approaches to things*".<sup>993</sup>
87. Nonetheless, the Skilled Persons forums were one of the key ways the FCA sought to mitigate the risk of inconsistent outcomes, by hosting roundtable discussions between the Skilled Persons to discuss emerging issues relating to the Scheme, and to assist the FCA in its supervision and in deciding whether it should offer informal guidance on

---

<sup>989</sup> FCA Records, *Meeting minutes*, 2 July 2013, 405455. See also FCA Records, *Email*, 17 October 2013, 421531.

<sup>990</sup> Meeting Transcript KPMG (P5:L19-21).

<sup>991</sup> Meeting Transcript KPMG (P85:L22).

<sup>992</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-009-0001, p. 11, para. 3.6.

<sup>993</sup> Meeting Transcript GQ, (P25:L11-14).

matters of interpretation, or issue FAQs to all banks and Skilled Persons.<sup>994</sup> One FCA employee informed this Review that the Skilled Persons' forums they and their colleagues attended served "*to reinforce some of our other expectations about: you're there to be independent, to challenge, to make sure we get the right outcomes, that this is a customer centric exercise*".<sup>995</sup>

### **Section 3 - The FCA's oversight of specific issues during the Scheme's implementation**

88. This Section considers several specific issues which emerged during the Scheme's implementation and which required the FCA to use its oversight function. Set out below are the most significant points that this Review believes the FCA needed to resolve.

#### **A. The decision not to publish the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters**

89. As a preliminary matter, this Review has considered the impact of the FCA's initial decision not to publish the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters. This was an issue which the FSA, and later the FCA, had to contend with throughout the implementation of the Scheme, and which is considered below.

90. Throughout 2013 and 2014, the FCA's position not to publish the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters with the banks was tested. The root of this issue can be found in the FCA's concern that the Scheme Terms were confidential and, whether the prohibition on disclosing confidential information under section 348 FSMA was engaged, thereby potentially rendering the disclosure of the

---

<sup>994</sup> For example, several FAQs were issued between May and July 2013, most notably: FAQs regarding novations, fixed rate loans and other redress principles, offsetting and the role of the Skilled Persons, see FCA Records, *Cover email and attachment*, 382519 and 382520, 1 May 2013; FAQs regarding dissolved companies, third party adviser costs, rebuttal of the maximum term presumption, confidentiality and full and final settlement clauses, the process by which Category B customers could opt into the Scheme and the role of the Skilled Persons in relation to implied volatility curves, see FCA Records, *FAQs for Skilled persons*, 23 May 2013, 387259; and FAQs regarding the reporting of Management Information and Category A customers, see FCA Records, *FAQs for banks and Skilled Persons*, 12 July 2013, 408029.

<sup>995</sup> Meeting Transcript S, (P46:L5-9).

Scheme Terms a criminal offence if the banks' consent was not obtained.<sup>996</sup> Additionally, the Scheme Terms contained a confidentiality clause preventing certain disclosures. In reality, there was little information in the Initial Agreement, the Supplemental Agreement, or the Exchange of Letters that had not previously been disclosed publicly,<sup>997</sup> but the sense that a "secret deal" had been struck between the banks and the regulator retained a powerful hold amongst critics of the Scheme.<sup>998</sup>

91. As discussed in Chapter 4, the FSA first sought the banks' consent to disclose the Initial Agreement in September 2012 following a Freedom of Information request. Such consent was however not obtained, with two first-tier banks declining this request.<sup>999</sup>
92. At a subsequent ExCo meeting, Clive Adamson took an action "*to ensure the banks involved in the IRHP redress scheme are informally contacted to establish whether they would be amenable to the details of their agreement with the FCA being published*" by 20 December 2013.<sup>1000</sup>
93. On or about April 2014, the FCA prepared a set of standard responses to cover frequently asked questions by customers and members of the public about the Scheme. It included a stock response that: "*We believe that we are prohibited from releasing these agreements and that we would be committing a criminal offence. The Information Commissioner and Information Tribunal has agreed with the FCA on this matter*".<sup>1001</sup>
94. The FCA had argued this position on appeal from the Information Commissioner in front of the First-Tier Information Tribunal General Regulatory Chamber (the "Information

---

<sup>996</sup> The Financial Conduct Authority, "*Information we can share*", 7 September 2020, accessible at <https://www.fca.org.uk/freedom-information/information-we-can-share> (ARTICLE 019).

<sup>997</sup> The FSA published its Pilot Findings Paper, which set out its findings from the Pilot Review, changes made to the terms of the Initial Scheme in advance of the implementation of the Scheme, including eligibility and redress, and a summary of what had been agreed with the banks. See FCA Records, *Interest Rate Hedging Products – Pilot Findings*, January 2013, FCA-ADD-0267.

<sup>998</sup> See Meeting Transcript T, (P22:L21–24): "*I think there was a profound dislike on the part of customers about what the FCA was doing...I think that there was an impression that we had entered into a secret deal with the banks*".

<sup>999</sup> See FCA Records, *Emails*, 26 September 2012, 408852; and FCA Records, *Emails*, 28 September 2012, 537701.

<sup>1000</sup> FCA Records, *Extended ExCo Weekly Minutes*, 12 November 2013, 431095, p. 4. See also, FCA Records, *Email*, 11 November 2013, 441771, which raises this point as an agenda item to be discussed at ExCo.

<sup>1001</sup> FCA Records, *Internal Document*, 15 April 2014, FCA-C-009-0013, p. 9.

Tribunal") in Jonny Landau v Information Commissioner and Financial Conduct Authority<sup>1002</sup> ("Jonny Landau v IC and FCA"). The Information Tribunal found in favour of the FCA that it had correctly applied the exemption from disclosure in section 44 (prohibition on disclosure) FOIA by refusing to publish the Initial Agreement because it constituted "confidential information" within the meaning of section 348 FSMA. The Information Tribunal commented that disclosure of confidential information protected by section 348 FSMA "*could lead to the unfortunate consequence of discouraging parties from proceeding where possible by informal negotiation, giving the FCA no alternative to a full investigation and sanction*", agreeing that an informal route may "*result in a faster, more efficient and favourable outcome to the public*".<sup>1003</sup> The Information Tribunal, however, did not consider or hear submissions as concerns the FCA's ability to publish confidential information contained in the Initial Agreement, pursuant to one of the exceptions outlined in section 349 FSMA and the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001. Those exceptions permit the disclosure of confidential information if (amongst other things) it is made for the purpose of enabling or assisting the FSA/FCA to discharge its public functions.<sup>1004</sup>

95. In June 2014, the TSC asked for copies of the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters as part of its inquiry into SME lending. At that time, the FCA responded that it was unable to release the documents on the basis that they were confidential.<sup>1005</sup>
96. Despite maintaining this public position, the FCA informed this Review that they "*subsequently wrote to the banks in Sept 2014*" to again seek their consent to disclose the Scheme Terms.<sup>1006</sup>

---

<sup>1002</sup> EA/2013/0098 [29].

<sup>1003</sup> Jonny Landau v IC and FCA EA/2013/0098 [24].

<sup>1004</sup> SI 2001/2188, regulation 3(1)(a).

<sup>1005</sup> The Financial Conduct Authority, "*Letter to Andrew Tyrie MP*", 26 June 2014, accessible at [https://www.parliament.uk/globalassets/documents/commons-committees/treasury/140626\\_Sean\\_Martin\\_to\\_Andrew\\_Tyrie.pdf](https://www.parliament.uk/globalassets/documents/commons-committees/treasury/140626_Sean_Martin_to_Andrew_Tyrie.pdf) (ARTICLE 024).

<sup>1006</sup> Request 54 to FCA ("*please provide any correspondence or documents between 1 January 2013 until the disclosure of the agreement in early 2015 by the FSA/FCA that may evidence a positive decision not to seek the banks' consent to disclose the agreements*"). For communication with

97. During a debate on 4 December 2014, Parliament discussed the Scheme. Transparency and, in particular, the FCA's refusal to publish the Initial Agreement, the Supplemental Agreement and the Exchange of Letters due to section 348 FSMA restrictions was a recurrent criticism. This was noted as a major failing by Guto Bebb MP in the Parliamentary backbench debate on 4 December 2014: "*On transparency, I am concerned that the agreement between the banks has not been disclosed. That means that it is very difficult to assess the success or otherwise of an outcome, because we do not know what to measure it against. The agreement has not been made available to the all-party group or the Treasury Committee, but I must ask why, because when the FCA says that it is robustly ensuring that the agreement is maintained, we cannot assess whether that is the case.*"<sup>1007</sup> An FCA specialist Supervision sub-division Board report noted that "*In light of the debate, ExCo agreed for Martin [Wheatley] to write to the banks to inform them of our intention to disclose the agreement to TSC [the Treasury Select Committee] in early January, giving the banks time to object if they wish to*".<sup>1008</sup>
98. On 22 December 2014, Martin Wheatley wrote to the CEO of one of the bank's parent companies that: "*We will note in our covering letter that several of the bank signatories agreed to disclosure to the TSC on the basis that the material is kept confidential and not to wider publication of the agreements.*"<sup>1009</sup>
99. A pro forma version of the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters was subsequently shared with the TSC on 9 January 2015 with an

---

HSBC, on this point see FCA Records, *Letter*, 5 September 2014, 548965; for RBS, see FCA Records, *Letter*, 5 September 2014, 1265972; for NAGE, see FCA Records, *Letter*, 5 September 2014, 602578; for Bank of Ireland, see FCA Records, *Letter*, 5 September 2014, 602582; for Co-op Bank, see FCA Records, *Letter*, 5 September 2014, 647897; and for AIB, see FCA Records, *Letter*, 5 September 2014, 602580.

<sup>1007</sup> House of Commons Debate, "*Financial Conduct Authority Redress Scheme*", 4 December 2014, Hansard volume 589, col.481, accessible at <https://publications.parliament.uk/pa/cm201415/cmhansrd/cm141204/debtext/141204-0002.htm#14120439000007>.

<sup>1008</sup> FCA Records, *Internal Document*, 7 January 2015, 572555, p. 2.

<sup>1009</sup> FCA Records, *Letter*, 22 December 2014, 584623.

explanation that the banks had given consent to disclosure to the TSC only.<sup>1010</sup> This version was then published by the TSC on 12 February 2015.<sup>1011</sup>

100. Commenting on the FCA's ability to publish the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters in 2015, one FCA employee informed this Review that once *"the Treasury committee demanded publicly that they publish the agreements... Within four hours of that the banks had agreed -- we'd got that consent. So it wasn't beyond the wit of the FCA to get that consent, they just didn't try to get that consent."*<sup>1012</sup> Another former FCA employee stated that: *"the lesson for the FCA was that on any future occasion the FCA should not enter into a private agreement"*.<sup>1013</sup>
101. In evidence given to this Review, FCA employee T told this Review that, in their opinion: *"had we been more transparent or had it benefited from wider consultation in the early stages to agree what the approach should be perhaps our job to manage stakeholders would have been easier. So because managing expectations was not done upfront, it had to be done when the scheme was producing its fruits. So it was we had to explain what had been done at a stage when people couldn't influence anymore, so they felt quite frustrated"*.<sup>1014</sup>

## **B. Other issues requiring resolution**

102. At the early stages of its oversight of the Scheme, the FCA's expectation was that the implementation of the Scheme would not require significant participation by the FCA. However, a number of stand-alone issues required a greater degree of intervention than the FCA had anticipated. Set out below are the most significant points that the FCA needed to resolve:
- a. alternative products offered by way of redress which required a "recalibration" of the interpretation of the redress principles;

---

<sup>1010</sup> FCA Records, *Letter*, 9 January 2015, 006680.

<sup>1011</sup> House of Commons Debate, *"Conduct and competition in SME lending - Treasury Contents"*, accessible at <https://publications.parliament.uk/pa/cm201415/cmselect/cmtreasy/204/20406.htm>.

<sup>1012</sup> Meeting Transcript II, (P98:L11-12).

<sup>1013</sup> FCA Records, *Internal Document*, 23 January 2015, 597741.

<sup>1014</sup> Meeting Transcript T, (P49:L19-P50:L2).

- b. the matter of expedited redress for certain customers;
- c. the conduct and output from "challenge meetings" intended to help ensure consistent customer-centric approaches;
- d. instances where a customer was entitled to break gains payable by the bank;
- e. interest payments and consequential loss;
- f. TBLs; and
- g. contingent liability.

103. As further described below, some of these matters were exacerbated by the FCA's lack of resourcing and its newly implemented systems of governance.

104. Each of the matters set out below is an illustration of what may be expected to happen when the terms of a consumer redress scheme are not clearly set out in full knowledge of the range and diversity of scenarios that might arise in practice. This not only led to a risk of divergent results and thus inequality of treatment, but also delay, and a high chance of customer disappointment.

i) *Alternative products: the "recalibration exercise" in late 2013*

105. In its evidence given in Holmcroft, the FCA stated that: "*the approach that the FCA has taken in supervising the IRHP review has been designed to ensure that there should be no material variations in outcomes for customers between banks which had appointed different Skilled Persons and between Skilled Persons within the same bank*".<sup>1015</sup> However, variations in the way that the banks and Skilled Persons assessed each of the key criteria of the Scheme (eligibility, compliance and redress) did arise and required oversight (and in some cases, direction) from the FCA.

106. The issue of which alternative product should be offered by way of redress had been discussed on 15 May 2013 when EY, Skilled Person 1 for Lloyds, flagged its concern

---

<sup>1015</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-009-0001, p. 16, para.4.5.

that the FCA's conduct in a meeting had arguably "*re-opened the approach*" to alternative products "*with an expectation that this should typically be a cap*", despite the bank's methodology, which did not include this expectation, having already been submitted and approved. The FCA's response to this was clear: "*This is not the intention... We do not have an expectation that the alternative product should typically be a cap, however we do have an expectation that a cap is given full consideration*".<sup>1016</sup>

107. This Review has not seen evidence to suggest that the FCA explored the consequences of the differing possible interpretations of the Scheme Terms regarding alternative products again until a divergence in approach taken by two Skilled Persons (Deloitte and KPMG) appointed by Barclays came to the FCA's attention in November 2013.<sup>1017</sup> Customers whose cases were being overseen by Deloitte, Skilled Person 2 for Barclays, "*appeared to be getting better redress outcomes than customers who were being overseen*" by KPMG,<sup>1018</sup> the first Skilled Person.<sup>1019</sup> In this case, it appeared from the regular Skilled Persons reporting that the difference arose mainly in respect to the Skilled Persons' approach to alternative products. The FCA had serious concerns about this: "*It could not be fair and reasonable that customers who were overseen by one skilled person were routinely getting more redress than customers who came under the oversight of the*

---

<sup>1016</sup> FCA Records, *Email*, 15 May 2013, 385060.

<sup>1017</sup> In its final Skilled Person report, KPMG, Skilled Person 1 for Barclays, notes that "*a combination of factors underpinned the decision, but most crucially was the consensus appearing to form between the FCA and certain other SPs, evident at the SP forum on 13 November 2013, that the majority of redress outcomes were expected to be caps. This discussion indicated to the FSP that MTM product outcomes would only generally be permissible in the minority of cases subject to very strict evidential requirements. The FSP observed that the Bank's current product mix was not consistent with that view.*" FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 24, para. 3.2.1.1 (REPORT 009).

<sup>1018</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-009-0001, p. 16, para.4.5.

<sup>1019</sup> According to the design of the Scheme, each customer's case was reviewed by only one Skilled Person (i.e. teams or individuals at either KPMG or Deloitte), so this comment related not to the two Skilled Persons taking different approaches in relation to the same customer file(s), but to the approach of different Skilled Persons with similar customer files.



*other skilled person*".<sup>1020</sup> Following, and as a result of, the FCA's intervention this issue required a significant "recalibration" of the interpretation of the redress principles.<sup>1021</sup>

108. As discussed in Chapter 4, the Scheme Terms entitled the banks to propose an alternative product by way of redress in certain circumstances. In many cases, an interest rate cap was the most financially advantageous alternative product from the customer's point of view, and was described by the FCA as a "*near-full refund*".<sup>1022</sup> The FCA concluded that the differences in outcome arose from the evidential bar being applied by each Skilled Person as regards the likelihood that a customer might choose a swap or collar, rather than a cap, when assessing the customer's likely attitude to risk as part of the counterfactual analysis.<sup>1023</sup>
109. In a meeting with a member of the CEDW Team, the Skilled Persons confirmed that they understood how the differences arose. The FCA informed the Skilled Persons that it was broadly in favour of Deloitte's approach. Namely, that the evidential bar being applied in determining fair and reasonable redress offers should include "*a "customer centric" layer requiring a greater level of evidence as the risk of customer detriment increases*". This was then communicated by FCA employee I to Clive Adamson and other FCA employees: "*it is clear that as redress judgements become less favourable to customers (i.e. swaps and collars), there is an expectation that banks and skilled persons take greater care to ensure that the evidence is sufficient and robust. Therefore, where there is doubt, a more prudent option is to favour the customer and opt for the safer outcomes (cap or full tear up)*".<sup>1024</sup>
110. The CEDW Team also noted that an "*inevitable*"<sup>1025</sup> outcome of advising KPMG (which notes that it was alerted to the risk of a misalignment at a Skilled Persons forum on 13

---

<sup>1020</sup> FCA Records, *Email*, 22 November 2013, 429608.

<sup>1021</sup> FCA Records, *Memorandum – Note For Record of meeting FCA, RBS, KPMG and Macfarlanes on IRHPs*, 16 December 2013, 466344.

<sup>1022</sup> FCA Records, *Internal Document*, 14 October 2015, 1173712, p.7.

<sup>1023</sup> At the time, the FCA summarised their understanding of the position thus: "*KPMG have been applying a "balance of probabilities" [test] whereas Deloitte enhance this with a "customer centric" layer by requiring a greater level of evidence as the risk of customer detriment increases. In practice this means setting a higher evidential bar when redressing a customer into a swap or collar*". See FCA Records, *Email*, 26 November 2013, 430852.

<sup>1024</sup> FCA Records, *Email*, 21 November 2013, 430852.

<sup>1025</sup> FCA Records, *Email*, 21 November 2013, 430852.

November 2013 and in subsequent discussions with Deloitte,<sup>1026</sup> and informed Barclays on 17 November 2013 and then the FCA on 18 November 2013 that it had voluntarily paused all work on alternative product redress outcomes while the FCA reached a view on this point)<sup>1027</sup> to recalibrate its position would be an increased cost of redress for Barclays and delays for those customers whose files had already been reviewed by KPMG under the previous approach, or whose file review had been delayed by the ongoing discussions.<sup>1028</sup>

111. Despite the significant impact this would have on the FCA's aim to communicate all redress outcomes by the end of December 2013, the FCA's view was that "*the right thing to do for customers was to resolve this matter*".<sup>1029</sup>
112. The FCA communicated its view to both Skilled Persons for Barclays at a meeting on 29 November 2013, giving the reason that: "*it would be extremely difficult to establish that a customer would have entered into a MTM [mark to market] product when there was neither an LCOL [legitimate condition of lending] or an express wish [i.e. a pre-existing intention to enter into an IRHP driven by the customer not the bank]... This was particularly in light of the significant failings seen to date in the sales process*".<sup>1030</sup> However, the FCA confirmed that "*it was not impossible for a customer to be offered an alternative product where neither an LCOL or an express wish could be demonstrated*".<sup>1031</sup>
113. In any event, the FCA's position on alternative products had hardened by late 2013 with the effect that banks would be generally expected to offer a cap as an alternative product in the absence of clear evidence that the customer would have chosen an alternative swap

---

<sup>1026</sup> FCA Records, *KPMG – November 2013 Monthly Report by First Skilled Person*, 18 December 2013, 423236, p. 5. See also Written Representations KPMG, addressed to the FCA, 15 October 2011.

<sup>1027</sup> FCA Records, *KPMG – November 2013 Monthly Report by First Skilled Person*, 18 December 2013, 423236, p. 3.

<sup>1028</sup> FCA Records, *Email*, 21 November 2013, 430852.

<sup>1029</sup> FCA Records, *Email*, 22 November 2013, 430852.

<sup>1030</sup> FCA Records, *KPMG – November 2013 Monthly Report by First Skilled Person*, 18 December 2013, 423236, pp. 6-7.

<sup>1031</sup> FCA Records, *KPMG – November 2013 Monthly Report by First Skilled Person*, 18 December 2013, 423236, p. 7.

or collar.<sup>1032</sup> This was required to find a "*workable solution*" to the divergence of approach taken by the two Skilled Persons for Barclays in relation to alternative products.<sup>1033</sup>

114. One Skilled Person noted to the FCA at the time that this would impact the Scheme significantly, as a very large percentage (40-50 per cent) of the IRHPs were sold without being a legitimate condition of the lending and that "*the incidence of an express wish is very rare in the Bank's review*".<sup>1034</sup> Notwithstanding this, the recalibration exercise affected some banks and Skilled Persons more than others, depending on their prior interpretation of the Scheme.<sup>1035</sup> This was reflected in the evidence given to this Review, in which Lloyds noted that this exercise "*impacted something like 25 to 30 percent of the [bank's review] population*"<sup>1036</sup> while HSBC commented "*I don't remember a big recalibration exercise*".<sup>1037</sup> One of the second-tier banks complained that the pace of their review was impacted by late changes to FCA guidance in November 2013, saying that the bank "*could have closed out this redress exercise 6 months ago but that guidance from the FCA kept changing*".<sup>1038</sup>
115. A number of those who gave evidence to this Review explained why they thought the recalibration exercise had been required:
- a. Barclays said: "*I think the terms under which we were operating probably didn't have the right level of detail... as to in which circumstances the offering or not of an alternate IRHP product was the right outcome for customers*".<sup>1039</sup>

---

<sup>1032</sup> FCA Records, *Email*, 28 November 2013, 1311540.

<sup>1033</sup> FCA Records, *Email*, 26 November 2013, 430852.

<sup>1034</sup> FCA Records, *KPMG – November 2013 Monthly Report by First Skilled Person*, 18 December 2013, 423236, p. 6.

<sup>1035</sup> In its final Skilled Person report, KPMG, Skilled Person 1 for Barclays, notes that "*although the amount of re-work required by the re-calibration exercise relating to decisions yet to be issued was significant and took several weeks, only 15 MTM redress outcomes had been issued at the end of November 2013 which needed to be reviewed as part of the recalibration.*" FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 25, para. 3.2.1.1 (REPORT 009).

<sup>1036</sup> Meeting Transcript Lloyds (P62:L18-19).

<sup>1037</sup> Meeting Transcript PB (P33:L6).

<sup>1038</sup> FCA Records, *Memorandum - Note for record*, 28 November 2013, 435860, p. 2.

<sup>1039</sup> Meeting Transcript Barclays (P56:L6-11).

- b. Lloyds agreed that: "*it involved quite a lot of extra work and I think our perspective would be that, actually, if that calibration exercise had taken place earlier and not after we'd already effectively completed 50 percent of ... assessment outcomes, then that would have been helpful for everyone*".<sup>1040</sup> On the other hand, the same bank commented that it was helpful that the FCA took a more active look at cases as part of the recalibration exercise: "*we understood it to be very useful from the FCA's perspective in that it did bring to life some of the complexities that we were facing. I think it's fair to say that there were very few what I would call 'straight-through cases'*".<sup>1041</sup>
- c. KPMG's evidence to this Review (in relation to its role as Skilled Person 1 for Barclays), confirmed that the guidance from the FCA was helpful, but came too late: "*Once we got through the recalibration process, the bank very readily took on board what it needed to do*".<sup>1042</sup> However, "*a lot of time would have been saved had the FCA been able to be explicit that this is the construct that you're going to apply*" after the Pilot Review, rather than many months into the implementation of the Scheme. At this stage, many cases had already been reviewed, and now required re-review.<sup>1043</sup>

ii) *Expedited redress*

116. In addition to the recalibration exercise, the FCA and certain banks agreed to procedures designed to speed up the redress process for customers whom the banks and Skilled Persons perceived as having limited ability to understand IRHPs. They were variously referred to as customers with higher information needs or "low lens", a concept explained below.
117. In its final report, KPMG, Skilled Person 1 for RBS, noted that, in November 2013, RBS agreed with the FCA to introduce an "Expedited Outcome" file review process for

---

<sup>1040</sup> Meeting Transcript Lloyds (P62:L21-P63:L1).

<sup>1041</sup> Meeting Transcript Lloyds (P63:L14-19).

<sup>1042</sup> Meeting Transcript KPMG (P:50:L10-12).

<sup>1043</sup> Meeting Transcript KPMG (P:52:L:20-23).

customers who met the specified criteria, which included having higher or average information needs.<sup>1044</sup>

118. RBS gave evidence to this Review that customers' information needs "*would be anything from very low, they were quite experienced borrowers, quite experienced traders, you know the interactions showed they had a view on market rates, they knew what they were doing, they weren't just passive, through to people really who had no knowledge really of what they were doing, they just needed a loan*".<sup>1045</sup>
119. RBS agreed to 2,379 trades (28 per cent of the total) being dealt with through this process with KPMG, Skilled Person 1 for RBS, noting that for a number of customers this "*resulted in outcomes that were more favourable than would have been the case under a full review*".<sup>1046</sup>
120. Similarly, in its final report, KPMG, Skilled Person 1 for Barclays, noted that through interaction with the FCA, Barclays was able to establish procedures, processes and controls to expedite decision-making for 'low lens' customers (in other words, those "*with a limited ability to understand IRHPs*") and Category A trades<sup>1047</sup> with 'low lens' customers automatically offered full tear-ups or caps as alternative products.<sup>1048</sup>

---

<sup>1044</sup> FCA Records, Skilled Person report (RBS), 19 May 2016, p. 116, para. 11.2.38 (REPORT 010). The other criteria were trades with a peak notional value of less than or equal to £750,000 where: (i) Aggregated debt exposure at the time of trade was less than £5 million; (ii) The customer was not a structured or off-shore SPV; and (iii) The customer was not part of a large group of companies. See also FCA Records, *Email*, 19 November 2013, 421102, and FCA Records, *Email*, 22 November 2013, 426667.

<sup>1045</sup> Meeting Transcript RBS (P24:L20-P25:L1).

<sup>1046</sup> FCA Records, Skilled Person report (RBS), 19 May 2016, p. 46, para. 3.2.33 (REPORT 010).

<sup>1047</sup> FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 18, para. 2.4.8 (REPORT 009).

<sup>1048</sup> FCA Records, Skilled Person report (Barclays), 11 April 2016, pp. 30-1, para. 3.3 (REPORT 009): "*for low lens Customers, with a limited ability to understand IRHPs, the Bank followed an approach which made generous assumptions in favour of the Customer to reflect the relative vulnerability of this category of Customer. For medium lens Customers, the approach took more account of the preponderance of the evidence as to what the Customer would have done in the counterfactual, but applied a Customer tilt, i.e. deciding in the Customer's favour in the absence of evidence or where the evidence was ambivalent. For high lens Customers, the Bank recognised that such Customers are close to sophisticated and therefore the ability to use inference was increased, albeit high lens Customers were still classified as unsophisticated and therefore some degree of "Customer tilt" was still required in assessing the evidence*".

121. Though full individual case reviews with the oversight of Skilled Persons had been a key tenet of the Scheme Terms, given the pressure on deadlines, the FCA concluded that where customer outcomes were unlikely to be improved by any further review, it was in the customer's best interest to move straight to redress rather than a full file review.
122. When asked why such measures could not simply be applied to all firms as a way of accelerating redress, the Central team replied: "*In essence, the acceleration ideas involve going beyond the agreement we reached in January [...] We can't require all the firms to do this as we have a voluntary agreement that sets out how the review should be conducted. What we are doing is continuing to push firms to deliver their targeted timeframes and are explaining that other firms are using accelerated methods to do so. We hope that this encourages all the banks in the review to consider going above and beyond what is strictly required*".<sup>1049</sup>

iii) *Challenge meetings*

123. From January 2014 to May 2014, the FCA began scheduling "*challenge meetings*" with individual banks and their respective Skilled Persons.
124. These meetings took place during the existing multilateral meetings that this Review refers to in Section 2 above. In advance of these meetings, the FCA invited each bank and Skilled Persons acting for those banks to present a selection of recent redress determinations.<sup>1050</sup>
125. One member of the CEDW Team commented that: "*The challenge meetings came about following the central teams [sic] discussions with Martin Wheatley, Clive Adamson and [FCA employee BG]. It was clear that we were carrying out a lot of work to hold banks to account but it was suggested that a more formalised process of scrutiny would be helpful. A proposal that the central team came up with, and which was endorsed by the*

---

<sup>1049</sup> FCA Records, *Email*, 6 December 2013, 435157.

<sup>1050</sup> FCA Records, *Email*, 11 December 2013, 427877: "*As part of our continuing oversight of the banks' reviews of sales of interest rate hedging products ("IRHPs"), it is our intention to periodically review a selection of redress determinations across all nine banks. The way we intend to do this is by inviting each bank and their skilled person to present to us a selection of recent redress determinations*". See also FCA Records, *Cover email and attachment*, 11 December 2013, 465521 and 465522.

*Steering Group, was to ask the banks to each present redress outcomes to us, in a way that would mirror a customer's experience of the redress outcome. The premise was that sitting in the shoes of the unsophisticated customer, the banks ought to be able to explain to us how they reached their decisions. We would then provide feedback, but importantly, we are not proposing to challenge the outcome".*<sup>1051</sup>

126. As with the recalibration exercise, the purpose of these meetings was to ensure a consistent customer-centric approach by the banks and Skilled Persons.<sup>1052</sup> The FCA: *"wanted to ensure that the banks were looking at cases in a way that was consistent with the Agreement, and with each other, and were presenting their outcomes to customers in a manner in which we thought the customer could understand. We did not, however, reach a determination as to whether each individual outcome presented was fair and reasonable. To make such a determination would have required a detailed assessment of all relevant information, which can often amount to several hundred documents".*<sup>1053</sup>
127. For these meetings, the FCA would identify a sample of customer cases to be discussed from a list of recent redress determinations across all nine banks<sup>1054</sup> and would occasionally add to this agenda where it had formed initial views on the handling of a particular customer's case.<sup>1055</sup> Given that only a sample of individual customer cases were examined in these meetings, it is difficult to assess the full extent to which these meetings changed the way the banks and Skilled Persons altered their wider approach to determining redress, or the impact on individual customers. However, the evidence shows that these meetings enabled banks and Skilled Persons to identify and, in some instances reconsider, both the approach that had been taken in relation to individual cases as well as wider considerations for determining redress.<sup>1056</sup>

---

<sup>1051</sup> FCA Records, *Email*, 23 January 2014, 1324060.

<sup>1052</sup> FCA Records, *Email*, 11 December 2013, 427877. See also FCA Records, *Cover email and attachment*, 11 December 2013, 465521 and 465522.

<sup>1053</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-009-0001, p. 14, para. 3.20.

<sup>1054</sup> FCA Records, *Email*, 13 January 2014, 469847.

<sup>1055</sup> FCA Records, *Email*, 26 November 2013, 1272896.

<sup>1056</sup> See, for example, FCA Records, *Email*, 26 November 2013, 1311600.

iv) *Break gains*

128. In February 2014, the FCA became aware of a potential issue in relation to break gains, and began investigating.<sup>1057</sup> Break gains arose in some cases when a customer was 'in the money' when they exited their IRHP. In these circumstances, rather than the break cost being payable by the customer to the bank, a break gain was payable by the bank to the customer. The Skilled Person for one of the banks reported to the FCA that it had found instances where bank staff appeared to have understated the value of the break gain to the customer and retained the difference as profit.<sup>1058</sup>
129. On 7 October 2014, Retail Banking Supervision prepared a draft paper proposing that the FCA supervisors should write to their respective banks to ask them to ensure they have in place robust policies and procedures to address this issue.<sup>1059</sup> The IRS Steering Group, and the Risk and Controls Committee considered the issue further in August and September 2015. It was agreed that: (i) this matter did not fall within the scope of the Scheme; (ii) all compliance assessments had now been completed; and (iii) the incidence appeared likely to be small (one of the first-tier banks reported to the FCA that around two per cent of its total IRHP sales were potentially impacted).<sup>1060</sup> As a result, it was determined that there was no scope "*within the existing IRHP review framework to consider those cases that are not already "self-corrected" as a result of a redress offer*". However, in instances where customers may remain out of pocket, "*Supervision teams could ask their firms to take reasonable steps to identify whether this issue potentially affects their customers, and where applicable, to consider whether redress is appropriate.*"<sup>1061</sup>

---

<sup>1057</sup> FCA Records, *Email*, 24 February 2014, 464724.

<sup>1058</sup> FCA Records, *Internal Document*, 1 May 2014, FCA-ADD-0110, p. 24, para. 54.5.

<sup>1059</sup> FCA Records, *Memorandum - Sub-DSRC Summary Paper – Interest Rate Hedging Products: Potential Overcharging/Misquoting of Break Costs/Break Gains*, 7 October 2014, 005346.

<sup>1060</sup> FCA Records, *Memorandum - Potential Misquoting of Break Costs/Gains*, 1 September 2015, 641385.

<sup>1061</sup> FCA Records, *Memorandum - Potential Misquoting of Break Costs/Gains*, 1 September 2015, 641385.



v) *Interest payments and consequential loss*

130. This section considers the issue of incorporating consequential loss and interest payments into the Scheme. In particular, this section examines how the FCA initially treated these items as distinct concepts in the Supplemental Agreements and the Exchange of Letters. Yet, by April 2014, the FCA had confirmed that interest payments and consequential loss should be considered together for the purposes of redress claims. Interest payments were subsequently described as a 'proxy' for consequential loss claims.
131. Neither interest payments nor consequential loss were considered or addressed in the Initial Agreement. Rather, the level of interest payable under the Scheme appears to have been determined by the FCA on 28 January 2013. At the meeting, the CSRC confirmed that: "*8% is a fair and reasonable interest rate*".<sup>1062</sup> The letters sent to banks dated 29 January 2013 confirmed that interest payments were payable. However, there was no explanation about the extent to which (if at all) it should be considered together with consequential loss. Rather, paragraph 33 of these letters deals only with interest rates and notes that "*[i]nterest should be paid on any redress due to Customers at a rate that is in line with the approach applied by the FOS, i.e. 8% a year simple, or in line with an identifiable cost that the Customer has incurred as a result of having to borrow money*".<sup>1063</sup>
132. The FSA had initially instructed external counsel to provide legal advice on the principles of recovery of consequential loss in November 2012.<sup>1064</sup> However, a reference to consequential claims was not introduced into the Scheme until the Exchange of Letters, which noted that "*Consequential loss" should be determined by reference to the general legal principles relevant to claims in tort or for breach of statutory duty (e.g. breaches of the FSA's rules). This will involve a consideration of causation and remoteness (i.e. whether the loss was reasonably foreseeable at the time of the breach of the Regulatory Requirements)*".<sup>1065</sup> These types of claims had not been included in the Pilot Review and,

---

<sup>1062</sup> FCA Records, *Internal Document*, 28 January 2013, FCA-B-0095, p. 13, final column.

<sup>1063</sup> FCA Records, *Letter*, 29 January 2013, FCA-ADD-0005, p. 32, para. 33.

<sup>1064</sup> We have seen evidence that Counsel was instructed in November 2012 for which a draft opinion and subsequent follow-up was provided to the FCA in December 2012. See, for example, FCA Records, *Email*, 30 November 2012, 340938; FCA Records, *Email*, 5 December 2012, 340988.

<sup>1065</sup> FCA Records, *Draft letter*, 29 January 2013, FCA-ADD-0005, p. 12, paras. 34-5.

without any detailed guidance, the banks and Skilled Persons turned to the FCA to explain exactly how redress for consequential loss should be calculated under the Scheme.

133. Accordingly, in July 2013 the FCA considered how the eight per cent interest and consequential loss provisions should be understood, which was described internally as a matter of "*deciphering what we intended by para 33 of our Annex to the 29 Jan letter*", prompting one of the FCA's legal advisers to comment: "*Unfortunately the January agreement doesn't provide an explanation of what the interest is intended to cover... it would be helpful to have a view from Technical as to what was intended/expected from para 33 when it was included and what the understanding with the banks is/was*".<sup>1066</sup>
134. As was noted by one of the banks, the issue of consequential loss "*became extremely onerous*".<sup>1067</sup> It not only delayed the implementation of the Scheme but also created a further risk of inconsistent approaches by banks and Skilled Persons. For example:
- a. In evidence to this Review, one Skilled Person noted that in respect of calculating consequential loss "*[w]e did have skilled persons forums where we used to talk about certain high-level principles and the sense, and it genuinely is a sense, is that people were applying different approaches to things*".<sup>1068</sup>
  - b. Osborne Clarke had not yet finished its assessment of the remaining consequential loss claims against HSBC when representatives from that firm gave evidence to this Review in February 2020,<sup>1069</sup> albeit, at that point, only four of 1,037 customers had yet to have their consequential loss claims concluded.
135. The primary "issue" was that "*the vast majority of consumers are making a claim for consequential loss*", but the legal advice taken by both the FCA and the Skilled Persons was that redress in relation to consequential loss "*will only be granted in very few occasions*". As such, customers were likely to be disappointed, and the timelines for settling claims under the Scheme much extended.<sup>1070</sup> The evidence given to this Review

---

<sup>1066</sup> FCA Records, *Email*, 31 July 2013, 1267152.

<sup>1067</sup> Meeting Transcript DX (P71:L11).

<sup>1068</sup> Meeting Transcript GQ (P25:L11-14).

<sup>1069</sup> Meeting Transcript Osborne Clarke (P3:L14 and P36:L19).

<sup>1070</sup> FCA Records, *Email*, 11 July 2013, 001820.

by an FCA employee at the relevant time was that the FCA found it difficult to bridge the gap between what customers were claiming, and the banks' position on claims, based on legal advice. One FCA employee commented: "*There was a lot of expectation on the part of the consumers... that they would automatically be very easily able to establish the consequential loss... and that's where it became quite difficult to manage. Because we knew the legal position. The banks knew the legal position...we did publish a document on our website that would help [with] managing expectations in this respect*".<sup>1071</sup>

136. In August 2013,<sup>1072</sup> the FCA issued a paper on consequential loss to the Skilled Persons and in September 2013 published information on its website<sup>1073</sup> in an attempt to better "*manage expectations around the types of losses that customers are more and less likely to be able to claim*".<sup>1074</sup> An FCA employee described to this Review the context of the decision to publish guidance: "*it was only published because there was a lot of noise...it was quite reactive*".<sup>1075</sup>
137. The public guidance published by the FCA in September 2013 came after many customers would have begun preparing their claims, but, for the first time, the FCA gave examples of the kinds of claims that might fall within the scope of consequential loss. It also included advice to customers as to claims for loss of profit. In particular, it said that "*if customers make a successful claim for loss of profits, this is likely to replace the 8% simple interest per year that the banks' initial redress offers will include and customers will not be able to claim both a loss of opportunity and interest where this would amount*

---

<sup>1071</sup> Meeting Transcript T (P56:L25-P57:L10).

<sup>1072</sup> FCA Records, *IRHP Reviews - Expectations of the Skilled Persons in relation to consequential loss claims*, undated, FCA-C-009-0015. A draft of this document was initially circulated to banks on 1 August 2013; see, for example, FCA Records, *Cover email and attachment*, 1 August 2013, 413045 and 413046.

<sup>1073</sup> The Financial Conduct Authority, "*Fair and reasonable redress*", archived on 4 September 2013, accessible at <https://webarchive.nationalarchives.gov.uk/20130904094655tf/http://www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products/fair-and-reasonable-redress>.

<sup>1074</sup> FCA Records, *'IRHP Reviews – Expectations of the Skilled Persons in relation to consequential loss claims'*, 15 August 2013, FCA-C-009-0015.

<sup>1075</sup> Meeting Transcript T (P58:L22-P59:1).

to "double recovery".<sup>1076</sup> In that context, the FCA also commented that: "*We hope this means that many customers can avoid making consequential loss claims which are likely to take longer to assess*".<sup>1077</sup> The IRS Steering Committee returned to the issue in February 2014, following a number of complaints made by Bully-Banks, but decided no further action was necessary.<sup>1078</sup>

138. By April 2014, the FCA confirmed that interest payments and consequential loss should be considered together, with customer communications describing the eight per cent interest payments as being a proxy for consequential loss.<sup>1079</sup> Further, it sought to discourage customers from making consequential loss claims unless they exceeded the value of the eight per cent interest payable on basic redress.<sup>1080</sup> It would appear that one reason for the FCA's change of position was that the timelines for implementing the Scheme had not taken into account the number and complexity of the consequential loss claims that would be made by customers. Indeed, in July 2013 the FCA met with the first-tier banks and their Skilled Persons and "[b]roadly, the view was that the volume and complexity of [consequential loss] claims would mean that reviews would take significantly longer than 12 months to complete",<sup>1081</sup> and: "*they said that if we (FCA, banks and skilled persons) do not find a pragmatic solution for the issue of consequential losses this will derail the review*".<sup>1082</sup>
139. A separate issue emerging from these consequential loss claims for the FCA to consider was whether to accept the argument raised by certain customers and their representatives that the Scheme should allow for basic redress and interest to be paid before

---

<sup>1076</sup> The Financial Conduct Authority, "*Fair and reasonable redress*", 4 September 2013, accessible at

<https://webarchive.nationalarchives.gov.uk/20130904094655/http://www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products/fair-and-reasonable-redress>.

<sup>1077</sup> The Financial Conduct Authority, "*Fair and reasonable redress*", 4 September 2013, accessible at

<https://webarchive.nationalarchives.gov.uk/20130904094655/http://www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products/fair-and-reasonable-redress>.

<sup>1078</sup> FCA Records, *IRS Steering Committee Minutes*, 6 February 2014, 467483.

<sup>1079</sup> FCA Records, *Internal Document*, 15 April 2014, FCA-C-009-0013, pp. 11-12.

<sup>1080</sup> FCA Records, *Internal Document*, 15 April 2014, FCA-C-009-0013, p. 11.

<sup>1081</sup> FCA Records, *Email*, 17 July 2013, 1317474.

<sup>1082</sup> FCA Records, *Email*, 10 July 2013, 001820. See further FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-009-0001, p. 14, paras. 4.1-4.4.

consequential loss claims were considered. It appears that the banks were hesitant to do this as they feared that customers would use the redress funds to appoint advisers to support consequential loss claims, which put both the costs and timescales of the project at risk.<sup>1083</sup> On the other hand, customers were keen not to be deprived of the basic redress offers for any longer than was necessary.<sup>1084</sup> A decision was taken by the FCA in October 2013<sup>1085</sup> to side with customers, and it persuaded eight out of the nine banks to agree to separate basic redress and consequential loss payments as a means of delivering appropriate redress to customers as soon as possible.<sup>1086</sup> One Skilled Person commented that the decision to separate basic and consequential loss payments was "*absolutely the right thing to do*" to ensure money could be returned to customers to "*stop people, frankly, going bust if they are teetering*".<sup>1087</sup> One of the first-tier banks agreed at the time that separating the payments "*was an effective solution in expediting cash flow to those in severe financial distress*".<sup>1088</sup>

140. The issue of consequential loss also led to the appointment of additional Skilled Persons assigned exclusively to consider consequential loss claims. For example, the scale and complexity of the task was such that Deloitte, Skilled Person 1 for HSBC, decided that it did not have sufficient resources and skills to apply the applicable legal principles in a timely manner. Despite concerns internally that such an appointment may "*potentially weaken [the FCA's] position that all skilled persons within the review are appropriately qualified to meaningfully assess and challenge whether the banks have applied the legal principles in a fair and reasonable manner*",<sup>1089</sup> the FCA approved the appointment of a

---

<sup>1083</sup> FCA Records, *Email*, 10 July 2013, 001820.

<sup>1084</sup> FCA Records, *Email*, 11 July 2013, 001820.

<sup>1085</sup> FCA Records, *Email*, 24 October 2013, 004331.

<sup>1086</sup> FCA Records, *Internal Document*, 15 April 2014, FCA-C-009-0013, p.17. Barclays instead agreed to an interest-free loan equal to the value of redress to customers in financial difficulties on a case-by-case basis; see FCA Records, *Email*, 22 October 2013, 1317419. By 21 November 2013, the FCA had begun noting that "*all banks have agreed to split payments for initial redress and consequential loss, except Barclays*", FCA Records, *FCA Board Papers and Minutes*, 12 December 2013, 530960, p. 12, para. 33.2. See also FCA Records, *Cover email and attachment*, 5 December 2013, 1325601 and 1325605.

<sup>1087</sup> Meeting Transcript GQ (P58:L13-20).

<sup>1088</sup> FCA Records, *Email*, 8 October 2013, 422760.

<sup>1089</sup> FCA Records, *Memorandum - IRS Proposal - HSBC proposal for consequential loss claims to be reviewed by SJ Berwin instead of Deloitte*, 2 October 2013, 1317159, para. 17.

separate team at the law firm SJ Berwin (later Osborne Clarke)<sup>1090</sup> to be the Skilled Person for all the consequential loss claims made by eligible customers of HSBC.<sup>1091</sup>

141. In addition to these concerns around the resources and expertise needed to appropriately and efficiently assess such claims, it would appear that this approach presented difficulties in ensuring the fair treatment for customers, with one Skilled Person stating in evidence to this Review that:

*"the "legal principles" approach [for consequential loss] ...did not serve customers well except in the most straightforward and/or inarguable of circumstances. The primary challenge of this approach was that, whereas in legal proceedings there is a judge who hears each side's interpretation of the principles and precedents then reaches a decision on who is most correct in law, under the review Skilled Persons were arguing against the bank with no-one to act as arbiter. Given the potentially large sums involved...it was inevitable that the banks would put up a robust challenge and it was extremely difficult to overcome their reluctance to concede on the grounds of fair treatment of customers as opposed to strict legal application."*<sup>1092</sup>

142. When discussing the time-consuming nature of these claims in oral evidence, Barclays' Programme Director for their IRHP redress scheme noted that *"they could involve quite a lot of information being sent in to substantiate the claim"*<sup>1093</sup> and as with any case-by-case review *"when you've got a sales process that could have run over many weeks or months in the lead up to the sale being executed, they will always take time in terms of making sure that you've given due [consideration] to all of the artefacts and the information surrounding the sale"*.<sup>1094</sup> For instance, despite law firms having experience of litigating claims for consequential loss, the average number of hours taken by lawyers

---

<sup>1090</sup> Later KWM, following the merger between those two firms, and then Osborne Clarke, following the collapse of KWM in late 2016 and transfer of relevant partners and staff from KWM to Osborne Clarke.

<sup>1091</sup> FCA Records, *Requirement Notice*, 22 March 2013, 825987; and FCA Records, *Memorandum - IRS Proposal - HSBC proposal for consequential loss claims to be reviewed by SJ Berwin instead of Deloitte*, 2 October 2013, 1317159. See also FCA Records, *Email*, 4 October 2013, 437278.

<sup>1092</sup> Written Representation HW, 31 January 2020.

<sup>1093</sup> Meeting Transcript Barclays, (P77:L10-13).

<sup>1094</sup> Meeting Transcript Barclays, (P77:3-7).

at Skilled Person 2 for HSBC on particularly complex cases, known as "outliers", was 96 (the equivalent of twelve eight-hour days) and the overall average time was 21.4 hours per case. That serves to illustrate the scale of the exercise. The figures for Skilled Person 2 for HSBC also follow the general trend that was evident across the Skilled Persons' reports, namely that the majority of consequential loss claims were unsuccessful. Out of a total of 5,533 claims (related to 1,029 files),<sup>1095</sup> HSBC accepted 1,252 (or 23 per cent) in whole or in part and rejected 4,281 in full. In total, across all of the banks, these claims yielded less than £50 million for customers claiming losses over and above eight per cent interest a year,<sup>1096</sup> compared with nearly £2.2 billion paid to customers for basic redress.<sup>1097</sup>

vi) *Tailored Business Loans*

143. As discussed at Chapter 2, the FCA had concluded that the scope of the Scheme should be limited to stand-alone IRHPs, rather than include TBLs, given that they were outside the regulatory perimeter. However, that did not mean that the issue was resolved, as many customers and their representatives (both professional and in Parliament) continued to advocate for the FCA to take action in relation to these products. The evidence to this Review from FCA employees indicates that they understood and empathised with the difficulties in understanding and communicating the technical basis for the exclusion of such products from the Scheme: *"It's trying to understand, trying to explain something that is only excluded because of a technicality, a legal technicality to someone that when they feel the consequences of both products it feels exactly the same. So it's very complex. But the legal position is that TBLs are embedded -- that a loan with an embedded swap is outside of the FCA perimeter. And then if you have a loan with a separate swap, the*

---

<sup>1095</sup> FCA Records, Skilled Person report (HSBC), 6 September 2017, pp. 2-5 and 15 (REPORT 017).

<sup>1096</sup> The Financial Conduct Authority, *"IRHP: claims for consequential loss"*, 4 November 2016, accessible at <https://www.fca.org.uk/consumers/interest-rate-hedging-products/claims-consequential-loss> (ARTICLE 023). As of September 2016 £509 million was payable to customers in respect of consequential loss, comprising of £463 million where eight per cent a year simple interest was added to offers and £46 million for losses over and above eight per cent a year.

<sup>1097</sup> The Financial Conduct Authority, *"Progress of sales through stages of the review as at 30 September 2016 – All banks"*, 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf> (ARTICLE 026). At 30 September 2016, customers had accepted basic redress offers amounting to £2,197,000,000 including eight per cent a year simple interest.

*swap is in the regulated perimeter. But if you have taken a loan with a swap, whether they are together or separate you [i.e. the customer] wouldn't know the difference.*"<sup>1098</sup>

144. Following the "legal cutover" from the FSA to FCA in April 2013, a new requirement to investigate and report on regulatory failure came into force.<sup>1099</sup> Shortly after this, a member of the IRS Steering Group raised with Martin Wheatley the fact that TBLs were falling outside of the FCA's regulatory perimeter was arguably a regulatory failure.<sup>1100</sup> Following internal discussion and consultation, it was decided that, since the detriment largely occurred before 1 April 2013, it fell outside the scope of the legislation and therefore would not be the subject of a regulatory failure investigation under section 73 FSMA.<sup>1101</sup> While the FCA sought to exercise some regulatory pressure on the banks to extend the Scheme to TBLs, the result was that by December 2013, only one bank agreed to voluntarily review their TBL portfolio and accepted to do so in relation to their fixed rate loans only.<sup>1102</sup>
145. Notwithstanding the FCA's conclusion that these products fell outside its regulatory remit, amidst continued concern from MPs and the public about the sale of TBLs, these loans continued to be on the FCA's agenda during the Scheme's implementation.
146. For instance, in May 2013, Martin Wheatley sent a letter to the Financial Secretary to the Treasury, Greg Clark MP, stating that customers with a TBL may be faced with exactly the same repayment features and same "*potentially large*" break costs as a customer with a loan and a stand-alone IRHP. Citing FCA data that more than 60,000 TBLs had been

---

<sup>1098</sup> Meeting Transcript T (P60:L21-P61:L8).

<sup>1099</sup> Under section 73 of the FS Act 2012, which came into force on 1 April 2013, the FCA is required to carry out an investigation and produce a report when: (i) events have occurred in relation to a regulated person or others which indicated a significant failure to secure appropriate consumer protection, or had or could have had a significant adverse effect on its integrity or competition objectives; and (ii) the events might not have occurred or the adverse effect might have been reduced but for a serious failure in the system established by FSMA or the operation of that system; The Financial Conduct Authority, "*How the FCA will investigate and report on regulatory failure*", April 2013, pp. 28-30 accessible at <https://www.fca.org.uk/publication/corporate/how-fca-will-investigate-and-report-regulatory-failure.pdf> (ARTICLE 016).

<sup>1100</sup> FCA Records, *Email*, 17 April 2013, 542023.

<sup>1101</sup> FCA Records, *Memorandum - 'IRHP Scheme Lessons Learned Review'*, 3 February 2015, 006262.

<sup>1102</sup> FCA Records, *IRHP Steering Committee Minutes*, 17 December 2013, 427890.



sold since 2001,<sup>1103</sup> "*significantly more than the 40,000 IRHP covered by our review,*" Martin Wheatley reiterated that "*there is a risk that banks may consider 'embedding' all their IRHPs into commercial loans in future, and thus avoid our regulatory oversight altogether*".<sup>1104</sup> However, it was ultimately a decision for HMT to determine whether to extend the FCA's remit to cover such products: "*this matter is one for Government to consider and lead on*".<sup>1105</sup>

147. Whilst the FCA reiterated its internal position in a March 2014 ERIC Summary Paper that the sale of these products is not a regulated activity and instead falls within the FOS's jurisdiction,<sup>1106</sup> it felt the need to obtain Counsel's advice to confirm this only months later.<sup>1107</sup> Subsequently, it confirmed to Andrew Tyrie MP that the FCA's position was consistent with this legal advice.<sup>1108</sup>
148. Thereafter, the FCA continued to monitor the situation, noting in May 2014 that it "*is reaching out to a number of banks and we are now seeking the submission of standardized information on a quarterly basis regarding loans with embedded derivatives*".<sup>1109</sup> The evidence suggests that it was only in October 2015 that this issue was effectively removed from meeting agendas with a "*Steering update*" stating that, even if Parliament extended the FCA's remit to cover these loans, it could not take action retrospectively.<sup>1110</sup> In addition to TBLs remaining a focus for the FCA, it collected

---

<sup>1103</sup> FCA Records, *Letter*, 9 May 2013, 419253.

<sup>1104</sup> In a 25 February 2013 letter to the Financial Secretary to the Treasury, Greg Clark MP, Martin Wheatley noted the FSA's concern that banks might respond to the FSA's intervention on IRHPs and "*take advantage of the limits to our regulatory remit in the future*" by designing products with embedded (rather than stand-alone) hedging features. FCA Records, *Letter*, 25 February 2013, 755210.

<sup>1105</sup> FCA Records, *Letter*, 9 May 2013, 419253, p. 2.

<sup>1106</sup> FCA Records, *Internal Document*, 31 March 2014, 1276333.

<sup>1107</sup> FCA Records, *Instructions to Counsel*, 16 May 2014, 485829; and FCA Records, *Email*, 4 June 2014, 005385.

<sup>1108</sup> FCA Records, *Letter*, 26 June 2014, 584652. The TSC subsequently instructed its own Leading Counsel to review the advice that the FCA received from Leading Counsel on its powers in respect of TBLs; see FCA Records, *Treasury Committee Opinion*, 7 January 2015, 1328013.

<sup>1109</sup> FCA Records, *Email*, 15 May 2014, 496015.

<sup>1110</sup> FCA Records, *Memorandum – IRHP review - Steering Update 14 October 2015*, 14 October 2015, 676735.

customer complaints data from banks on these loans and remained aware of the proactive business reviews that various banks were privately carrying out.<sup>1111</sup>

vii) *Contingent liability*

149. The question of contingent liability was brought to the FCA's attention during the implementation of the Scheme, and has been raised a number of times in evidence to this Review.<sup>1112</sup> In summary, the contingent liability associated with an IRHP is the internal calculation made by the bank (and each bank may calculate such values slightly differently, based on their own modelling approach) of the customer's potential exposure to the bank in an extreme scenario.<sup>1113</sup> It has been suggested by certain customers and representative groups that the Scheme Terms failed to take into account the impact of the banks' calculation of the contingent liability of IRHPs (at the point of sale, and subsequently) on a customer's creditworthiness and available credit lines.<sup>1114</sup> As a result, it is argued, many customers were not adequately compensated (at either basic redress or consequential loss stage). It is said, firstly, that if a customer had been informed at or before the point of sale that the bank had assessed its potential exposure to any or a particular IRHP as being significant (i.e. the bank considered there was risk that the customer might not be able to afford to make ongoing payments due under the loan/IRHP in an extreme interest rate environment), then the customer may have either decided to purchase an alternative product, or no product at all. In addition, it is argued that the banks' internal assessments of a customer's creditworthiness having entered into an IRHP impacted upon its ability to: (i) re-bank (re-finance existing borrowings with a different lender); (ii) borrow further funds; or (iii) remain within maximum/peak borrowing

---

<sup>1111</sup> By 30 May 2018, three further banks had agreed to carry out past business reviews. FCA Records, *Memorandum - Briefing on Fixed Rate Commercial Loans*, 30 May 2018, 1328015.

<sup>1112</sup> See, for example, FCA Records, *Letter*, 17 April 2013, 1100288, point 10; and FCA Records, *Letter*, 27 June 2013, 405074. The point was also raised in the Manches judicial review claim; see FCA Records, *Witness statement of Simon Bridbury in R (New Century Care Homes Limited and others) v Financial Conduct Authority*, 29 April 2013, 459499, paras.32-38.

<sup>1113</sup> Meeting Transcript N, (P50:L8-P51:L24).

<sup>1114</sup> For instance, one stakeholder gave evidence to this Review that "*a crucial problem that we're finding is that actually was contingent liability ever investigated by the scheme?*"; Meeting Transcript Q (P37:L24-P:38:L1).

commitment ratios or other banking covenants, which may have taken contingent liability into account.

150. This Review has considered the documentary evidence on this topic, including the evidence from customers, customer groups, individuals at the FCA at the time, banks and Skilled Persons:

- a. An independent financial adviser suggested to this Review that customers should have been made aware of the contingent liability calculated by the banks in relation to each IRHP trade, at the point of sale: *"The idea that people could just sell an investment, tell people there might be a break cost and put credit in place without telling them for those losses was just to me stunning, it was just absolutely criminal."*<sup>1115</sup>
- b. In its written representation given to this Review, the APPG echoed this view, commenting that *"without full disclosure of this issue unsophisticated customers would not have been able to make an informed decision about which IRHP, if any, to enter into"*.<sup>1116</sup>
- c. In evidence to this Review, one IRHP customer noted the impact on a customer's borrowing capacity with their bank: *"The majority of small businesspeople [sic.] were overwhelmed with this sudden liability"*.<sup>1117</sup>

151. This Review has not found evidence of the FCA recognising this as a potential issue until many months into the implementation of the Scheme. There does not appear to have been any substantive discussion of this topic during the scoping of the issues in the spring of 2012, nor the design and negotiation of the Scheme Terms between June 2012 and January 2013.

152. However, when it was considered by the FCA, on 19 November 2013, the issue was summarised in internal correspondence thus:

---

<sup>1115</sup> Meeting Transcript X (P11:L16-20).

<sup>1116</sup> Written Representations APPG, 24 January 2020, p. 11 (WRITTEN REPRESENTATION 001).

<sup>1117</sup> Meeting Transcript W (P26:L5-7).

*"It has been suggested, at least in relation to one bank, that even if a customer didn't break their IRHP, the (unrealised) MTM [mark to market] loss could still have had a detrimental effect on customers. For example, requiring additional security or in one case, not allowing the customer to re-mortgage the loan with another bank unless the liability was settled. There doesn't seem to be any indication that this was disclosed to customers at the point of sale".*<sup>1118</sup>

153. The matter was further discussed at a meeting of the FCA's IRS Technical Group the following day.<sup>1119</sup> Though this Review has not seen any notes of, or a record of, actions arising from this meeting, subsequent FCA correspondence demonstrates the FCA's settled position on this point. It considered that the Scheme Terms already addressed the serious failure of banks to adequately explain the risks of IRHPs, and the potential costs arising from them, particularly in a falling or low interest environment. For example, in a March 2015 letter to a customer's representative who had raised this point, the FCA responded:

*"The contingent liability is an internal risk monitoring tool for the banks to estimate their potential credit exposure to the customer. The customer's actual exposure on an interest rate swap only arises from market movements in interest rates. The review scheme assesses whether or not the banks sufficiently explained this risk to customers. Further, the review considers whether or not the customer would likely have entered into a swap had they understood the risk of downward movements in interest rates".*<sup>1120</sup>

154. This issue has been brought to the High Court's attention on a number of occasions and it has similarly described the calculation made by the banks as being an internal risk monitoring tool. In November 2020, the High Court described it as *"a bank's internal and subjective estimate of the near worst-case risk to the bank, at any given time, of default by the customer under the IRHP"*.<sup>1121</sup> In addition, the courts have commented that

---

<sup>1118</sup> FCA Records, *Email*, 19 November 2013, 428040.

<sup>1119</sup> FCA Records, *Email*, 20 November 2013, 1323925, FCA Records, *Email*, 20 November 2013, 1323949.

<sup>1120</sup> FCA Records, *Letter*, 27 March 2015, 581351.

<sup>1121</sup> Fine Care Homes Limited -v- (1) National Westminster Bank Plc (2) Natwest Markets Plc [2020] EWHC 3233 (Ch), 126.

this calculation "*is not a contingent liability of the customer*"<sup>1122</sup> and there was no specific requirement for a bank to disclose its internal credit limits to IRHP customers at the point of sale.<sup>1123</sup>

155. It is slightly less clear how contingent liability was assessed at the consequential loss claim stage, if at all. In the absence of any centralised guidance from the FCA about how a customer's inability to re-bank/refinance or meet financial covenants in light of the contingent liability should be redressed, it may well be that customers did not receive consistent outcomes. In addition, customers faced the general difficulty of proving causation (particularly in the context of a global recession) as between a bank's mis-selling and the customer's subsequent inability to make payments/meet covenants.
156. One Skilled Person who gave evidence to this Review said that it was taken into consideration when assessing consequential loss claims: "*For the claims where they said that they would have sought to borrow, if there were records that showed that their borrowing was declined because their credit line was too high (and that would not have been the case had the IRHP credit line not been included) then that would be a successful loss of profits claims. If what happened was that their interest rating increased because of the size of their credit line (and that would not have been the case had the IRHP credit line not been included) then the bank would run a calculation on the entirety of their borrowing of the difference between the interest rate that it would have been with a credit risk rating that was that much lower to the credit risk with the IRHP-- to the interest rate that it actually was charged and they would pay them the difference*".<sup>1124</sup> However, the FCA did not require Skilled Persons to report specifically on this point, and so it is not clear that every bank and Skilled Person approached these claims in the same way.

viii) *FCA resourcing and system of governance during implementation*

---

<sup>1122</sup> Fine Care Homes Limited -v-(1) National Westminster Bank Plc (2) Natwest Markets Plc [2020] EWHC 3233 (Ch), 127. See also Ramesh Parmar & Anor -v- Barclays Bank Plc [2018] EWHC 1027 (Ch), 209.

<sup>1123</sup> See, for example, Property Alliance Group Limited -v- The Royal Bank of Scotland plc [2018] EWCA Civ 355, 78-81; and Fine Care Homes Limited -v- (1) National Westminster Bank Plc (2) Natwest Markets Plc [2020] EWHC 3233 (Ch), 125-138.

<sup>1124</sup> Meeting Transcript GQ (P51:L12-25).

157. At the beginning of the implementation of the Scheme, the newly-formed FCA changed its system of internal governance of the project. It devolved significant responsibilities to individuals who had not been involved in the earlier stages of the project, whilst others, who had been central to the negotiations and design of the Scheme, moved on to other internal and external roles. This is confirmed in the evidence given in the Holmcroft case:

*"In April 2013 the new regulatory system, involving the replacement of the FSA by the FCA and Prudential Regulatory Authority took effect. At this time the FCA took the opportunity to restructure some of the teams within the FCA's Supervision Division. As part of this restructuring, central management of the FCA's project on Interest Rate Hedging Products was transferred to my team [the Complex Event Driven Work Team]. From April 2013, I have managed the FCA's project on the past business review and redress exercise relating to the sale of IRHPs".*<sup>1125</sup>

158. Though the CEDW Team was responsible for the day-to-day management of the implementation of the Scheme, that *"small team was not a decision-maker as such"*,<sup>1126</sup> with some decisions taken by the IRS Steering Group<sup>1127</sup> or escalated internally as appropriate. In its evidence given in Holmcroft, the FCA provided a summary of the activities of the CEDW Team:

*"My team has liaised closely with both the banks and the independent reviewers [or Skilled Persons] appointed by them to review claims for redress by eligible customers. At a general level, our role in this regard has been to ensure that there is consistency of approach, proper application of the methodology agreed with the FCA, timely delivery of redress to customers and appropriate independent review of the banks' decisions in relation to claims for redress ... The FCA has been closely involved in providing oversight of these matters, including through dialogue and*

---

<sup>1125</sup> FCA Records, *Witness statement on behalf of FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-009-0001, para. 1.6.

<sup>1126</sup> Meeting Transcript T (P15:L25-P16:L1).

<sup>1127</sup> Meeting Transcript T (P15:L10-14): *"every time that we would encounter a bump, and there were many of them in relation to the sophistication test, in relation to consequential losses et cetera, we would bring these issues to this steering group for decision"*.

*correspondence with the banks, independent reviewers, customers and other stakeholders.*"<sup>1128</sup>

159. In its evidence given in Holmcroft, the FCA emphasised that the FCA had "*liaised closely*" with the banks and the Skilled Persons as well as being "*closely involved*" in providing oversight. This "*liaison*" which was required in relation to the review of a total population of customers of nine banks of just over 30,000 sales<sup>1129</sup> rested on a very small, dedicated unit numbering only a handful of people at any one time.<sup>1130</sup> Admittedly, the CEDW Team worked with others at the FCA, and provision was made for individuals in the IRS Steering Group and the IRS Technical Group to be involved (at least in the first year of the implementation of the Scheme). Nonetheless, even with the assistance of other individuals in the IRS Steering Group and the IRS Technical Group, the FCA's available resource was dwarfed by the resources employed by the Skilled Persons and the banks. In its evidence given in Holmcroft, the FCA stated that the banks had paid "*roughly £300 million*" to the Skilled Persons and "*incurred roughly £500 million [in] administrative costs*".<sup>1131</sup> The Scheme was far from over when this evidence was provided in September 2015. The FCA's Annual Report and Accounts 2019/20 show that the updated Skilled Persons' costs (borne by the banks) for the Scheme (at the time of writing, some of which are still ongoing) were £420.5 million as at 31 March 2020.<sup>1132</sup>
160. The IRS Steering Committee was certainly aware of the constraint faced by the FCA due to a lack of resources. In October 2013, the Steering Committee asked the CEDW Team

---

<sup>1128</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-009-0001, para. 1.8.

<sup>1129</sup> The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf> (ARTICLE 026). The data records that the total review population across the banks was 30,784. Of these, 20,207 sales were assessed as "non-sophisticated".

<sup>1130</sup> Meeting Transcript T, (P12:L18-P13:L21): "*I was the manager, [FCA employee I] was the lead, then I had [xx] and [yy] doing like the associate work. [zz], who was our administrator*".

<sup>1131</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-009-0001, para. 5.2

<sup>1132</sup> The Financial Conduct Authority, "*FCA Annual Report and Accounts 2019/20 (for the year ended 31 March 2020)*", 10 September 2020, accessible at <https://www.fca.org.uk/publication/annual-reports/annual-report-2019-20.pdf#page=159> (REPORT 001).

whether it "[was] monitoring the quality of the offers. The IRS Central Team explained that we checked the first 10 offers made by the banks and provided detailed feedback to each bank. After that, we are relying on the robustness of the process that is in place (i.e. checks by the Skilled Persons). Steering queried whether we should be doing more in this space. Central explained that the main issue is resources, we do not have sufficient resources to check all offers made (or to QA [quality assure] a sample of offers)."<sup>1133</sup>

Commenting on the feedback provided by the FCA on customer files, a Skilled Person noted in evidence given to this Review that "[t]he priority was seeing that we were hitting the numbers. I do not recall any quality control over individual files."<sup>1134</sup>

161. Limited resource was identified as a risk to the project by the IRS Steering Committee on 13 November 2013.<sup>1135</sup> Despite this, the resources for the FCA's oversight of the Scheme were not increased, and were in fact reduced during the implementation of the Scheme. A member of that team described the impact: "*We were overstretched. We were very busy, working very long hours...it was very intense*".<sup>1136</sup> The same individual commented, however, that while this lack of resources placed strain on the team it was not, in their view, a factor in the failure to ensure that all customers had a redress outcome by December 2013. This was caused, they said, by the fact that "*the review was much more complicated than originally anticipated*" and it therefore took "*much, much longer than expected*" for the banks to be "*able to start making determinations and making offers*".<sup>1137</sup> This would suggest that the FCA did not fully anticipate the scale and complexity of the process it had designed. In evidence given to this Review, the FCA's resourcing was also highlighted by the banks and Skilled Persons, with Skilled Person 2 for HSBC commenting that "*[t]here were several changes in the personnel who were involved at the FCA so continuity was a slight concern*."<sup>1138</sup>

---

<sup>1133</sup> FCA Records, *IRS Steering Committee Minutes*, 22 October 2013, 439925, para.12.

<sup>1134</sup> Written Representations SR, 17 August 2020, p. 7.

<sup>1135</sup> FCA Records, *IRS Steering Committee Minutes*, 13 November 2013, 429896.

<sup>1136</sup> Meeting Transcript T, (P20:L9-13).

<sup>1137</sup> Meeting Transcript T, (P19:L23-P20:L2).

<sup>1138</sup> Written Representations KWM, 17 August 2020, p. 6.



ix) *Consideration of the FCA's enforcement powers*

162. While the CEDW Team within Supervision was primarily responsible for overseeing the Scheme, at various points between 2013 and 2015 the Enforcement division was consulted as to whether the FCA should consider using its enforcement powers against the banks and individuals at the banks.<sup>1139</sup> During this period, the FCA identified that a referral to Enforcement would be "*an opportunity to achieve a public message in respect of the root causes of the failings*"<sup>1140</sup> and send "*a strong message to the industry that the FCA does not tolerate widespread poor conduct, and the argument that credible deterrence requires more than firms simply putting right the damage caused by their misconduct through redress exercises*".<sup>1141</sup> The FCA identified further benefits of an Enforcement referral including that it "*will allow us to consider the root cause of the mis-selling, which has not been considered to date. This consistent standard of investigation will allow us, if appropriate, to differentiate clearly between banks in the outputs of any investigation*".<sup>1142</sup>
163. One hesitation about taking such action arose from the considerable time that had passed since the misconduct first came to light publicly in 2012. Commenting in a 4 January 2013 internal Lessons Learned Review meeting with members of the Enforcement, FCA Employee C noted that "*I have the feeling that it is off the table ... We can do it legally. Whether we should do it is another question*".<sup>1143</sup> By November 2013, Enforcement already recognised the risk that enforcement action "*could already be perceived as too late*" and flagged the possibility that the banks' "*approach to the redress exercises will be negatively impacted as a result of a referral to Enforcement*".<sup>1144</sup> Enforcement was

---

<sup>1139</sup> FCA Records, *Email*, 13 May 2013, 1099564; and FCA Records, *Memorandum – Interest Rate Hedging Products: pros and cons of potential Enforcement referral*, 12 November 2013, 1095206.

<sup>1140</sup> FCA Records, *Internal Document*, 18 April 2013, 373954, p.10. In addition a 14 January 2014 ExCo paper recognised that "*An Enforcement referral will also send a strong message to the industry that the FCA does not tolerate such widespread poor conduct*." FCA Records, *Internal Document*, 14 January 2014, 467008, p.8.

<sup>1141</sup> FCA Records, *Internal Document*, 20 January 2015, 1324751, p. 4.

<sup>1142</sup> FCA Records, *Internal Document*, 20 January 2015, 1324751, p. 10.

<sup>1143</sup> FCA Records, *Internal Document*, 4 January 2013, FCA-ADD-003-0057, p. 6.

<sup>1144</sup> FCA Records, *Internal Document*, 12 November 2013, 1102839. Additionally, by January 2015, the FCA noted that "*any messages coming out of Enforcement referrals are likely to have less impact now (given that they will come many years after the misconduct first came to light publicly*

nonetheless of the view that *"the four banks should be referred to Enforcement now for investigation"* noting that *"there are circumstances to suggest widespread and serious breaches, and the public rightly expects us to discipline those who have caused what appears to be very significant customer detriment."*<sup>1145</sup>

164. A 27 January 2014 DSRC Summary Paper notes that *"[t]o date, capacity for new referrals has been significantly affected"* by the allocation of resources to another investigation within Enforcement. The paper additionally notes that *"[i]n relation to Retail Enforcement, we now have capacity to consider further referrals over the coming months."*<sup>1146</sup>

165. Despite this increased capacity and the *"considerable time"* Enforcement spent *"considering the issues, identifying relevant information, and presenting the relevant factors to senior management"*,<sup>1147</sup> by January 2015 the FCA decided against referring the banks to Enforcement as it *"may lose the goodwill generated to date with the banks"* and *"an Enforcement referral might prevent us from obtaining similar voluntary agreements in the future."*<sup>1148</sup> It further noted that *"[t]he decision was made in February 2014 not to refer firms at that stage, and what we have learned about the misconduct since then does not make it any more serious in our view. In addition, the passage of a further year reduces the impact which the FCA would achieve from any messages coming out of the enforcement action."*<sup>1149</sup>

166. The January 2015 ExCo Summary Paper recommended investigating whether there had been failings by senior management at the banks, as it would not *"be appropriate for customer detriment to have been caused on such a scale without anyone being held to account"*.<sup>1150</sup> A suggestion was made for a preliminary investigation to be carried out using the FCA's general investigation powers under section 167 FSMA, with an

---

*in 2012) and might also cause evidential difficulties";* FCA Records, *Internal Document*, 20 January 2015, 1324751.

<sup>1145</sup> FCA Records, *Internal Document*, 12 November 2013, 1102839, p. 4, para. 19.

<sup>1146</sup> FCA Records, *Internal Document*, 27 January 2014 447332, p. 2.

<sup>1147</sup> FCA Records, *Email*, 18 February 2014, 475397.

<sup>1148</sup> FCA Records, *Internal Document*, 20 January 2015, 1324751, p. 10.

<sup>1149</sup> FCA Records, *Internal Document*, 20 January 2015, 1324751, p. 10.

<sup>1150</sup> FCA Records, *Internal Document*, 20 January 2015, 1324751.

accompanying public announcement confirming this action. This was rejected by ExCo in favour of a "very limited (non-public) investigation carried out to establish the prospect of bringing a successful case against one or more individuals".<sup>1151</sup> This Review has not seen any evidence to suggest that any such investigation was ever carried out, and an FCA case report tracker records that in February 2015 the "*feedback from Directors [was] that the limited scoping exercise [in respect of potential enforcement action against individuals] should be put on hold while plans for the lessons learned review are finalised.*"<sup>1152</sup> Following discussions between the FCA and TSC on 11 February 2015 regarding the difficulties of taking enforcement actions concurrently with the Scheme, Martin Wheatley confirmed that the Enforcement division should "*stand down*" from any further work on potential enforcement.<sup>1153</sup>

## Section 4 - Conclusion of the Scheme

167. This Section Four details the actions taken by the FCA as the Scheme drew to a close. In particular, it considers the process by which the Scheme could be brought to an end as well as the subsequent steps taken by the FCA to close the Scheme.

### A. Process by which the Scheme could be brought to an end

168. By January 2015, consideration had turned to setting a final date for customers to enter into the Scheme. The FCA noted internally that "*the review was never intended to be an open-ended process*",<sup>1154</sup> however the Scheme Terms were silent on the topic. The FCA was of the view that, if it ensured the banks: (i) kept customers informed as to the process and deadlines, and (ii) gave customers a reasonable amount of time to respond to final communications, then this would largely mitigate any risk from a legal challenge. It considered that "*a court would be very unlikely to take the view that the review should be kept open indefinitely*".<sup>1155</sup> Accordingly, at a 12 January 2015 meeting, the IRS Steering Group decided to set a final date of 31 March 2015 for Category C customers to

---

<sup>1151</sup> FCA Records, *ExCo Weekly Minutes*, 20 January 2015, 584252.

<sup>1152</sup> FCA Records, *Internal Document*, 10 March 2015, 579988.

<sup>1153</sup> FCA Records, *Email*, 16 February 2015, 583347.

<sup>1154</sup> FCA Records, *Meeting Minutes*, 12 January 2015, 600634, p. 1.

<sup>1155</sup> FCA Records, *Email*, 2 September 2014, 005034.

join the Scheme.<sup>1156</sup> A memorandum from the IRHP Review Central Team dated 6 May 2015 notes that the banks "*committed to write to [these Category C] customers in good time [to] warn them before their offers expire*". Additionally, the IRHP Review Central Team proposed that the banks send a further letter to customers asking them to confirm whether they would accept their offer.<sup>1157</sup> This Review has seen evidence that the FCA commented on some of these draft letters before they were sent to customers.<sup>1158</sup>

169. By October 2015, around 1,400 offers<sup>1159</sup> had been made to customers but not yet accepted. It was decided that these customers would receive a reminder in relation to their offers, and would then be given a time period of at least a further three months to accept that offer (customers who received a reminder letter would have already had a number of months to discuss their offers with their banks and, where appropriate, challenge the outcome). Each bank committed to providing a reasonable amount of time for all customers to consider their offers and also committed to leaving customers' final offers on the table and available for acceptance, for as long as the Scheme remained open.
170. As the completion of review populations varied from bank to bank, the deadline for accepting offers was different for each bank. To alleviate the concerns of some customers, the banks agreed to keep their offers open whilst customers were in a FOS process. However, this deadline was not explicitly extended for customers who were still considering their offers for other reasons, including litigation and waiting for judicial review outcomes.<sup>1160</sup>

## **B. Ending the Scheme (April 2016 – December 2018)**

171. By April 2016, only 15 customers were waiting for a basic redress offer and around 350 customers<sup>1161</sup> were waiting for their consequential loss claims to be assessed. This led the FCA to remark in an April 2016 report to its Board that the "*review is coming to a*

---

<sup>1156</sup> FCA Records, *Meeting Minutes*, 12 January 2015, 600634.

<sup>1157</sup> FCA Records, *Memorandum - Banks reaching the end of their reviews*, 6 May 2015, 1140364.

<sup>1158</sup> FCA Records, *Note for record – IRHP Review – NFR Steering Committee on 25 June 2015*, 25 June 2015, 632187.

<sup>1159</sup> FCA Records, *Internal Document*, 14 October 2015, 1173712, p. 1.

<sup>1160</sup> FCA Records, *Internal Document*, 14 October 2015, 1173712, p. 2.

<sup>1161</sup> FCA Records, *Internal Document*, 6 April 2016, 1113545, p. 2.

close".<sup>1162</sup> The Scheme's winding down was further apparent with the FCA's Risk Register closing the Scheme as a risk in October 2016, and the IRHP Steering Group confirming "*that the risk had been successfully mitigated and we have reached our target outcome*".<sup>1163</sup>

172. In spite of this, the FCA needed to handle additional matters before the Scheme could be closed. This Report considers the work carried out by the FCA from April 2016 and, in particular, examines:

- a. the capacity issues created when responsibility for the Scheme was passed from Event Supervision to Retail Banking;
- b. the discrete issues that occupied the FCA, including its investigation into the potentially incorrect exclusion of certain customers;
- c. the FCA's review of final Skilled Person reports; and
- d. the FCA's public response to the Scheme.

*i) Handover to Retail Banking*

173. In September 2017, oversight of the Scheme passed from the CEDW Team, which sat within Event Supervision, to Retail Banking.<sup>1164</sup> As set out in a preliminary handover note drafted in relation to this transition,<sup>1165</sup> the three main strands of the residual IRHP work by July 2017 largely comprised of: (i) handling correspondence and complaints from customers; (ii) overseeing the remaining review process with banks and Skilled Persons; and (iii) responding to actual or threatened legal challenges.<sup>1166</sup>

174. From the evidence seen by this Review, the bulk of the work related to investigating and responding to customer complaints. The Retail Banking team noted that, in relation to this workstream alone, it tended to receive "*two new cases a week (though in some weeks it is many more)*". That led to "*significant strain on our [Retail Banking's] already*

---

<sup>1162</sup> FCA Records, *Internal Document*, 6 April 2016, 1113545, p. 2.

<sup>1163</sup> FCA Records, *Internal Document*, 18 October 2016, 1120629, p. 7.

<sup>1164</sup> FCA Records, *Internal Document*, 4 August 2017, 1036434.

<sup>1165</sup> FCA Records, *Internal Document*, 13 July 2017, 968393, pp. 1-3.

<sup>1166</sup> FCA Records, *Internal Document*, May 2017, 897739.

*stretched resources*", which had not been increased when it assumed responsibility for the oversight of the Scheme, and which lacked subject-matter expertise on the history and development of the Scheme.<sup>1167</sup>

ii) *Discrete issues occupying the FCA*

175. In addition to these ongoing workstreams, the FCA remained occupied by various discrete issues. This included the FCA's oversight of banks sending final reminder letters to customers. In particular, the FCA received a significant number of customer complaints about one bank's handling of this process.<sup>1168</sup>
176. The FCA was further occupied by its fact-finding and investigation into the potentially incorrect exclusion of customers who, at the point of sale, were deemed by banks to be "intermediate" (for pre-MiFID sales) or "professional" (for post-MiFID sales).<sup>1169</sup> The issue first came to the FCA's attention in 2013 when a bank informed the FCA that it had excluded IRHP customers from its review due to incorrectly interpreting the definition of a SPV.
177. Moreover, in 2017, Santander informed the FCA that it might have also incorrectly excluded a number of customers from its review due to a similar issue.<sup>1170</sup> To identify whether other banks in the Scheme were exposed to similar issues, the FCA wrote to the banks asking them: (i) to explain their approach to classifying customers at the point of sale; and (ii) when determining which customers would be eligible for the Scheme, what assurance activity was undertaken to ensure that SPV customers who were being excluded on the basis of being classified as professional or intermediate did not actually have the characteristics of Retail Clients/Private Customers. From the responses received to its request for information, the FCA noted that "[n]one of [the banks] had a set policy

---

<sup>1167</sup> FCA Records, *Internal Document*, 19 March 2018, 1188115, para. 3 and paras. 20-23.

<sup>1168</sup> For customers who did not accept or reject their full and final offers, the banks agreed to leave their offers on the table and available for acceptance for an extended period. Before withdrawing any offer, the banks agreed to send customers a final reminder of their offers, giving them an additional 3 months to decide. See FCA Records, *Email*, 2 June 2017, 942362.

<sup>1169</sup> FCA Records, *Email*, 9 August 2018, 005586.

<sup>1170</sup> FCA Records, *Email*, 9 August 2018, 005586.

to classify all SPVs as 'intermediate/professional'" and that they "have not identified cause for concern that leads us to think there is a widespread problem".<sup>1171</sup>

iii) *Final Skilled Person reports*

178. Once each bank, along with its Skilled Person, neared the completion of their reviews, they were required to send final Skilled Person reports to the FCA.<sup>1172</sup> With the exception of the second and third Skilled Persons reports for Barclays, which had been received earlier, these reports were received from April 2016 onwards.<sup>1173</sup> Among other things, these reports generally included detailed information on the outcomes and key statistics from the Skilled Person's review and a section on the lessons learned from their review.<sup>1174</sup> This information would seemingly be useful for assessing whether the banks and Skilled Persons had achieved consistent outcomes for customers. Indeed, a partner at KWM, Skilled Person 2 for HSBC, highlighted that they had included their findings on the root cause of IRHP miss-selling in its final report for which "*we have had no feedback on the [final] report from the FCA*",<sup>1175</sup> and further commented that "*I was surprised not to hear from the FCA in relation to our final report and I am not aware of any published summary of the final reports arising from the Scheme.*"<sup>1176</sup>
179. However, the extent to which the FCA reviewed these final reports is unclear. An FCA employee, who gave evidence to this Review, expressed the sense that they would contain limited new information: "*the feeling that we had in relation to these reports, it was a little bit of déjà vu...it was just a compilation of everything that we knew already*".<sup>1177</sup> Furthermore, an internal FCA update note stated that "*we understand it is not a significant amount of work to review the reports and we should not expect any*

---

<sup>1171</sup> FCA Records, *Internal Document*, 6 September 2018, 1194266, pp. 6-7.

<sup>1172</sup> FCA Records, *Internal Document*, 19 March 2018, 1188115.

<sup>1173</sup> FCA Records, Skilled Person report (Barclays), 11 November 2015 (REPORT 012); FCA Records, Skilled Person report (Barclays), March 2016 (REPORT 004).

<sup>1174</sup> See, for example, FCA Records, Skilled Person report (RBS), 19 May 2016 (REPORT 010).

<sup>1175</sup> Written Representations SR, 17 August 2020, p. 5.

<sup>1176</sup> Written Representations SR, 17 August 2020, p. 9.

<sup>1177</sup> Meeting Transcript T (P71:L3-10).

*major surprises given the extensive interaction with the Skilled Persons earlier in the review process".*<sup>1178</sup>

iv) *FCA's public response to the Scheme*

180. In fact, as the Scheme wound down and the remaining customer cases were resolved, greater attention was devoted to the FCA's public response to the Scheme and the lessons it had learned.

181. An ExCo paper on public confidence risk reporting noted that the "*regular criticisms of the FCA's work on redress has a slowly corrosive effect on our reputation*"<sup>1179</sup> and, following calls from the TSC and HMT for a lessons learned exercise with independent oversight, the FCA confirmed publicly that they intended to perform such a review once relevant legal proceedings had been concluded.<sup>1180</sup> It was confirmed in October 2018 that there would be no appeal to the Supreme Court in the Holmcroft case. The further steps taken by the FCA after this date fall outside the scope of the Review, but this confirmation appears to have cleared the path for this Review to be established.<sup>1181</sup>

182. The increase in the FOS's award limit also appears to have been connected to criticism aimed at the Scheme. Before 1 April 2019, "*only 'microenterprises' (businesses with fewer than 10 employees and annual turnover or annual balance sheet (i.e. gross assets) below €2m) could refer complaints to FOS.*"<sup>1182</sup> The FOS was therefore not an option for some customers who wished to contest their Scheme redress offer or who fell outside of the FOS's jurisdiction. Its limited jurisdiction was therefore a source of criticism for the Scheme, which lacked an internal appeal mechanism.<sup>1183</sup> Additionally, as raised by the APPG, the FOS's maximum award limit of £150,000 "*was unlikely to be sufficient to*

---

<sup>1178</sup> FCA Records, *Overview of IRHP supervisory work*, 19 March 2018, 1188115, p. 2, para. 7.

<sup>1179</sup> FCA Records, *ExCo Paper*, 7 June 2016, 1121059, p. 5, para. 3.15.

<sup>1180</sup> FCA Records, *Internal Document*, 26 May 2016, 1093841, p. 24.

<sup>1181</sup> FCA Records, *Email*, 29 October 2018, 1328131.

<sup>1182</sup> Confidential work package 3, undated, p. 3, para. 2.8 (WORK PACKAGE 003).

<sup>1183</sup> For example, a representative of an IRHP customer gave evidence to this Review that: "*Invariably consequential loss claims being made after the FCA review were in excess of the £150K limit of FOS, nor were many of the customers in the FCA review able to meet the micro-enterprise tests to be able to make a complaint*". Written Representation GR, 24 January 2020, p. 16.



*cover the losses of many businesses which were mis-sold IRHPs*".<sup>1184</sup> A December 2016 ExCo paper acknowledged these issues and noted that the access to redress for SMEs was "*tested by high-profile cases such as Interest Rate Hedging Product (IRHP) mis-selling.*" The paper proposed changes to SME size thresholds for FOS eligibility.<sup>1185</sup> These changes were ratified internally and subsequently confirmed publicly by the FCA on 16 October 2018, meaning that SMEs with an annual turnover below £6.5 million and fewer than 50 employees, or a balance sheet total below £5 million would be able to refer unresolved complaints to the FOS, with the award limit increasing from £150,000 to £350,000.<sup>1186</sup>

183. The results of the Scheme are considered in Chapter 6.

---

<sup>1184</sup> Written Representations APPG, 24 January 2020, p. 6 (WRITTEN REPRESENTATION 001).

<sup>1185</sup> FCA Records, *Internal Document*, 6 December 2016, 1092840, p. 3, para. 1.1.

<sup>1186</sup> The Financial Conduct Authority, "*FCA confirms greater access for SMEs to the Financial Ombudsman Service*", 16 October 2018, accessible at <https://www.fca.org.uk/news/press-releases/fca-confirms-greater-access-smes-financial-ombudsman-service> (ARTICLE 012).

## Chapter 6

### Results of the Scheme

#### Introduction

1. This Chapter considers the following matters:
  - a. The results of the Scheme as reported by the FCA and whether those were appropriately communicated to customers.
  - b. The Scheme in the context of the "*Success Criteria*" as part of the CEDW Team wider project mandate against which the FCA noted "*success of this project will be measured*" (the "*Success Criteria*").<sup>1187</sup>
  - c. A brief outline of some of the evidence this Review has seen on the human impact caused by the (mis-)sale of IRHPs and the Scheme.

#### Section 1 - FCA Scheme Data

2. This Section considers the outcomes in relation to the 30,784 IRHP sales which fell to be reviewed under the Scheme and whether these outcomes were appropriately communicated to customers.
3. The figures set out in this Chapter are based on the FCA's "*final position*"<sup>1188</sup> on the "*Progress of sales through stages of the review as at 30 September 2016*" chart.<sup>1189</sup> That position is based on the numbers of "*sales*" of IRHPs, as opposed to the numbers of customers, some of whom had purchased more than one IRHP.
4. Data published by the FCA notes that, as at 30 September 2016:<sup>1190</sup>

---

<sup>1187</sup> FCA Records, *Internal Document*, 22 October 2013, 389072, p. 6, para. 3.4.

<sup>1188</sup> Financial Conduct Authority, "*Interest rate hedging products (IRHP)*", 14 May 2020, accessible at: <https://www.fca.org.uk/consumers/interest-rate-hedging-products> (ARTICLE 039).

<sup>1189</sup> The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf> (ARTICLE 026).

<sup>1190</sup> The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf> (ARTICLE 026).

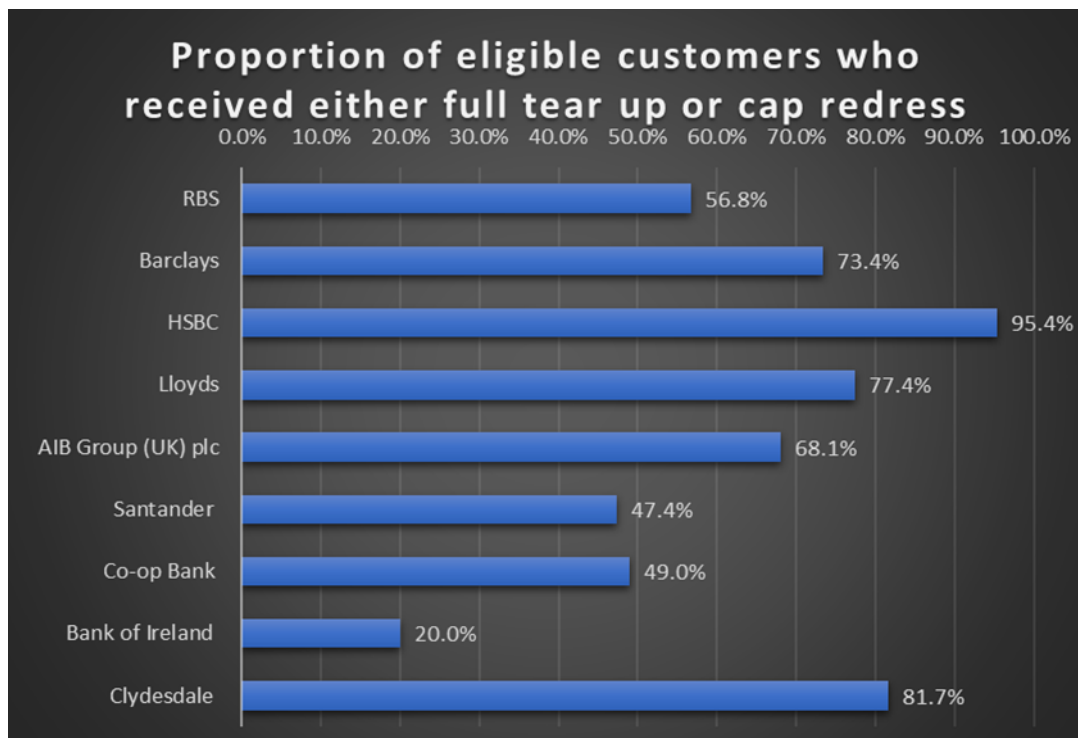
- a. 10,577 sales were excluded on the basis that they were assessed as sales to 'sophisticated' customers under the Sophisticated Customer Criteria;
  - b. 20,207 sales were assessed as sales to 'non-sophisticated' customers;
  - c. of those 20,207, 1,599 were Category A sales;
  - d. of 7,501 Category C sales, 2,328 were to customers included within the Scheme, having proactively raised a complaint, and who were found to be 'non-sophisticated';
  - e. of the sales of Category B and C IRHPs to customers found to be 'non-sophisticated', 15,014 sales were assessed as non-compliant and 1,556 were assessed as compliant sales;
  - f. of 20,207 sales to 'non-sophisticated' customers, the banks communicated initial redress outcomes in relation to 16,613 sales, of which:
    - i. 8,281 offers of a full tear-up were accepted;
    - ii. 4,152 offers of a cap as an alternative product were accepted;
    - iii. 1,503 offers of an alternative product, other than a cap, were accepted;
    - iv. 1,942 sales were assessed as non-compliant but no redress offers were made;<sup>1191</sup> and
    - v. as a result, it appears that customers rejected (or did not respond to) redress offers in relation to 735 sales.
5. The above figures at the time of publication were aggregated for all banks. Consequently, the public was unable to discern and compare any difference of outcome at each bank and/or between banks. The published data would not show each bank's results as concerns, for example: (i) number and types of IRHPs sold, (ii) customer eligibility, (iii)

---

<sup>1191</sup> FCA Records, Skilled Person report (Lloyds), 9 September 2019, p. 22, para. 3.5 (REPORT 006). This would occur where "*the Customer was either 'in the money' (i.e. benefitted from the product) or implementing the redress would otherwise have put the customer in an adverse economic position.*"

compliance with the Sales Standards, and (iv) the proportion of customers receiving a full tear-up or cap redress. Chapter 5, Section 1 outlines the varying number of sales excluded as a result of the sophistication test across the first-tier banks.<sup>1192</sup>

6. For illustrative purposes, Figure 5 below demonstrates the differences between the banks with respect to the number of redress offers that were either full tear-ups or caps and Figure 6 below demonstrates the differences between banks with respect to the number of sales to eligible customers by product category.<sup>1193</sup>



*Figure 5 – Proportion of IRHP sales to eligible customers resulting in either a full tear-up or a cap as their redress offer based on the data in the Skilled Persons reports<sup>1194</sup>*

---

<sup>1192</sup> See Chapter 5, Section 1, para. 25.

<sup>1193</sup> Given the small number of offers of an alternative product, other than a cap, that were accepted (1,503), these are not broken down by bank.

<sup>1194</sup> Compiled information of redress outcomes from Skilled Person reports prepared by this Review, 18 September 2020 (REPORT 015).

Bank	Category A	Category B	Category C
RBS	546	9,248	936
Barclays	756	2,638	74
HSBC	241	2,456	1,093
Lloyds	81	1,681	222
AIB Group (UK) plc	0	484	55
Santander	1	145	25
Co-op Bank	0	90	8
Clydesdale	25	178	15

Figure 6 – Total IRHP sales to eligible customers by product category based on the data in the Skilled Persons reports<sup>1195</sup>

7. In late 2014, GCD identified "[i]nconsistency in the treatment of customers" as one of two areas where "there may be a greater likelihood of criticism", should an independent inquiry into the Scheme take place. Despite raising this issue, GCD noted that "[g]iven the volume of cases and the amount of detail a review would have to go into, an attempt to measure 'consistency' is also likely to be resource intensive and take a considerable amount of time."<sup>1196</sup>
8. The FCA did produce a short note detailing the redress outcomes by bank as at 31 January 2015.<sup>1197</sup> This note offered various bullet-point explanations for differences in outcomes observed at the time, such as differences in the mix of businesses across the banks, the timing of the sales, and the level of breaches as between the banks. However, this Review has seen no evidence to suggest that any detailed analysis was carried out in relation to these potential explanations. Moreover, the author of the note has offered a further

<sup>1195</sup> Compiled information of redress outcomes from Skilled Person reports prepared by this Review, 18 September 2020 (REPORT 015). EY, Skilled Person 1 for the Bank of Ireland, did not provide data on the number of Category A-C products that were sold.

<sup>1196</sup> FCA Records, *Internal Document*, 28 October 2014, 922673, pp. 3-4, para. 10.

<sup>1197</sup> FCA Records, *Internal Document*, 31 January 2015, 1246138.

explanation to this Review, namely that "*variances were inevitable because the underlying redress methodology [was] highly subjective.*"<sup>1198</sup>

9. This Review has additionally identified inconsistencies in the data published by the FCA as at 30 September 2016. Even though some of the customers had purchased more than one IRHP, the FCA appears to have used the terms "customers" and "sales" interchangeably. For example, the FCA's 'Management Information' records that basic redress offers were accepted in the case of 13,936 sales across the banks.<sup>1199</sup> However, the FCA's website reported the same figure by reference to customers, rather than sales.<sup>1200</sup> Furthermore, there are discrepancies between the overall redress outcomes published by the FCA as at 30 September 2016<sup>1201</sup> and the actual results submitted to the FCA in the Skilled Persons' final reports. For instance, one possible inaccuracy is that, where part of a bank's customer population was reviewed by a second or third Skilled Person, this data may not always have been included in the FCA's published results.<sup>1202</sup> This may have affected any internal analysis undertaken by the FCA to assess the results of the Scheme and, perhaps more significantly, has seemingly affected the accuracy of the results that were shared publicly. Alongside the FCA's decision not to distinguish between the results of individual banks, this point further calls into question the appropriateness with which the FCA communicated its Scheme results to customers.

---

<sup>1198</sup> Written Representations I, 17 May 2021, para. 2.6.3.

<sup>1199</sup> See for example FCA Records, *Cover email and attachment*, 13 October 2016, 774050 and 774051. See FCA Records, *Internal Document*, 1 September 2016, FCA-ADD-0033 and The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf> (ARTICLE 026).

<sup>1200</sup> "*To date, around 13,900 customers have accepted a redress offer*", The Financial Conduct Authority, "*Interest rate hedging products (IRHP)*", 14 May 2020, accessible at; <https://www.fca.org.uk/consumers/interest-rate-hedging-products> (ARTICLE 039).

<sup>1201</sup> The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at; <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf> (ARTICLE 026).

<sup>1202</sup> For example, it does not appear that the figure of 10,577 customers assessed to be sophisticated in the FCA's 30 September 2016 progress chart includes the 441 customers deemed sophisticated by the second Skilled Person for one of the first-tier banks. See FCA Records, *Skilled Person report (Lloyds)*, 12 May 2017, p.3 (REPORT 014).

## Section 2 - FCA Success Criteria

10. This Section considers the Success Criteria for the Scheme. The Success Criteria stated:

*"The success of this project will be measured against the following criteria:*

*- participating banks and Skilled Persons follow the agreement reached with the FCA and the redress principles throughout the review process;*

*- participating banks must have issued final redress determinations to most of their customers by the end of December 2013; and*

*- where redress is offered, [most] customers accept the redress offer as being fair and reasonable in the circumstances for the mis-sale of IRHPs".<sup>1203</sup>*

### A. Adherence to the agreement – First Criterion

11. The first criterion against which the success of the Scheme was to be measured required that *"participating banks and skilled persons follow the agreement reached with the FCA and the redress principles throughout the review process".<sup>1204</sup>*

12. The FCA carried out ad hoc file reviews and interventions on individual customer complaints, or occasional spot checks on the banks and Skilled Persons. The CEDW Team went to significant lengths to ensure the first success criterion was met in the cases that came to its attention. For instance, one FCA employee commented that *"I was able to follow-up [on] individual cases when the concerns raised suggested that the banks may not have been adhering to the agreements and I did in fact follow-up hundreds of cases with the banks."<sup>1205</sup>*

13. However, the evidence does not suggest that the FCA systematically analysed the wider caseload against the first success criterion. There was no formal process which would have enabled the FCA to form a meaningful view on whether this criterion was met across all cases.

---

<sup>1203</sup> FCA Records, *Internal Document*, 22 October 2013, 389072, p. 6, para. 3.4.

<sup>1204</sup> See the FCA Project Mandate dated 14 June 2013; FCA Records, *Internal Document*, 1 June 2013, FCA-C-003-0015, p. 5, para. 3.4.

<sup>1205</sup> Written Representations I, 16 February 2020, p. 16, para. 3.10.

14. Some of the IRHP customers that were interviewed expressed their scepticism as to whether the FCA appropriately monitored how the banks and Skilled Persons applied the Scheme Terms. One customer suggested that "*[t]he FCA isn't enforcing the agreement it made with the banks.*"<sup>1206</sup>
15. The evidence given by some Skilled Persons also indicates that the FCA's success in providing effective oversight was limited. Among the shortcomings raised, one Skilled Person highlighted the need for more FCA support in the "*overseeing of the operation of the process between the different banks to ensure consistency in approach and if there were particular issues ... where there was a judgment call to be made as to which side of the line things fell*".<sup>1207</sup>

**B. Timely issuance of redress offers – Second Criterion**

16. The second criterion against which the success of the Scheme was to be measured, required that "*participating banks must have issued their redress offers to most of their customers by the end of December 2013*".<sup>1208</sup>
17. Chapter 5 considers some of the causes for the delay in implementing the Scheme. It is apparent that the FCA failed to meet the second criterion. The complex nature of the Scheme and lack of prescriptive detail on how it should operate meant that it could not be implemented at sufficient scale and pace to meet the deadline set by this criterion.<sup>1209</sup> An FCA employee's written submission to this Review highlight these issues in the Scheme's design: "*In principle a redress scheme ought to be a very simple process. However, the IRHP methodology seemed 'over-engineered' and had far too many complex features ... seeing overly-complicated and 'clever' design features where one is expecting simple process is something of a warning sign.*"<sup>1210</sup>

---

<sup>1206</sup> Meeting Transcript R (P28:L8-9).

<sup>1207</sup> Meeting Transcript GQ (P64:L3-8).

<sup>1208</sup> See the FCA Project Mandate dated 14 June 2013; FCA Records, *Internal Document*, 1 June 2013, FCA-C-003-0015, p.6, para. 3.4.

<sup>1209</sup> FCA Records, *Email*, 7 January 2014, FCA-B-0131. As at 31 December 2013, only 4,500 redress offers had been communicated to customers with 1,000 customers reaching full and final settlement.

<sup>1210</sup> Written Representations I, 16 February 2020, p. 4, para. 2.3.



18. Accordingly, it was not until the FCA published its progress update on 30 September 2016 that it could say that all compliance, sophistication and initial basic redress outcomes had been assessed and communicated to customers.<sup>1211</sup> Consequential loss claims continued to be determined after this.
19. This is in spite of a clear desire on the part of the FCA to ensure speedy redress for customers. For example, FCA Employee C commented to this Review that "*This was an opportunity to distinguish the FCA from the FSA and that was to be characterised by speed, moving from analysis to action quickly, being forthright and confident in our conclusions and being bold effectively.*"<sup>1212</sup>
20. The failure to secure speedy redress for small businesses drew attention from Parliament and the press alike. Speaking in a House of Commons debate, Mark Williams MP commented that "*[w]e have looked to the FCA to sort out this mess and to do so in a way that is both fair and timely, but that has not happened*".<sup>1213</sup> This sentiment was echoed by one IRHP customer who commented to the BBC that "*The redress scheme has gone on too long*" believing that this delay might "*push people out of the way because they do not have the financial resources to continue fighting*".<sup>1214</sup>

---

<sup>1211</sup> At 30 June 2016, two alternative product basic redress outcomes were still to be communicated; The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 June 2016 – All banks*", 4 September 2016, accessible at <https://webarchive.nationalarchives.gov.uk/20160907200627/https://www.fca.org.uk/publication/publications/aggregate-progress.pdf> (ARTICLE 025). By 30 September 2016 these final two cases had been determined and communicated; The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf> (ARTICLE 026).

<sup>1212</sup> Meeting Transcript C (P18:L1-5).

<sup>1213</sup> House of Commons Debate, "*Financial Conduct Authority Redress Scheme*", 4 December 2014, col. 502, accessible at <https://publications.parliament.uk/pa/cm201415/cmhansrd/cm141204/debtext/141204-0003.htm#14120449000402>.

<sup>1214</sup> BBC News, "*Action in wake of interest rate swaps scandal debated by MPs*", 4 December 2014, accessible at <https://www.bbc.co.uk/news/uk-wales-30321999> (ARTICLE 001).

### C. Customers' acceptance of redress offers as fair and reasonable – Third Criterion

21. The third criterion against which the success of the Scheme was to be measured, required that "*most customers accept the redress offer as being a fair and reasonable compensation for the misale of IRS product*".<sup>1215</sup>
22. In most cases, it is unknown whether customers considered the redress offers to be fair and reasonable, a matter compounded by the lack of any appeal mechanism within the Scheme or through the FOS. Thus, it is difficult to determine whether customers accepted their offer in the belief that it amounted to "fair and reasonable" compensation, or, rather, that the offer was simply better than nothing. By 30 September 2016, the majority of redress offers (13,936 sales out of 14,671) had been accepted.<sup>1216</sup>
23. The significant cost and uncertainty of obtaining relief through the courts may have tacitly encouraged customers to accept their offers.<sup>1217</sup> One SME owner who gave evidence to this Review remarked in respect of the financial challenge in bringing court proceedings against their bank: "*we costed it and it was about half a million pounds to sue a bank. You know, it was battle of deep pockets. And all the wee guys were screwed on that.*"<sup>1218</sup> Additionally, in evidence given to the TSC, Bully-Banks suggested that the continuing relationship between an SME and its bank made legal action difficult, saying that "*the practical reality is that, given the dependence of the SME on its bank, it is an incredibly difficult decision for an SME to decide to sue its bank.*"<sup>1219</sup>
24. The apparent absence of a detailed post-Scheme effort by the FCA to obtain and analyse customer feedback makes any balanced examination of its success against this criterion difficult. Such a review would have been useful for assessing whether public criticism of

---

<sup>1215</sup> See the FCA Project Mandate dated 14 June 2013; FCA Records, *Internal Document*, 1 June 2013, FCA-C-003-0015, p. 6, para. 3.4.

<sup>1216</sup> The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf> (ARTICLE 026).

<sup>1217</sup> The common hurdles that customers encountered when engaging in litigation are set out in more detail in Section 4 of Chapter 2.

<sup>1218</sup> Meeting Transcript B, (P29:L10-13).

<sup>1219</sup> House of Commons Treasury Committee, "*Conduct and Competition in SME lending*", (Eleventh Report of Session 2014-2015), 10 March 2015, accessible at [https://www.parliament.uk/globalassets/documents/commons-committees/treasury/Conduct\\_and\\_Competition\\_in\\_SME\\_lending.pdf](https://www.parliament.uk/globalassets/documents/commons-committees/treasury/Conduct_and_Competition_in_SME_lending.pdf), p. 62.

the Scheme was justified.<sup>1220</sup> The Review sought to rectify this by asking the FCA to give examples of positive customer feedback on the Scheme. From the nine examples provided by the FCA, the apparent surprise at receiving such feedback was particularly striking. One FCA employee commented internally that a customer's feedback "*is a nice change of pace [it] is essentially quite positive*",<sup>1221</sup> while in response to separate feedback another employee commented: "*Just to see the other side – a happy customer*".<sup>1222</sup> It is perhaps unsurprising that more customers complained about the Scheme than those offering positive feedback. Nevertheless, it is evident from the post-Scheme customer feedback and representations provided by IRHP customers to this Review that many customers were left with a steadfast belief that their redress offer did not amount to fair and reasonable compensation.

### Section 3 – Human Impact

25. The evidence considered by this Review demonstrates the significant human impact that IRHP mis-selling had on many customers and the corresponding real practical importance of the issues raised in the ToR. For example:
- a. One former SME owner noted that "*I am still living it day-in-day-out today.*"<sup>1223</sup>
  - b. Another customer stated that taking out an IRHP "*has had a devastating effect on my famil[y's] lives, our financial ability to provide for all our family members resulting in physical and mental stress coupled with the final liquidation of our business.*"<sup>1224</sup>

---

<sup>1220</sup> In regard to public criticism, the Treasury Select Committee has commented in relation to the mis-sale of hedging products that the committee's inability to determine whether customer complaints "*are examples of isolated exceptions to an adequate process, or are signs of a wider, systemic problem with the review [...] in itself is indicative of a flaw in the process which the FCA should address.*" Further, the TSC recommended that: "*the FCA should collect the information necessary to establish whether there are systemic failures in the review.*" The Treasury Select Committee, "*Conduct and competition in SME lending*", 13 March 2015, paras. 114-5, accessible at <https://publications.parliament.uk/pa/cm201415/cmselect/cmtreasy/204/20406.htm>.

<sup>1221</sup> FCA Records, *Email*, 13 November 2013, 1260161.

<sup>1222</sup> FCA Records, *Email*, 27 January 2016, 1314017.

<sup>1223</sup> Meeting Transcript R (P30:L19).

<sup>1224</sup> Written Representations SK, 29 January 2020, p.21.

- c. One IRHP customer, who assisted others customers through the group Bully-Banks, recalled the emotional impact *"I was like a nurse, chatting, everybody had the conversation. I tried to cut it down and I couldn't and I would need to spend at least an hour chatting to the people to get them to feel someone was taking notice and someone was going to try and do something about it."*<sup>1225</sup>
  - d. An FCA employee expressed empathy when giving evidence to this Review: *"when we were dealing with these small businesses, this, what was happening to them, was very personal to them. So there was a lot of anger. There was a lot of emotion. There was a lot of personal tragedy ... marriages had broken down. Severe health problems. The business that their grandparents had set up has now gone down the drain so they felt responsible, they felt a failure."*<sup>1226</sup>
26. Others expressed a prevailing sense of injustice at the redress outcomes delivered by the Scheme, in particular in respect of consequential loss. For example:
- a. An IRHP customer whose business subsequently entered into an insolvency process noted in respect of the bank's consequential loss offer of £27,000 *"that in any insurance claim, or other legal action, [its consequential loss claim] would have been 5.288 million [pounds]... It's a joke. A complete farce."*<sup>1227</sup>
  - b. Another IRHP customer whose consequential loss claim was rejected expressed dissatisfaction with the bank's communication of its redress decision, suggesting that it failed *"to provide a proper written explanation of its decision making process"* or the evidence that it relied on.<sup>1228</sup>
  - c. An IRHP customer told the Review: *"I'm ashamed of how the FCA responded to what happened."*<sup>1229</sup> They stated that, in their view, banks *"deliberately and in a structured way in the process that was littered with deceit, mis-sold these products*

---

<sup>1225</sup> Meeting Transcript W (P6:L20-25).

<sup>1226</sup> Meeting Transcript T (P26:L25-P27:L9).

<sup>1227</sup> Meeting Transcript R (P27: L3-4 and P37:L20).

<sup>1228</sup> Written Representations HS, 30 January 2020, p.7.

<sup>1229</sup> Meeting Transcript W (P7:L5-6).

*which were wholly unsuitable to a targeted group". They considered this was never properly addressed by the FCA and "[w]hat happened was a disgrace."*<sup>1230</sup>

27. Another commonly raised concern was the banks' influence over the design and/or conduct of the Scheme, and the perceived lack of independence of the Skilled Persons:
- a. The representative of an IRHP customer emphasised that *"schemes to deliver fair redress to customers for their bank failings cannot be administered by the banks themselves if a fair outcome is to be expected."*<sup>1231</sup>
  - b. Another customer commented: *"I think they [the FSA/FCA] need to be a lot tougher, frankly, I think they allowed the banks too much latitude in the design of this system."*<sup>1232</sup>
  - c. Several customers and their representatives expressed misgivings around the independence of the Skilled Persons. One stakeholder commented to this Review, expressing their view that *"[t]he FSA allowed the Big 4 accounting firms essentially to audit the decision-making of firms who they were either auditing or hoping to audit or provide consulting services to in the future."*<sup>1233</sup>
  - d. One SME owner pointed to the inability of customers to communicate with Skilled Persons: *"where they [i.e. the FCA] failed is that they let the banks appoint the skilled person and wouldn't let the victims anywhere near them. And that really has led to a sense of injustice."*<sup>1234</sup>
  - e. This concern was echoed by a customer representative: *"The customer was not able to meet or speak to the individuals who were involved in their case nor were they able to verify their experience and expertise [...] the customer had no understanding of what exactly had been provided to the IR [Skilled Person] and*

---

<sup>1230</sup> Meeting Transcript W (P10:L12-20).

<sup>1231</sup> Written Representations GR, 24 January 2020, p.16.

<sup>1232</sup> Meeting Transcript K (P15:LB).

<sup>1233</sup> Written Representations TM, 18 December 2019.

<sup>1234</sup> Meeting Transcript B (P29:L17-20).

*there was a belief that in some cases only a summary of the claim was provided.*"<sup>1235</sup>

28. In its written submission, the APPG noted such concerns and highlighted the customers that 'opted out' of the Scheme - in relation to Category B IRHPs, in 2,038 of the 16,280 sales, the 'non-sophisticated' customers opted out (or were deemed to have opted out). The APPG made the point that this "*figure of 2,038 customers*" represents a "*significant chunk of the review population [who] elected not to benefit from any redress that might have been due to them through the scheme*" and this indicated "*a lack of confidence*" in the Scheme.<sup>1236</sup>

---

<sup>1235</sup> Written Representations GR, 24 January 2020, p.13.

<sup>1236</sup> Written Representations APPG, 17 July 2020, p.23.

## Chapter 7

### Terms of Reference: Questions 1 to 4

#### Introductory comments on my approach to the issues in the ToR

1. In this Chapter, I set out my conclusions on the questions set out in paragraph 5 of the ToR.
2. Some of the issues set out in the ToR ask me to address whether the FSA's, and later the FCA's, approach to the intervention was "*reasonable*", while others ask whether it was "*appropriate*". This suggests the possibility of different standards of review being applied in respect of different questions. I doubt, however, that the Board had that in mind when framing the questions. There is no obvious reason why I should adopt different standards for broadly similar issues. Given the aim of identifying lessons learned, it would also not be right for me to assess the FSA/FCA's approach by reference to a mere rationality threshold.<sup>1237</sup>
3. I therefore consider that the standard of review I should adopt is what was objectively reasonable, appropriate, and proportionate in all the circumstances. On that basis, I have assessed the conduct of the FSA/FCA by the standard of an experienced, skilled and efficient regulator acting in accordance with its statutory duties and taking full account of the evidence available to it at the time of the decisions. I have avoided using the benefit of hindsight in this evaluation, although hindsight is relevant when considering the lessons to be learned by the FCA.

---

<sup>1237</sup> By "mere rationality", I mean the so-called Wednesbury test applied in public law whereby a decision of a public authority, such as an independent regulator, may be quashed if the decision is irrational in the sense of being so unreasonable that no reasonable authority could ever have come to it (*Associated Provincial Picture Houses Ltd. v Wednesbury Corporation* [1948] 1 K.B. 223).

## ToR 1

*"1) Whether the FSA's approach to the intervention, including the potential benefits over alternative options and parameters for the scheme, was a reasonable response to the FSA's concern about the mis-selling of IRHPs, including:*

- (a) The extent of the FSA's jurisdiction over sales of IRHPs*
- (b) The work undertaken to collate and analyse information and assess the extent of IRHP sales*
- (c) The use of a pilot scheme and development of the full scheme, including implementation of any learnings*
- (d) The voluntary nature of the scheme and whether, in light of scope of the FSA's jurisdiction, it was an appropriate way to address concerns about the sale of IRHPs*
- (e) The appropriateness of the communication of the substance and operation of the scheme, including the issuing of guidance, to persons potentially affected by it*
- (f) The transparency of the scheme, including the confidentiality of the agreements with the firms*
- (g) The work to identify relationships with key internal and external stakeholders and the extent, nature and frequency of any communications."*

**(a) The extent of the FSA's jurisdiction over the sales of IRHPs**

1. In considering the extent of the FSA's jurisdiction over the sales of IRHPs, I have adopted a broad interpretation of "jurisdiction" and have considered the following aspects:
  - a. **The FSA/FCA had jurisdiction in respect of the relevant activities:** As described in Chapter 2,<sup>1238</sup> the FSA's jurisdiction over the sales of stand-alone IRHPs derives, and derived at all relevant times, from the inclusion of those products as "specified investments" within the RAO,<sup>1239</sup> specifically as contracts

---

<sup>1238</sup> See Chapter 2, Section 3, paras. 35-6.

<sup>1239</sup> S.I. 2001/544 as amended, which specifies types of investment for the purposes of section 22 FSMA.



for differences. In my view, it was therefore appropriate for the FSA to intervene in respect of suspected mis-selling of stand-alone IRHPs given its jurisdiction over such activities and products.

- b. **The FSA's jurisdiction was applied differently as between different kinds of customer groups:** The banks were required to comply with the COB rules when selling IRHPs to Private Customers until 1 November 2007.<sup>1240</sup> After that date, following the UK's implementation of MiFID, they had to comply with the revised COBS rules when selling IRHPs to Retail Clients.<sup>1241</sup> Notwithstanding the change in customer classification/client categorisation, at all material times, the relevant conduct of business rules clearly distinguished between Private Customers/Retail Clients and other categories of customers/clients, who were professional investors and financial market counterparties. There was thus a good jurisdictional basis for regulatory intervention in respect of that customer group.<sup>1242</sup> This was the obvious line the FSA should have adopted in determining who was to be eligible under the Scheme.<sup>1243</sup>
- c. **The FSA lacked jurisdiction in respect of commercial loans with embedded IRHP terms/TBLs:** Unlike stand-alone IRHPs, the FSA had no jurisdiction over commercial loans with embedded IRHP terms/TBLs. In particular, the COB and COBS rules had no application to the sales of such products. For the reasons explained in ToR 2,<sup>1244</sup> I have therefore concluded that it was right not to intervene in respect of these products.

2. In summary, the FSA/FCA's intervention regarding IRHPs was within its jurisdictional scope. With regard to the customer population, the FSA/FCA's intervention had a sound jurisdictional basis to focus on Private Customers/Retail Clients as a group. As I go on to find in ToR 2, however, I do not consider that the FSA's further sub-division of this

---

<sup>1240</sup> See Chapter 2, Section 3, para. 47.

<sup>1241</sup> Broadly, all customers previously classified as Private Customers fell within the new definition of Retail Clients. Moreover, the new definition of Retail Clients also covered some customers previously outside the classification of Private Customers, thus affording them extended protections. See further: Chapter 2, Section 3, paras. 47-63.

<sup>1242</sup> See further ToR 2, para. 4.

<sup>1243</sup> See further ToR 2.

<sup>1244</sup> See ToR 2, paras. 47-50.

group into sophisticated and non-sophisticated customers was reasonable – but that is not a jurisdictional issue.

**(b) The work undertaken to collate and analyse information and assess the extent of IRHP sales**

3. As I comment on the impact of the Pilot Review in response to ToR 1(c) below, I limit my analysis in this section to the work undertaken by the FSA prior to entering into the Initial Agreement in June 2012.
4. Having been jolted into action in March 2012 by public and political pressure,<sup>1245</sup> the FSA had to make a rapid initial assessment of the nature and extent of any mis-selling issues. At that point, it had no real understanding of the number of customers who had been sold IRHPs, and assumed a mis-selling rate of around only five per cent.<sup>1246</sup>
5. The FSA's work to collate and analyse information and assess the extent of IRHP mis-selling was constrained, however, by a self-imposed deadline to publish its findings and next steps by the end of June 2012.<sup>1247</sup> As such, the initial information-gathering exercise was carried out under significant time pressure,<sup>1248</sup> and was correspondingly narrow in scope. In essence, it consisted of collating relatively limited material obtained from the banks and from customers/their representatives,<sup>1249</sup> and undertaking a more detailed review of relevant FOS decisions.<sup>1250</sup>
6. The initial information-gathering exercise nonetheless was sufficient for the FSA to conclude that: (i) the volume of IRHP sales to Private Customers/Retail Clients over the Relevant Period was substantial, with around 29,000 sales;<sup>1251</sup> (ii) there had been a range of inappropriate selling practices, including insufficient disclosure of information, the selling of unsuitable products, and inappropriate sales incentives;<sup>1252</sup> and (iii) the mis-

---

<sup>1245</sup> See Chapter 3, Section 1, para. 10.

<sup>1246</sup> See Chapter 3, Section 3, paras. 21-2.

<sup>1247</sup> See Chapter 3, Section 5, para. 49.

<sup>1248</sup> See Chapter 3, Section 3, paras. 27-8.

<sup>1249</sup> See Chapter 3, Section 3, paras. 18 and 23.

<sup>1250</sup> See Chapter 3, Section 3, para. 24.

<sup>1251</sup> See Chapter 3, Section 3, para. 32; and FCA Records, *Internal Document*, May 2012, 268304, slide 4.

<sup>1252</sup> See Chapter 3, Section 3, para. 31.

selling rate was likely to be much higher than it had first thought.<sup>1253</sup> Given the time pressure, however, the evidence regarding the mis-selling available to the FSA at the time was still limited.<sup>1254</sup> In the circumstances, its approach to intervention proceeded on a number of assumptions regarding the mis-selling.

7. Much of that information gap was a consequence of the lack of any material supervisory intervention by the FSA on the sale of IRHPs during the previous decade.<sup>1255</sup> While that prior period is outside the ToR for this Review, it is clear that the FSA's delay in appreciating and addressing the issues posed by those sales of IRHPs materially contributed to the paucity of information it could draw on in the spring of 2012, and the concomitant constraints on its options for an appropriate regulatory response.
8. Some of the gaps in the FSA/FCA's knowledge were never filled, either before the Initial Agreement, or at any time thereafter. A good example of this is the information the FSA initially considered should be obtained to enable it to understand what it referred to as the "*root causes*" of IRHP sales.<sup>1256</sup> Establishing what these root causes were (such as, for example, filling a gap in revenues/profits previously generated from other business activities, inappropriate sales incentivisation, failures in systems and controls, etc.), was relevant to determining the most appropriate option(s) for a response, and to the strength of the FSA's case for intervention. From the evidence considered by this Review, however, no formal questions appear to have been put to the banks on matters such as what drove the sale of IRHPs, why this surged in the period between 2005 and 2008, what contribution the sales had made to the profits of the banks, and what internal records there were that might throw light on the policy to sell more IRHPs to Private Customers/Retail Clients.
9. Thus, by the time of the Initial Agreement, it still had only limited evidence about what had happened over the period from 2001, and even less evidence about why it had happened. This meant it entered into the Initial Agreement on the basis of only a partial

---

<sup>1253</sup> See Chapter 3, Section 3, para. 21.

<sup>1254</sup> See Chapter 3, Section 3, paras. 28-9.

<sup>1255</sup> See Chapter 3, Section 1, paras. 2-9.

<sup>1256</sup> See Chapter 3, Section 3, para. 19; and FCA Records, *Internal Document*, 21 March 2012, FCA-B-0003, p.2.

and incomplete picture of the evidence. Many FCA employees interviewed in the course of the Review noted that this lack of information was a considerable obstacle at least for the purposes of commencing an enforcement action, imposing an OIVOP, or using the mechanism of sections 382 or 384 FSMA to require restitution.<sup>1257</sup> Indeed, the FSA even acknowledged the lack of evidence at the time, taking the view that the information before it was insufficient to warrant the immediate use of its statutory powers to require the banks to pay redress.<sup>1258</sup>

10. In my view, the combination of the FSA's lack of early awareness of the issues posed by IRHPs, and its self-imposed deadline of the end of June 2012, proved a serious limitation on its ability to gather and digest sufficient information to fully understand the situation and inform its response. I consider the impact of these shortcomings in ToR 1(d), below.
11. As described in Chapter 4, however, the subsequent Pilot Review did much to reduce the information deficit, including, the more intensive examination of sample customer files it entailed.<sup>1259</sup>

**(c) The use of a pilot scheme and development of the full scheme, including implementation of any learnings**

12. There are three connected issues in relation to the use of the Pilot Review:
  - a. whether it was reasonable for the FSA to require a Pilot Review to be undertaken in the autumn of 2012, given that the Initial Agreement did not provide for this;
  - b. whether, having decided on a Pilot Review, the information obtained as part of that exercise was sufficiently comprehensive to determine whether the Initial Agreement needed to be refined, developed, or even abandoned; and

---

<sup>1257</sup> See references to the FCA employees noting lack of evidence (for example, Chapter 3, Section 5, para. 53.)

<sup>1258</sup> A 31 May 2012 ESRC Summary Paper notes that "*we do not yet believe we have sufficient evidence to exercise our statutory powers to require firms to pay redress (our sample file review was intended to better understand the scale and nature of the issue and was not statistically significant).*" In this paper, GCD notes "*At this stage we do not consider the current evidence would be sufficiently strong to require the banks to provide redress formally under e.g. a s.404 scheme.*" FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, pp.1 and 4.

<sup>1259</sup> See Chapter 4, Section 3, paras. 57-9.

- c. whether the information-gathered as part of the Pilot Review was reasonably applied in making refinements to the Scheme and/or in otherwise determining the course of action the FSA took in January 2013, when it agreed the components of the Main Scheme with the first-tier banks.
13. The Initial Agreement imposed obligations on the banks that were enforceable, as a matter of contract, by the FSA and the banks. In particular, the duty to provide proactive redress to every 'non sophisticated' customer who had bought a structured collar (a Category A IRHP) was in express terms.<sup>1260</sup> However, as explained in Chapter 3, the Initial Agreement went beyond a straightforward voluntary redress scheme, in which liability is accepted and redress can be readily calculated.<sup>1261</sup> The banks did not agree to provide automatic redress for sales of IRHPs other than structured collars, but only to carry out a PBR in respect of such sales to customers deemed non-sophisticated (and, in the case of caps, only if a complaint had been made). On the basis of that PBR, they would then decide whether there had been a mis-sale and, if so, whether redress should be provided and in what form.
14. In my view, the FSA had to do more work to test how the Initial Agreement would work in practice and to ensure that it was fit for purpose as the basis for an effective remediation scheme. Three specific areas stand out:
  - a. First, it was not sufficient simply to require the banks to appoint and pay for Skilled Persons, as they might do in circumstances where the Skilled Persons would report to the FSA as the decision-maker. Under the Initial Agreement, the banks were the primary decision-makers, with the role of the Skilled Persons less clear-cut and arguably more challenging. The FSA had to ensure that the Skilled Persons had the means, competence and independence necessary to ensure the banks' decisions were fair and reasonable and not unduly favourable to their own position. In my view, the Pilot Review, along with the FSA's evaluation of each bank's Pilot methodology,<sup>1262</sup> provided an effective means of doing this.

---

<sup>1260</sup> See Chapter 3, Section 5, para. 77.

<sup>1261</sup> See, for example, Chapter 3, Section 5, paras. 71-2.

<sup>1262</sup> See Chapter 4, Section 1, para. 30.

- b. Second, despite the agreement that conduct would be assessed by reference to the relevant Regulatory Requirements, taking into account in particular the Sales Standards, it was not clear how in practice the banks and the Skilled Persons would apply them to individual cases.<sup>1263</sup> The Pilot Review gave the FSA the opportunity to identify and consider at least some of these issues and to provide guidance to the Skilled Persons, including in the form of compilations of FAQs.<sup>1264</sup> The findings which emerged in the course of the Pilot Review further crystallised key issues, such as the banks' obligations in respect of disclosure of break costs or the application of the sophistication criteria, and allowed the FSA to refine its position in respect of these.<sup>1265</sup>
- c. Third, there was a lack of clarity as to how the banks and the Skilled Persons would arrive at a decision on what was fair and reasonable redress. In the course of the Pilot Review, the FSA developed its detailed principles of redress, which set out how the banks and Skilled Persons were to approach this.<sup>1266</sup>
15. Chapter 4 describes how the FSA dealt with these matters and thus managed to use the Pilot Review to fill many of the gaps left open by the Initial Agreement. Even so, as is apparent from Chapter 5, there still remained significant problems in respect of the implementation of the Scheme,<sup>1267</sup> which led to further uncertainty and delay.
16. The gaps and inadequacies in the Initial Agreement inevitably required time to work through and the FSA was right to utilise a Pilot Review for this purpose and to further develop the Scheme. More generally, I consider that the use of a pilot exercise was an appropriate and effective way of identifying and addressing at least some of the practical issues which are likely to affect any scheme of this complexity. Despite the delay inherent in the Pilot Review, it is likely that this still saved time in the long run. The FSA should,

---

<sup>1263</sup> See, for example, Chapter 4, Section 1, para. 35.

<sup>1264</sup> See Chapter 4, Section 2, paras. 47-8.

<sup>1265</sup> See Chapter 4, Section 3, para. 64-73.

<sup>1266</sup> See Chapter 4, Section 1, para. 36.

<sup>1267</sup> See Chapter 5, Section 3, paras. 105-157.

however, have done more to manage stakeholder expectations in respect of the likely implications of the Pilot Review.<sup>1268</sup>

17. The information obtained as part of the Pilot Review ought to have been sufficient for the FSA to appreciate how the Initial Agreement should be refined. I have concluded that some of the learnings from the Pilot Review were indeed effectively implemented, such as in the development of the redress principles<sup>1269</sup> and in providing guidance on how to apply the Regulatory Requirements including the Sales Standards. Matters which were not adequately addressed, however, were the issues around consequential loss,<sup>1270</sup> the lack of an appeal process,<sup>1271</sup> and the changes to the eligibility criteria,<sup>1272</sup> all of which are discussed in more detail below.

**(d) The voluntary nature of the scheme and whether, in the light of scope of the FSA's jurisdiction, it was an appropriate way to address concerns about the sale of IRHPs**

18. As described in Chapter 2, the FSA had a range of regulatory tools available to it in order to secure compliance with FSMA, and the Principles and rules made under it.<sup>1273</sup> It also had extensive powers of investigation and enforcement. Chapter 3 addresses how the FSA considered the advantages and disadvantages of the different options for regulatory intervention that were available to it, before settling on its approach.<sup>1274</sup>
19. In the course of June 2012, the FSA decided that preparatory work should commence on:  
(i) a section 166 FSMA report and an enforcement review, and (ii) negotiations with the four major banks on securing redress for customers. In parallel, the FSA planned to consider what would be required in terms of time and resource to conduct a review itself, should the negotiations with the firms fail.<sup>1275</sup> In respect of the enforcement options available to the FSA (including the use of an OIVOP, restitutionary powers, and/or section 166 FSMA powers), at the time, the FSA considered it did not have sufficient

---

<sup>1268</sup> See Chapter 4, Section 5, para. 123.

<sup>1269</sup> See Chapter 4, Section 5, para. 139c.

<sup>1270</sup> See ToR 3, paras. 20-6.

<sup>1271</sup> See ToR 3.

<sup>1272</sup> See ToR 2.

<sup>1273</sup> See Chapter 2, Section 3, paras. 68-101.

<sup>1274</sup> See Chapter 3, Section 4, paras. 34-47.

<sup>1275</sup> See Chapter 3, Section 4, para. 33.

information on breaches to assess or implement a potential exercise of its enforcement powers, with a view to imposing sanctions, obtaining redress, or both.<sup>1276</sup> In those circumstances, the FSA's decision to commence such preparatory work was appropriate.

20. The choice between a voluntary, industry-wide scheme (in which the specific terms and conditions are critical) and the use of the FSA's statutory powers cannot be considered in the abstract. Both options have advantages and disadvantages:
  - a. By using its **statutory powers under section 166 FSMA** in a more conventional manner, the FSA would have retained its role as the primary decision-maker. Section 166 FSMA permits reliance on the Skilled Persons, who can carry out the necessary investigative work (at the cost of the banks) and then report directly to the FSA. This limits the demands on the regulator, while allowing it to retain control over the process. The Skilled Person forms a view as to whether and, if so, in what form redress should be provided. It is then for the FSA to decide whether to exercise its powers to require redress, for example, by obtaining a restitution order under section 382 FSMA, requiring restitution under section 384 FSMA, or by imposing an OIVOP. Such a decision, however, may be subject to legal challenge, such as by way of a contested court application (in respect of a restitution order) or a merits-challenge in the Upper Tribunal, which would likely engender significant delay.
  - b. A **voluntary agreement** with a regulated firm has the potential of avoiding difficulty and delay, most notably where the firm agrees to pay redress for its past conduct. The more complex such an agreement is, however, and the more extensive the negotiations underpinning it, the greater the risk of an inappropriate regulatory compromise, with commensurate damage to the interests of those affected by the firm's breaches.
21. Which of these choices is appropriate will depend on the particular context and the objectives being pursued, since the mechanism is a means to an end. The context in June 2012 was one in which the FSA sought to ensure that customers who had suffered or were exposed to financial detriment as a result of being mis-sold IRHPs should be swiftly

---

<sup>1276</sup> See Chapter 3, Section 4, paras. 40 and 58. See also ToR 1, paras. 3-11.



and appropriately compensated. It considered that such an outcome would reflect the new (future) FCA philosophy,<sup>1277</sup> given the then forthcoming change from FSA to FCA. In the circumstances, the FSA found voluntary agreements to be the preferable approach, as it considered them likely to lead to fairer and faster redress than consumers might otherwise receive, to be legally robust/enforceable, and not to place unsustainable burdens on its resources given its other priorities and commitments.<sup>1278</sup>

22. In its representations to the Review, the FCA referred to what it described as "*the relative weakness of the FSA's position at the time*"<sup>1279</sup> and argued that the use of statutory powers would have involved significantly more time, resources, and evidence, including in relation to the root causes of IRHP sales.<sup>1280</sup> The FCA acknowledged that the FSA did not have all the information it needed to make a fully informed decision as to the likelihood of success of using its statutory powers.<sup>1281</sup> Yet, any such difficulties were of the FSA's own making. It should never have found itself in that position.
23. Nevertheless, by 'locking' the banks into a review, to determine breaches by reference to an agreed and rigorous set of standards and to provide fair and reasonable redress, the 'bird in the hand' of a voluntary redress scheme meant that the FSA gained an advantage compared to the use of statutory powers with less certain and likely slower outcomes. As the FCA noted in its representations, "*the outcome is never guaranteed and there is always the risk of losing if challenged or having the parameters of any redress scheme narrowed*".<sup>1282</sup> The use of a voluntary scheme also allowed the FSA greater scope in ensuring redress on the basis of breach of its Principles for Businesses as well as the COB/COBS rules, which may otherwise have entailed lengthy and uncertain legal disputes with the banks (in particular on issues such as break cost disclosure obligations). Finally, this allowed the FSA to provide for redress in relation to sales going back as far as 2001, thus avoiding any potential limitation issues.<sup>1283</sup>

---

<sup>1277</sup> See Chapter 2, Section 1, para. 13.

<sup>1278</sup> See Chapter 3, Section 4, para. 38.

<sup>1279</sup> FCA representations dated 30 March 2021, para. 1.3.

<sup>1280</sup> FCA representations dated 30 March 2021, para. 2.5.

<sup>1281</sup> FCA representations dated 30 March 2021, para. 2.6.

<sup>1282</sup> FCA representations dated 30 March 2021, para. 2.6.

<sup>1283</sup> See Chapter 3, Section 4, paras. 38-40.

24. The FSA gave some consideration to whether the agreements should be entered into by way of a VVOP rather than by way of a simple contractual arrangement, or as voluntary agreements supported by a VVOP, but chose not to do so.<sup>1284</sup> It is arguable that a VVOP could have achieved a similar, if not identical, outcome to the voluntary agreement, with the added benefit of proceeding/being enforceable on a statutory footing. Conversely though, it is likely that the FSA would have faced even greater resistance from the banks than it encountered in relation to the voluntary scheme.
25. Overall, I consider that the FSA was aware of the various options available to it before it committed itself to the Initial Agreement and that it reasonably evaluated the relative advantages and disadvantages of these options. In my view, it was reasonable for the FSA to aim for a voluntary agreement with the first-tier banks, rather than using any of its statutory powers. I am not convinced that delaying entering into the Initial Agreement in order to carry out further investigations pursuant to the FSA's powers under section 166 FSMA would have led to a preferable outcome. In principle, a voluntary agreement was a reasonable means by which to address concerns about the sale of IRHPs and, for the reasons explained above, was arguably preferable to the alternatives. That conclusion, however, is heavily caveated by what happened next, especially in relation to the scope of the Scheme.
26. The opposition the FSA met from the first-tier banks as to the scope of the voluntary scheme it envisaged led to intensive negotiations. In the course of these, the FSA made some significant, and in my view inappropriate, concessions, in particular on eligibility, which had the effect of excluding thousands of Private Customers/Retail Clients from the scope of the Scheme without proper justification.<sup>1285</sup> This issue is considered further in ToR 2, below.<sup>1286</sup>
27. However, ToR 1 asks me to consider not what might have happened if the FSA had stuck to its original intention of including all Private Customers/Retail Clients within the scope of the exercise of its jurisdiction, but "*whether the FSA's approach to the intervention, including the potential benefits over alternative options and parameters for the scheme,*

---

<sup>1284</sup> See Chapter 3, Section 4, paras. 39-40.

<sup>1285</sup> See Chapter 5, Section 1, para. 25, Figure 4.

<sup>1286</sup> See ToR 2, paras. 41-44.

*was a reasonable response to the FCA's concern about the mis-selling of IRHPs...*". By the date of the Initial Agreement, it is plain that the FSA's "concern" was limited to providing redress only to a sub-class of Private Customers/Retail Clients – otherwise it would never have entered into that Agreement. While I disagree with what the FSA did, as a matter of regulatory policy in the exercise of its jurisdiction, nevertheless I have to consider whether, in respect of those customers it considered to be the proper subject of that exercise, its approach through a voluntary agreement was preferable to the alternative options. To that degree there is a symmetry between the questions in ToR 1 and ToR 3, which are expressly limited to the outcomes for customers within the scope of the Scheme.

28. In the event, the FCA went on to agree a further narrowing of the Scheme's scope. As with the Initial Agreement, the FSA had imposed another essentially arbitrary deadline to settle the terms of its agreement with the major banks – the end of January 2013. Timeliness of redress had been a major objective for the FSA throughout. By the end of January 2013, with no redress yet made by the banks, and no money transferred to eligible customers, the FSA was coming under considerable pressure.<sup>1287</sup> It agreed further major concessions on eligibility and did not include any adequate appeal mechanism from the decisions of the banks/Skilled Persons.
29. There is a question as to whether the Scheme Terms, as finally agreed by the FSA with the banks in early 2013, constituted such a deviation from the terms of the Initial Agreement as to place customers in a materially worse position than if the FSA had used its statutory powers. I would have expected the FSA to consider this in depth, and after appropriate consultation with all stakeholders. Yet, there is no evidence of any such consideration, whether at Board level or below. Nevertheless, I consider that, for those eligible, the Scheme still provided outcomes which were likely preferable to what they might have obtained through alternative options.
30. In the circumstances, I have concluded that:

---

<sup>1287</sup> See, for example, Chapter 4, Section 3, para. 110.

- a. The Initial Agreement was flawed from the outset, primarily by reason of its inappropriately narrowed eligibility, without proper justification.<sup>1288</sup> For those that remained eligible (just over 20,000 IRHP sales)<sup>1289</sup> and accepted their offers of redress,<sup>1290</sup> however, it likely led to a much greater gain than they might have achieved in the absence of the industry-wide agreement the FSA secured.
  - b. Even when the Initial Agreement was further, and inappropriately, narrowed after the Pilot Stage, it retained its relative advantages for those who continued to benefit from the Scheme.<sup>1291</sup> On balance, I am therefore of the view that the voluntary nature of the Scheme remained an appropriate way for the FSA to address concerns about the sale of IRHPs in respect of those customers.
  - c. Seen from the perspective of those Private Customers/Retail Clients not within scope, the Scheme was an inadequate regulatory response to the FSA's concern about the mis-selling of IRHPs, leaving them without any of the benefits it afforded to eligible customers. I deal with this issue in ToR 2, below.
31. Moreover, from a lessons learned perspective, the process by which the Scheme was agreed and developed illustrates some of the difficulties inherent in relying on a voluntary agreement. In particular, these include: (i) the risk of being driven to excessive concessions in the course of the negotiations, and (ii) the risk of limiting the regulator's ability, in law and/or in practice, to abandon the agreement and use its statutory powers instead.
32. The FSA, and later the FCA, did give some consideration to pursuing potential disciplinary action in parallel to the Scheme. However, each time this came up for consideration, the decision was taken not to institute enforcement proceedings against any of the banks or individuals and, at best, only limited progress was made in preparing

---

<sup>1288</sup> See ToR 2.

<sup>1289</sup> This figure refers to the number of customers who remained eligible after the further changes made to the eligibility criteria in January 2013. See Chapter 5, Section 1, para. 25, Figure 4

<sup>1290</sup> See Chapter 6, Section 1, para. 4.

<sup>1291</sup> See ToR 3, para. 74.

any potential enforcement action.<sup>1292</sup> This appears to have been partially driven by concerns about perceived risks to the implementation of the Scheme. Yet, it left the FSA without a viable fallback option and thus arguably in a significantly weaker bargaining position. The decision not to pursue enforcement, and particularly disciplinary options, meant that elements of possible misconduct (other than those appropriate to be dealt with by way of a redress scheme) avoided any regulatory action – for example, potential issues such as inappropriate sales incentives, and shortcomings in systems and controls, were not addressed by the Scheme.

33. In my view, the FSA/FCA should have carried out a more intensive investigation of the root causes of the mis-selling before concluding not to pursue enforcement action. Nothing in the Scheme prevented that and it could have been done in parallel to the creation and implementation of the Scheme. With the benefit of such further investigatory work, the FSA/FCA would have been in a much better position to assess whether to pursue enforcement action in addition to the Scheme and, if so, to implement such action(s) successfully.

**(e) The appropriateness of the communication of the substance and operation of the scheme, including the issuing of guidance, to persons potentially affected by it**

**(f) The transparency of the scheme, including the confidentiality of the agreements with the firms**

**(g) The work to identify and maintain relationships with key internal and external stakeholders and the extent, nature and frequency of any communications**

34. The appropriateness of the communication of information about the Scheme, the issue of transparency, and the engagement with stakeholders are best considered together.

35. The common law requires those who take public law decisions to do so in accordance with due process. As such, regulators must not only aim to make the appropriate substantive decisions in the exercise of their jurisdiction but must do so in the appropriate

---

<sup>1292</sup> See FCA Records, *Internal Document*, 4 January 2013, FCA-ADD-003-0057, p. 5 and FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-C-010-0004, p. 4; see further Chapter 3, Section 4, paras. 52-3 and Chapter 5, Section 3, paras. 163-7.

way. Transparency is an important aspect of ensuring due process and should be part of the "culture" of any regulatory body.<sup>1293</sup> A lack of transparency risks undermining fair and balanced decision-making, alienating those whose interests are to be protected and, more generally, jeopardising the efficient operation of the regulated markets.

36. I have concluded that in the period I am covering under ToR 1, from March 2012 to April 2013, the FSA fell below the appropriate standards of transparency for the reasons outlined below. The lack of transparency had a knock-on effect on the appropriateness of the FSA's communications during this period, resulting in inadequate information being provided to those potentially affected by the Scheme, and/or in information being provided to them in an ineffective (and hence inappropriate) manner.
37. The FSA's principal failing on transparency, in my opinion, was the lack of consultation on: (i) the nature, terms and scope of the Scheme before it entered into the Initial Agreement with the banks (including the decision to proceed by way of a voluntary agreement), and (ii) the changes subsequently made to the Scheme following the Pilot Review. Consultation, in this context, does not necessarily require a formal consultation exercise. It does, however, entail affording a meaningful opportunity to all stakeholders, including those potentially affected by the Scheme, to make representations on the planned course of action and thereby potentially influence the decision-making process.
38. As regards the Initial Agreement, and in particular the decision to limit the scope of the Scheme to only a subset of the class of Private Customers/Retail Clients, this was of such importance that it should have been preceded by consultation. I consider that the FSA should have set out the different options and its reasons for proposing to limit the agreement to only a subset of Private Customers/Retail Clients below a certain size or lacking knowledge and experience of IRHPs. Such an exercise would have resulted in much more effective scrutiny of the proposals, as well as greater stakeholder 'buy-in'. It would also have provided a check on the FSA making inappropriate concessions in the course of the negotiations.

---

<sup>1293</sup> As expressly acknowledged in the FCA's regulatory principles under section 3B(h) FSMA from 24 January 2013.

39. To similar effect, I consider that consulting on the subsequent changes to the Initial Agreement would have contributed to better decision-making by: (i) providing the FSA with a wider and more balanced range of views, (ii) limiting the scope for inappropriate and rushed concessions, and (iii) improving the – real or perceived – fairness of the process. The perception of fairness, in particular, must not be underestimated: while the FSA had regular contact with a range of stakeholders, including some customers and their representatives, they were not afforded a proper opportunity to give meaningful input on key changes before these were agreed. Rather, the changes to the Scheme – which made it considerably less favourable to customers – were negotiated in last-minute discussions behind closed doors with the banks. The only other stakeholder to be consulted on these at the time was HMT – then the main shareholder of two of the first-tier banks.<sup>1294</sup> The evidence considered by the Review shows that the inability of other stakeholders (and particularly those directly affected by these changes) to have any meaningful input at the time seriously undermined trust in the integrity of the regulatory process and in the Scheme more generally.<sup>1295</sup>
40. In its representations to this Review, the FCA argued that it was "*not realistic to expect the FSA to have consulted on the nature, terms or scope of the Scheme before agreement was entered into, or subsequent changes to be made after the Pilot review*" and that a formal consultation "*would have clearly delayed the achievement of settlement and therefore the swift substantial redress and other actions needed to ensure customers that were most at risk did not continue to experience detriment.*"<sup>1296</sup> However, any consultation could have been carried out in an expedited manner. To the extent that the FSA was concerned about further delay, it could have sought to agree (or, failing agreement, impose under its statutory powers) interim triage measures, such as foreclosure restrictions and payment moratoria akin to those included in the Initial Agreement. Moreover, substantial redress was "*delayed*" in any event: it took almost a

---

<sup>1294</sup> See Chapter 4, Section 4, paras. 116-24.

<sup>1295</sup> See, for example, Meeting Transcript Q (P20:L19-20) and (P21:L24-P22:L1). This point is also considered at Chapter 3, Section 5, para. 57.

<sup>1296</sup> FCA representations dated 30 March 2021, para. 3.8.

year from the Initial Agreement to start implementing the Scheme in May 2013 and it took years for all eligible customers to receive redress.<sup>1297</sup>

41. Former and existing FCA personnel stressed that there were regular communications with external stakeholders, including customers, their representatives such as Bully-Banks and the FSB, individual MPs, the TSC, the APPG, and experts on derivatives, all of which I accept. The decisive shortcoming in respect of these was that key decisions made by the FSA/FCA were generally presented to these interlocutors as a *fait accompli*, rather than affording stakeholders an opportunity to shape the decision-making process. In the absence of such engagement, and in circumstances where key aspects of the Scheme were not, or not readily, accessible to them, the FSA/FCA failed to persuade many such stakeholders of the merits of the Scheme or the fairness of the process leading to its adoption.
42. There is a further issue as to whether the FSA's wider communications to stakeholders, and the public generally, allowed a level playing field between the banks (who were privy to all the information in relation to the Scheme Terms) and the customers who were potentially the beneficiaries of redress. In my view they did not. While the FSA put into the public domain a significant amount of information about the Scheme Terms, this was provided in piecemeal fashion across multiple disparate website publications, including "click through" pages and via FAQs and links on its website.<sup>1298</sup> Critically, it also did not include the actual Scheme Terms which third parties were unable to access until it was published by the TSC in 2015.<sup>1299</sup> This undermined wider public trust in the Scheme and in the process by which it was established.<sup>1300</sup>
43. The above conclusions also raise the question whether the FSA/FCA would have been able to comply with the principle of transparency without acting in breach of the law. In its representations to this Review, the FCA argued that: (i) before agreement was reached, the proposed nature, terms or scope of the Scheme were part of "*without prejudice*" negotiations and "*the banks would have had to agree to the lifting of 'without prejudice'*

---

<sup>1297</sup> See Chapter 5, Introduction, para. 2.

<sup>1298</sup> See Chapter 5, Introduction, para. 3 and Chapter 5, Section 1, paras. 18-21.

<sup>1299</sup> See Chapter 5, Section 3, para. 89-101.

<sup>1300</sup> See ToR 3 and 4.



*restrictions*", that (ii) section 348 FSMA applied to confidential information received as part of "*without prejudice*" negotiations – as well as, subsequently, the information contained in the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters – and disclosing the information without the banks' consent would have amounted to a criminal offence; and (iii) in any event it was bound by the confidentiality clause in the Initial Agreement.<sup>1301</sup>

44. In respect of those representations, however:

- a. The "*without prejudice*" rule is a rule of evidence which prevents a party from relying, in court, on what was said in settlement negotiations. It does not, without more, prevent a party from disclosing the contents of negotiations to third parties.<sup>1302</sup> In any event, even without reference to "*without prejudice*" material, some form of consultation would have been possible.
- b. As to section 348 FSMA, Parliament has recognised that regulatory authorities, having statutory powers to obtain confidential information, must protect the confidentiality of that information – but not to the extent that it overrides the exercise of their statutory functions, such as the protection of consumers. That is why the relevant statutory provisions provide for a number of exceptions which permit disclosure of confidential information. These exceptions allow the regulator to disclose confidential information in various circumstances including, for example, where disclosure is made for the purposes of enabling or assisting the regulator to discharge any of its public functions.<sup>1303</sup> Whether the publication of the confidential information comprised in the Scheme Terms would have been permitted under the exceptions set out in section 349 FSMA was never tested before the courts.<sup>1304</sup> Contrary to the representations made by the FCA to this

---

<sup>1301</sup> FCA representations dated 30 March 2021, para. 3.8.

<sup>1302</sup> See *EMW Law LLP v Mr Scott Halborg* [2017] 3 Costs LO 281 at paras. 44-5.

<sup>1303</sup> Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001/2188, reg. 3(1). These exceptions were not considered in the 2013 First-Tier Tribunal decision in *Jonny Landau v IC and FCA* EA/2013/0098, where the FCA itself argued that it was prohibited from disclosing the Initial Agreement to Mr Landau pursuant to section 348 FSMA.

<sup>1304</sup> The nearest case being the First Tier Tribunal decision in *Jonny Landau v IC (Freedom of Information Act 2000)* EA/2013/0098.

Review,<sup>1305</sup> I consider that disclosure of the kind referred to above likely would have fallen within one or more of the exceptions.<sup>1306</sup> In any event, I have seen no evidence that the FSA/FCA properly considered this and carried out the kind of balancing exercise that would have been appropriate to determine whether and what disclosure was possible in this case.

c. As to the confidentiality clause in the Initial Agreement,<sup>1307</sup> to the extent that the FSA/FCA was bound not to disclose the relevant terms to any third party on that basis, it was the author of its own misfortune. The FSA/FCA allowed itself to be (and to be seen to be) entirely dependent on the banks for its ability to inform Parliament and the public about the specific terms and conditions of the Scheme, of which it was the author and which was designed to bring redress to thousands of customers. The FSA never should have agreed to a clause in those terms.

45. In all the circumstances, my view is that the FSA/FCA did not strike the appropriate balance between the two public interest principles of transparency and the protection of confidential information.

46. Finally, I should comment on the interaction with HMT. There was some evidence before the Review that HMT sought to influence the FSA in connection with the likely cost of the Scheme to the banks, both generally, in respect of the FSA's reasoning and approach, and particularly, in relation to eligibility. Despite this, the evidence suggests that throughout the period from March 2012 to April 2013, the creation and development of the Scheme remained under the control of the FSA and that its decisions were those of an independent body. In particular, the evidence does not suggest that it was the cost of

---

<sup>1305</sup> The FCA's initial position, in its representations dated 30 March 2021, was that "*there were no relevant gateways [i.e. exceptions] under which the information could be disclosed.*"; FCA representations dated 30 March 2021, para. 3.16. Subsequently, in its further representations dated 2 July 2021, the FCA said its "*considered view [was]... that an expansive interpretation of the [discharge of public functions] self-help gateway, which on a wide reading might be thought to allow the FCA to publish any information it considers it appropriate to publish, is problematic, not least because it would substantially undermine the s348 secrecy obligations which Parliament has considered sufficiently important to make it a criminal offence to breach.*" FCA representations dated 2 July 2021, para. 3.13.

<sup>1306</sup> See further Chapter 5, Section 3, para. 94.

<sup>1307</sup> The confidentiality clause only came into effect after the Initial Agreement was entered into on 29 June 2012.

the Scheme to the banks that persuaded the FSA to agree to the limitations on eligibility (even if these limitations did in practice result in a reduction of the banks' costs).

47. In order to protect the practice and public perception of the system of independent regulation, both the executive and the regulator have to be keenly alert to ensuring the FCA's independence is maintained and seen to be maintained at all times. This applies especially where HMT has a direct financial interest in the outcome of decisions taken by the FCA, as it did in relation to the matters that are the subject of this Review.

## ToR 2

**"2) Whether the criteria for eligibility to benefit from the Scheme were appropriate, including:**

- (a) The scope of the Scheme in light of the FSA's jurisdiction, including the definition of SMEs who might benefit from it, the products covered and whether it was right to exclude commercial loans with MTM break costs.**
- (b) The different approach to remediation based on the complexity of the products."**

### **(a) The scope of the Scheme**

1. My main conclusion on the scope of the Scheme is that the FSA was wrong to confine it to a subset of Private Customers/Retail Clients which it designated as 'non-sophisticated'. The FSA thus avoided, without adequate objective justification, its wider responsibilities to secure redress for all Private Customers/Retail Clients who had been mis-sold IRHPs and to whom the banks owed the same regulatory obligations they owed to 'non-sophisticated' customers. Moreover, to the extent that the FSA's objective was to secure redress only for customers other than those who knew or should have known about the risks of IRHPs, it failed to find a mechanism appropriate to that objective: it relied on a complex mix of quantitative criteria never properly tested for their suitability for that task, as well as an alternative qualitative test.
2. The regulatory context, and specifically the FSA's jurisdiction, is my starting point for consideration of whether the FSA acted appropriately in excluding from the Scheme all of those Private Customers/Retail Clients designated by the FSA as 'sophisticated'. As explained in Chapter 2,<sup>1308</sup> the COB and the COBS respectively seek to classify/categorise customers according to their relative knowledge, expertise and experience – and the corresponding degree of regulatory protection they need. They differentiate between Private Customers/Retail Clients on the one hand,<sup>1309</sup> and

---

<sup>1308</sup> See Chapter 2, Section 3, paras. 49-63.

<sup>1309</sup> While there are differences between the Private Customer and Retail Client classifications, in both cases such customers were the lowest of the three categories and therefore afforded the highest degree of regulatory protection.

Intermediate Customers/Professional Clients on the other hand (including the process of "opting up" those in the former categories and instead including them in the latter).<sup>1310</sup>

3. After MiFID came into force,<sup>1311</sup> due to differences in the requirements, some corporates who may previously have been categorised as Intermediate Customers fell to be classified as Retail Clients (rather than Professional Clients, which was the nearest equivalent to the Intermediate Customer category). As such, more customers were categorised as Retail Clients and thus afforded greater protection than before.
4. I am satisfied that in the same way as the FSA Rules and MiFID drew the line between Private Customers/Retail Clients and Intermediate Customers/Professional Clients, the FSA was right in not extending the Scheme to Intermediate Customers/Professional Clients. The former category was entitled to greater protection under the rules than the latter, notwithstanding that a number of the same COB/COBS rules may have been engaged for both.<sup>1312</sup> However, all Private Customers/Retail Clients were entitled to equal regulatory protection. There was no proper basis for differential treatment of different customers within that category.
5. As other regulatory authorities, the FCA may use its judgment and discretion where appropriate. It is not necessarily inappropriate for the FSA/FCA to treat persons within the same client class/category differently. These categories do not operate as a straitjacket allowing no discretion on the part of the regulator, under which intervention for one must mean precisely the same kind of intervention for all. However, persons falling within the same category all have rights, which the regulator has a corresponding duty to protect. The FSA/FCA should not discriminate between them without an adequate and well-evidenced objective justification for different treatment.
6. Where the FCA considers that there is an objective justification for limiting the scope of redress only to certain persons within a defined category, there should be proper consultation with stakeholders before any such action is taken. In that context, the FCA should explain its intended approach and the reasons for it (for instance that that sub-

---

<sup>1310</sup> See Chapter 2, Section 3, paras. 49-67.

<sup>1311</sup> See Chapter 2, Section 3, para. 67.

<sup>1312</sup> See Chapter 2, Section 3, paras. 49-63.

group alone has suffered detriment and/or that the wider scope would be disproportionate) and allow affected persons and other stakeholders a proper opportunity to make representations in respect of the proposed restriction of scope. None of this was done in relation to the exclusion of 'sophisticated' customers from the scope of the Scheme.

7. Those considerations are supported by the FSA/FCA rules. The importance of the distinction between the different categories of customers/clients and where that line is drawn is underlined by the fact that the rules and MiFID impose stringent conditions upon a bank if it wishes to elevate a Private Customer/Retail Client from that category to that of Intermediate Customers/Professional Clients, with the resulting reduction in regulatory protections afforded to them. Those conditions include an assessment of the customer's relevant experience and knowledge, and obtaining their consent to the reclassification.<sup>1313</sup> Despite imposing such conditions in relation to the removal of protections for Private Customers/Retail Clients in its own COB/COBS rules, the FSA decided that it could and should disenfranchise from the Scheme all of those Private Customers/Retail Clients that it considered to be 'sophisticated' without itself complying with those requirements (including, in particular, obtaining the relevant customers' consent to the reclassification).
8. In its representations to this Review, the FCA acknowledged that "*the ideal redress scheme would have included all customers who had suffered loss as a result of being mis-sold IRHPs.*"<sup>1314</sup> It argued, however, that "*achieving the outcomes... through a voluntary agreement necessarily involved some trade-offs.*"<sup>1315</sup> Overall, the FCA considered that "*[i]n the context of a tough negotiation in a short time, significant push back from some of the banks and with a relatively weak bargaining position, the FSA achieved a very substantial result.*"<sup>1316</sup>
9. In particular, in its representations to the Review, the FCA did not agree that all Private Customers/Retail Clients were (or are) entitled to equal regulatory protection, or that the FSA had a responsibility to secure redress for all Private Customers/Retail Clients.

---

<sup>1313</sup> See Chapter 2, Section 3, paras. 53-5.

<sup>1314</sup> FCA representations dated 30 March 2021, para. 1.4.

<sup>1315</sup> FCA representations dated 30 March 2021, para. 1.4.

<sup>1316</sup> FCA representations dated 30 March 2021, para. 1.5

Referring to the consumer protection objective under section 5 FSMA (which applied to the FSA in 2012),<sup>1317</sup> the FCA argued that this did not impose a duty on the FSA to protect all customers of the banks against any risk.<sup>1318</sup> It submitted that it was reasonably open to the FSA to take the view that some customers falling within the Private Customer/Retail Client group likely would have appreciated the risks in purchasing an IRHP, and that any redress scheme should be limited to non-sophisticated customers in order to secure more timely redress given the very difficult financial circumstances that many of them were facing.<sup>1319</sup>

10. That representation does not, however, sit well with the legal and regulatory framework. Under FSMA, a "*consumer*" includes any person who uses regulated financial services, whether they be retail clients, investment professionals or market counterparties.<sup>1320</sup> Given the breadth of the definition, a different level of protection is appropriate for different categories of such "*consumers*". This was reflected in the COB/COBS customer classifications/client categories. It does not follow, however, that the FSA or the FCA was justified in further differentiating, by reference to the consumer protection objective or at all, as between consumers *within the same category* without adequate objective justification and without prior proper consultation with stakeholders. I have also seen no contemporaneous evidence to suggest that the FSA analysed or justified the concessions it made from time to time by reference to the consumer protection objective.

---

<sup>1317</sup> Section 5 FSMA was revoked on 1 April 2013. The consumer protection objective also applies to the FCA, section 1C FSMA.

<sup>1318</sup> In particular, the FCA pointed to the following factors which are relevant to the consumer protection objective: (a) the differing degree of risk involved in different kinds of investments or other transactions (section 5(2)(a) FSMA); (b) the differing degrees of experience and expertise that different consumers may have had in relation to different kinds of regulated activity (section 5(2)(b) FSMA); and (c) the general principle that consumers should take responsibility for their decisions (section 5(2)(d) FSMA).

<sup>1319</sup> FCA representations dated 30 March 2021, paras. 3.20-23.

<sup>1320</sup> Former section 5(3) FSMA (in force in 2012), read together with section 425A FSMA. See also section 1G FSMA.

i) *The Initial Agreement – major concessions to the banks*

11. The structure of the draft Initial Agreement shared with the banks on 25 June 2012<sup>1321</sup> provided for different obligations in respect of different sub-categories of customers, depending on the type of IRHP. The most stringent requirements applied in respect of the mis-sale of structured collars, in respect of which the banks were required to provide what was referred to as proactive redress. The FSA was prepared to limit such redress to only a subset of customers termed 'non-sophisticated', rather than to the whole category of Private Customers/Retail Clients.<sup>1322</sup> This was the stepping-stone to a much more extensive disapplication of the principle that all Private Customers/Retail Clients should be treated by the FSA in a like manner. As such, it was of profound significance in its effects on the accountability of the banks for their mis-selling.
12. The great majority of IRHPs sold during the Relevant Period were not structured collars, but a range of other products such as swaps, simple collars or caps.<sup>1323</sup> In respect of products other than structured collars, the banks were being asked to agree a PBR of sales against the relevant Regulatory Requirements, taking into account in particular the Sales Standards, with sales of caps only to be reviewed if complaints were raised by customers. Initially, the FSA intended that these reviews would cover sales to all Private Customers/Retail Clients.<sup>1324</sup> It was only in respect of structured collars that eligibility was to be limited to those classified as non-sophisticated.
13. The evidence before this Review shows that some of the banks made representations to the FSA that the scope of the whole Scheme, and not just Category A products, should be limited to non-sophisticated customers.<sup>1325</sup> The FSA assented to this, after what would appear to be the briefest possible consideration<sup>1326</sup> – thus changing the substance of the

---

<sup>1321</sup> See Chapter 3, Section 5, para. 66; and FCA Records, *Cover email and attachments*, 25 June 2012, 263741, 263742 and 263743. See also FCA Records, *Cover email and attachments*, 25 June 2012, 350753, 350754 and 350755. See further, Meeting Transcript G (P53:L19-25).

<sup>1322</sup> See Chapter 3, Section 5, paras. 56(e) and 66(b).

<sup>1323</sup> See Chapter 2, Section 2, paras. 21-32.

<sup>1324</sup> See Chapter 3, Section 4, para. 37 and Section 5, para. 66; and FCA Records, *Cover email and attachments*, 25 June 2012, 263741, 263742 and 263743. See also FCA Records, *Cover email and attachments*, 25 June 2012, 350753, 350754 and 350755. See further, Meeting Transcript G (P53:L19-25).

<sup>1325</sup> See Chapter 3, Section 5, para. 71.

<sup>1326</sup> See Chapter 3, Section 5, paras. 72-3.



Scheme with a couple of strokes of the pen, and taking thousands of customers and IRHP sales outside of its scope.

14. I have tried to establish, from contemporary written records and from interviews, why that major decision was taken. I have found no material records to assist me in understanding the FSA's reasoning, and interviewees who were involved in the decision-making process were unable to explain why the change was made.
15. The FSA knew at the time that around 30,000 IRHPs were sold to Private Customers/Retail Clients from 2001 to 2011 (many of them during the period from 2005-2008)<sup>1327</sup> and that a significant proportion of these were likely to have been mis-sold.<sup>1328</sup> Nonetheless, it decided that only some of these customers should be eligible for any relief for mis-selling under the Initial Agreement, with a cut-off point if they were above a certain size,<sup>1329</sup> which was considered to be some form of a proxy for sophistication (and which was termed the "*objective test*").<sup>1330</sup> Customers above the low quantitative threshold had no ability under the Scheme to demonstrate that they should be eligible.
16. The quantitative criteria used were taken from provisions in the Companies Act, which had no connection with FSMA, but were concerned with limiting the scope of companies required to undertake statutory audits.<sup>1331</sup> The FSA adopted this threshold with no adequate formal or informal consultation with stakeholders as to the utility or scope of such a quantitative test. It remains unexplained why a remedy under the Scheme should be denied to a customer just because, applying the quantitative criteria, it met two or more out of three indicators regarding its size (turnover, assets, employees). Why, putting it more simply, should the relative size of a Private Customer/Retail Client alone exclude

---

<sup>1327</sup> See Chapter 3, Section 3, paras. 31-2 and FCA Records, *Internal Document*, 268304, slide 4.

<sup>1328</sup> See Chapter 3, Section 3, para. 21 and FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-B-0010, pp. 9-10 and 29, which sets out that, by the end of May 2012, the FSA estimated that the mis-selling rate was between 5 per cent and 30 per cent and used an estimate of 20 per cent for the purposes of determining the redress estimate for swaps and collars.

<sup>1329</sup> There was also the alternative subjective test in the Initial Agreement, as referred to in para. 18 below, added in late June 2012. The alternative subjective test was applied to determine whether such customers were or were not deemed sophisticated based upon whether the customer had the necessary experience and knowledge to understand the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved.

<sup>1330</sup> See Chapter 3, Section 5, para. 67.

<sup>1331</sup> Sections 382 and 477 Companies Act.

it from eligibility for redress for a mis-sold product? I have seen no adequate explanation of why the Companies Act test was adopted or what the FSA's objective was in doing so. In my view, the automatic quantitative threshold was not objectively reasonable, nor appropriate.

17. Specifically, the Review has found no clear evidence as to how the Companies Act size test was identified as appropriate. There was no clear evidence of any impact analysis having been undertaken (save a subsequent and very basic exercise in relation to the revisions to the Scheme, which sought to identify in numerical terms how many more customers would be included and excluded).<sup>1332</sup> There was no examination of whether the test or tests to be applied were the right ones, and the "*blunt tool*" as it has been described appears to have been adopted at the suggestion of one of the banks.<sup>1333</sup>
18. By comparison, the rationale of the alternative subjective test for sophistication, which was not included in the draft Initial Agreement but was added in late June 2012,<sup>1334</sup> is clearer. This enabled a bank to refuse eligibility if it found a customer to have knowledge and experience of the relevant products and their risks, even if that customer was otherwise eligible under the quantitative criteria. Under a number of the Regulatory Requirements and Sales Standards, an individual customer's knowledge and experience may be material to whether there was a mis-sale of IRHPs.<sup>1335</sup> However, a customer's knowledge and experience at the time of the contract does not relieve a bank from its obligations under the regulatory rules. The status of a customer cannot give the bank an automatic regulatory 'free pass' to avoid the consequences of its own breaches. This applies especially in respect of IRHP mis-sales where knowledge and experience would have been irrelevant (such as where the bank unreasonably insisted on a duration longer than the term of the loan, or unfairly and unnecessarily tied the purchase of an IRHP to

---

<sup>1332</sup> See Chapter 4, Section 3, paras. 68 and 89; and Chapter 5, Section 1, paras. 14-7.

<sup>1333</sup> As it was described in the FCA's Summary Grounds of Resistance in R (Jenkinson and ors.) v FCA (unreported; CO/5140/2013). See FCA Records, *Correspondence*, 22 May 2013, 500852, para. 21.

<sup>1334</sup> Chapter 3, Section 5, paras. 71(a) and 72(a).

<sup>1335</sup> See Initial Agreement and Appendix, FCA Records, Initial Agreement, June 2012, FCA-ADD-002-0001; see also, for example, COB 2.1.3 R and COB 2.1.4 G at Chapter 2, Section 3, para. 66.a, and COBS 9.2.1 R, at Chapter 2, Section 3, para. 67.c.

the loan, each of which would be considered as a breach). In my view, the subjective criterion, therefore, was also not appropriate.

19. Together, the two tests meant that the FSA agreed to exclude from the scope of the Scheme any customer who had or acquired knowledge and experience of the relevant IRHPs, or who was deemed, by its relative size, to have had, or should have had, such an understanding. The FSA appears to have taken the view that either scenario relieved it from any responsibility to look after such customers' interests in the event of any breaches of the rules designed for their protection.
20. Customers found to be 'sophisticated' under either test fell outside the boundaries of the Scheme and were deemed to be able to look after themselves. As such, they could not rely on any support from the FSA/FCA but were confined to whatever recourse there might be through the courts, the FOS, or the banks' internal complaints processes. While the FSA recognised such opportunities for redress were available outside the Scheme, it knew or ought to have known that they were limited.<sup>1336</sup> The FOS was an option only for individuals or micro-businesses.<sup>1337</sup> Success in the courts could generally not be achieved through reliance on breaches of the regulatory rules (unless the customer was a "*private person*", which excludes incorporated businesses),<sup>1338</sup> but only through establishing a case in contract or tort. Such general rules of law are far less prescriptive in their obligations than the Regulatory Requirements (including the Sales Standards) which those eligible under the Scheme could rely on.<sup>1339</sup> Moreover, by January 2013, when the components of the Main Scheme had been agreed with the major banks, many

---

<sup>1336</sup> The Financial Services Authority, "*Interest rate hedging products*", 18 August 2012, accessible at <https://webarchive.nationalarchives.gov.uk/20120818011014/http://www.fsa.gov.uk/static/pubs/other/interest-rate-hedging-products.pdf>

<sup>1337</sup> Chapter 2, Section 4, paras. 102-4; and Chapter 3, Section 1, para. 7 and Section 3, para. 25.

<sup>1338</sup> See Chapter 2, Section 3, paras. 99-103. See also the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001, section 3.1. In these Regulations, "private person" means - (a) any individual, unless he suffers the loss in question in the course of carrying on: (i) any regulated activity; or (ii) any activity which would be a regulated activity apart from any exclusion made by article 72 of the Regulated Activities Order (overseas persons); and (b) any person who is not an individual, unless he suffers the loss in question in the course of carrying on business of any kind.

<sup>1339</sup> Chapter 2, Section 4, paras. 102-4.

of the claims in common law would have become barred due to expiry of limitation periods.

21. Despite the severe impact of that new policy on eligibility, it appears to have 'gone through on the nod' and was never subsequently reversed. I am clear that the FSA should never have agreed to limit eligibility for the Scheme, without adequate justification and consultation. Concluding the Initial Agreement on this basis (i.e. limiting eligibility within the category without such justification/consultation) was a serious regulatory error. This was exacerbated by the speed with which the relevant decisions were taken, the absence of any proportionality assessment weighing likely benefits and detriments, the lack of any meaningful involvement by the Board, and the failure to pause for proper consultation, formal or informal, with stakeholders.
22. In reaching these conclusions, I have considered the context of many customers in serious financial hardship requiring rapid regulatory intervention. It may be argued<sup>1340</sup> that the FSA did the best it could, that the regulator has to be able to use its discretion to go for a less than perfect solution in order to concentrate on those most in need, and that knowledge and experience of the products and their risks was a justifiable "*blunt tool*"<sup>1341</sup> to distinguish between customers in a less than homogeneous category. However, that was not the way the FSA first approached the problem in 2012 when it recognised, correctly, that its duties were to the category as a whole, for the purposes of a PBR. It then departed from this position without adequate justification or consultation. The FSA/FCA, like any regulator, should comply with the principles of transparency and proportionality before any such exclusionary policy is adopted but failed to do so in this case.
23. At a minimum, the FSA should have been prepared to take the potential agreement off the table and step back from its self-imposed June 2012 deadline. In its representations to this Review, the FCA argued that: (i) by keeping the agreement "*on the table*", the FSA succeeded in securing significant benefits, including speedy redress for customers

---

<sup>1340</sup> Some of the following arguments were broadly the arguments raised by the FCA in R (Jenkinson and ors.) v FCA (unreported; CO/5140/2013).

<sup>1341</sup> As it was described in the FCA's Summary Grounds of Resistance in R (Jenkinson and ors.) v FCA (unreported; CO/5140/2013). See FCA Records, *Correspondence*, 22 May 2013, 500852, para. 21.

within scope; (ii) it is by no means clear that taking the agreement "*off the table*" would have achieved a better outcome for excluded customers; (iii) it "*would have led to slower redress for those customers within scope of the Scheme*"; and (iv) the use of alternative regulatory tools might eventually have resulted in the same overall level of benefits for some customers within the scope of the Scheme, but it is likely that others (for example those affected by limitation periods) would not have received redress and the results, if achieved at all, would have been achieved significantly more slowly and with far greater use of FSA resources.<sup>1342</sup> However, as noted above, to the extent the FSA was concerned about further delay, it could have agreed or imposed interim 'triage' measures.<sup>1343</sup> This would then have allowed the FSA to undertake the necessary and proper analysis and consultation as to whether, exceptionally, differential treatment of customers in the same category was justified.<sup>1344</sup>

24. In any event, a decision had been taken. The Scheme would henceforth include a concept whereby a certain subset of Private Customers/Retail Clients would never be entitled to benefit, regardless of whether or not the sales of IRHPs to such customers were compliant with the Regulatory Requirements, including the Sales Standards.
25. The consequence of the FSA's decision to draw a distinction between customers on the basis of inappropriate criteria was to give the banks immunity from responsibility under the Scheme in respect of the ineligible customers. Moreover, no further regulatory action was taken by the FSA/FCA in respect of the banks' agreements with these customers.
26. In the round, I consider that the FSA should have stayed within its regulatory rules and parameters when designing and agreeing the Scheme Terms. It was inappropriate to make the concessions described above, both in substance and in the way in which these came about, and thereby to restrict its intervention to only a subset of the customers entitled to regulatory protection. By thus restricting the scope of the Initial Agreement, the FSA deprived a cohort of Private Customers and Retail Clients of the ability to benefit from

---

<sup>1342</sup> FCA representations dated 30 March 2021, para. 3.5.

<sup>1343</sup> See ToR 1, para. 40. There was no evidence before this Review suggesting that the banks would have resisted such interim measures and, in any event, they could have been imposed by an OIVOP or an OIReq.

<sup>1344</sup> As to the FCA's representations on consultation, see ToR 1, para. 40 above.

the Scheme.<sup>1345</sup> The banks would have had ample opportunity, had the Scheme encompassed all Private Customers and Retail Clients, to avoid financial responsibility in appropriate cases, such as by showing that, on the facts, a sale was compliant in accordance with the Sales Standards.

27. In my view, therefore, the inclusion of the Sophisticated Customer Criteria in the Initial Agreement was inappropriate.

*ii) The Supplemental Agreement: further changes to the criteria for exclusion*

28. I now turn to the changes to the Sophisticated Customer Criteria that the FSA agreed after the Initial Agreement, in the period leading up to the Main Scheme. As described in Chapter 4, the Initial Agreement was followed by the Pilot Review. Having agreed the initial scope of eligibility (which in my view was already inappropriate), in the course of the Pilot Stage, the FSA made further concessions on the Sophisticated Customer Criteria.<sup>1346</sup> The Review has seen no evidence as to whether the FSA and later the FCA ever established the number of customers deemed to be non-sophisticated under the quantitative test set out in the Initial Agreement who were moved across into the category of sophisticated customers.<sup>1347</sup> However, the final reports of the primary Skilled Persons of the first-tier banks highlight the high number of customers that were ultimately excluded from the Scheme because of the quantitative test in the Supplemental Agreement.<sup>1348</sup> The changes to the eligibility criteria were all agreed 'behind closed

---

<sup>1345</sup> See Chapter 5, Section 1, paras. 16-7, which details the banks' responses to an FSA request to compare the numbers of customers who would have been included under the Initial Sophisticated Customer Criteria used in the Initial Scheme and the Sophisticated Customer Criteria. By way of example, the banks' responses estimated that the numbers of non-sophisticated customers had fallen from: 4,024 to 2,848 (Lloyds); 3,133 to 2,933 (Barclays); 403 to 297 (AIB); and 91 to 63 (Co-op Bank). See respectively FCA Records, *Email*, 1 March 2013, 822329; FCA Records, *Email*, 1 March 2013, 371179; FCA Records, *Email*, 1 March 2013, 826830; and FCA Records, *Email*, 27 February 2013, 823224.

<sup>1346</sup> See Chapter 4, Section 4, paras. 125-33.

<sup>1347</sup> See Chapter 5, Section 1, paras. 16-7 and 24-5.

<sup>1348</sup> According to the final report of KPMG, Skilled Person 1 for Barclays, 542 customers were excluded on the basis of the quantitative test; FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 65 (REPORT 009). According to the final report of KPMG, Skilled Person 1 for RBS, 2,258 customers were excluded on this basis; FCA Records, Skilled Person report (RBS), 19 May 2016, p. 107 (REPORT 010). According to the final report of Deloitte, Skilled Person 1 for HSBC, 1,229 customers were excluded on this basis; FCA Records, Skilled Person report (HSBC), 10 November 2016 p. 60 (REPORT 005). According to the final report of EY, Skilled

doors', without consultation or explanation, meaning that customers found themselves suddenly excluded from the Scheme without knowing why this was being done and without any opportunity to comment before the changes were made (although the FSA's Pilot Findings Paper did subsequently seek to explain the changes).<sup>1349</sup>

29. In the course of the Pilot Review, the FSA reached the view that there were a number of "weaknesses"<sup>1350</sup> in the eligibility criteria set out in the Initial Agreement.<sup>1351</sup> In particular, it was concerned that under those criteria certain types of businesses (such as bed & breakfasts and farms) would be ineligible to benefit from the Scheme, while others (such as SPVs linked to large multinational companies) would qualify. Despite these concerns, mostly taking the form of illustrative examples (rather than a proper assessment of which businesses would or would not be covered), they were sufficient for the FSA to consider amending the Sophisticated Customer Criteria. It thereby sought to ensure that only the 'right' subset of Private Customers/Retail Clients would be eligible for the Scheme – without ever clearly articulating what that subset should be. Aided by this lack of specificity, the banks succeeded in getting the FSA to make several substantial concessions on the scope of the Sophisticated Customer Criteria. The position eventually arrived at – a mix of criteria of considerable complexity, as set out in the Supplemental Agreement – reflected the banks' very considerable success in further limiting their financial exposure to redress for Private Customers and Retail Clients.
30. In reviewing, for the purposes of this Report, the gradual evolution of the Sophisticated Customer Criteria, a key indicator of the appropriateness of the FSA's actions is found in the repeated warnings from GCD.<sup>1352</sup> It alerted the CSRC, which had primary responsibility for the relevant decisions, that any changes to the Sophisticated Customer Criteria would need to be rational, reasonable, capable of justification, and based on

---

Person 1 for Lloyds, 3,382 customers were excluded on this basis; FCA Records, Skilled Person report (Lloyds), 9 September 2019, p. 20 (REPORT 006).

<sup>1349</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, March 2013, FCA-A-0011, p.11.

<sup>1350</sup> FCA Records, *Internal Document*, 7 February 2013, 814079, para. 9.

<sup>1351</sup> In its Pilot Findings Paper, the FSA noted that "*During the pilot exercise, we observed that the original sophistication test, specifically the application of the three 'objective' criteria, did not always achieve the outcome we expected*"; see FCA Records, *Interest Rate Hedging Products – Pilot Findings*, March 2013, FCA-A-0011, p. 11.

<sup>1352</sup> See Chapter 4, Section 3, paras. 82-3 and, 98 and Section 4, para. 130.

sufficient assessment of the advantages, disadvantages and impacts on both customers and banks. These warnings were not heeded.

#### The Companies Act Group Test

31. One of the relevant changes concerned customers who were part of a group for the purpose of consolidating their accounts. In respect of these, the FSA now accepted that the Sophisticated Customer Criteria should be applied by reference to the group, rather than the particular customer. If the group of companies collectively failed to satisfy a small Companies Act group test,<sup>1353</sup> it did not matter whether any individual members of the group were below the thresholds. They were all deemed to have the status of a sophisticated customer and thus were ineligible.<sup>1354</sup> This change in approach meant that, in effect, the FSA assumed knowledge and experience of IRHPs as a result of the group structure, even if none existed at the level of the subsidiary that had purchased the relevant IRHP.

#### The £10 million Value Test

32. A further change meant that what had originally been proposed as a notional value "overlay"<sup>1355</sup> became a new, stand-alone exclusion in respect of the aggregation of a customer's notional value of IRHP contracts to a figure of £10 million.<sup>1356</sup> The assumption made by the FSA was that, at the time of the sale of the IRHP which tipped the total value above £10 million, such a customer had, or should have, acquired the appropriate knowledge and experience of the IRHPs and their risks. A customer (such as a property developer) who had purchased an IRHP with a value of £10 million or more for the first time was assumed to have, or ought to have had, the necessary knowledge,

---

<sup>1353</sup> The test applied distinguished between Companies Act groups which were deemed to be a small Companies Act groups or not under section 383 Companies Act. Section 383 provided for "*Companies qualifying as small: parent companies*" and stated "(1)A parent company qualifies as a small company in relation to a financial year only if the group headed by it qualifies as a small group." Section 383 applies in a very similar way in which the section 382 Companies Act, which differentiate between those companies deemed large and those deemed small, applying near identical size criteria. In both cases, the effect was to relieve the small company or small parent company of the obligation to file audited accounts.

<sup>1354</sup> See Chapter 4, Section 3, paras. 93-100.

<sup>1355</sup> See Chapter 4, Section 3, paras. 88 and 95.

<sup>1356</sup> See Chapter 4, Section 4 paras. 127-33.



even if *ex hypothesi* it did not have the experience. In either scenario, the customer was left to carry the risk, simply on the size of the contract or contracts. The £10 million threshold for this appears to have been an essentially arbitrary figure, again with minimal underpinning analysis or impact assessment by the FSA, albeit still significantly higher than the threshold suggested by the banks.<sup>1357</sup>

33. In addition, the £10 million notional test was further extended to apply not only to individual customers but as an aggregate test across any Companies Act group, even if the individual group members' IRHPs did not exceed that threshold.

#### The BIPRU test

34. A further change was that customers who were not part of a small Companies Act group could nonetheless be treated as part of a group if they met the so-called BIPRU test.<sup>1358</sup> If a BIPRU group had IRHPs amongst them of over £10 million in value, all of the members of the group would be assumed to be sophisticated, irrespective of the knowledge and experience of the individual customer.

#### *iii) The effect of the further changes*

35. As indicated above, I have seen no evidence of any adequate analysis or impact assessment underpinning the various changes, whether individually or collectively.<sup>1359</sup> The FSA should not have proceeded simply on the basis of untested assumptions, which themselves were built on the error of adopting the Companies Act test as a proxy in the first instance. Rather, the FSA could and should have obtained evidence on the likely impact of the various proposed iterations of the Sophisticated Customer Criteria on the population of Private Customers/Retail Clients who were (mis-)sold IRHPs during the

---

<sup>1357</sup> See Chapter 4, Section 4, paras. 130-3.

<sup>1358</sup> See Chapter 4, Section 4, paras. 113 and 127-30.

<sup>1359</sup> Although the minutes of the CSRC meeting on 15 January 2013 refer to obtaining a view on the impact of the proposed changes, this appears to have been limited to an assessment of the likely impact of some of these changes on a sample drawn from Barclays' customer population. This was far from thorough or complete and, in my view, provided no authoritative means by which the FSA could reach a meaningful view on the impact the changes would have. FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089; FCA Records, *CSRC Minutes*, 15 January 2013, FCA-B-0090, pp. 1-2.

Relevant Period. It should have carried out both a proper analysis of whether it was appropriate to exclude such customers, and a process of consultation.<sup>1360</sup>

36. Moreover, the final version of the Sophisticated Customer Criteria in the Supplemental Agreement no longer included the previously contemplated safeguards for customers who would fall outside the scope of the Scheme as a result of changes to the criteria.<sup>1361</sup>
37. Together, these changes excluded many previously eligible customers from the scope of the Scheme,<sup>1362</sup> creating an overall decrease in the number of customers falling within the scope of the Review.<sup>1363</sup> In its representations to this Review, the FCA argued that *"the FSA introduced these changes following consideration with both the banks and consumer groups during the Pilot Review, which identified that there were businesses who were classified as 'non-sophisticated' under the original test that it thought were likely to have understood the risks associated with IRHPs and should not be included in the review"*.<sup>1364</sup> The FCA also referred to SPVs as companies that were reasonably taken out of the scope of the Scheme. There is nothing in the evidence before this Review that suggests that *"consumer groups"* were consulted on, or approved of, these changes. The FCA also asserted that it is inaccurate simply to describe the sophistication criteria as 'narrowing' post-Pilot and that the (then draft) Report placed emphasis on the changes that were made which excluded more customers. The FCA said that *"a large focus"* at the time was to ensure that certain customers previously identified as excluded were included.<sup>1365</sup> Yet, the number of customers excluded significantly exceeded those included as a result of the changes.<sup>1366</sup>

---

<sup>1360</sup> As set out in Chapter 5, Section 1, paras. 14-5, the IRS Steering Group asked banks to compare the number of customers who would have been included under the Initial Sophisticated Customer Criteria and those included under the Sophisticated Customer Criteria. However, this request was made after the Supplemental Agreements were signed and the Review has found no evidence that the FSA considered making any changes to the test, at this point or as a result of the information provided. Rather, it seems that this request was for the FSA's information only.

<sup>1361</sup> In particular, the removal of the feedback loop, and a proposed clause in the agreement that no customers who were previously eligible for the Scheme should be removed from its scope as a result of the proposed amendments.

<sup>1362</sup> See Chapter 5, Section 1, paras. 16-7.

<sup>1363</sup> See Chapter 5, Section 1, paras. 16-7.

<sup>1364</sup> FCA representations dated 30 March 2021, para. 3.37.

<sup>1365</sup> FCA representations dated 30 March 2021, paras. 3.36 and 3.37.

<sup>1366</sup> See Chapter 5, Section 1, para. 17.

38. On the FCA's own analysis,<sup>1367</sup> the Sophisticated Customer Criteria resulted in over one-third of all trades with Private Customers/Retail Clients being removed from the scope of the Scheme. The final reports of the primary Skilled Persons for the first-tier banks show that for three of the banks the excluded sales as a result of the amended Sophisticated Customer Criteria varied from 18 per cent to 23 per cent. For the fourth first-tier bank, excluded sales represented no less than 70 per cent of its Retail Clients and Private Customers who had been sold IRHP(s) in the Relevant Period.<sup>1368</sup>
39. In the circumstances, in the period following the Initial Agreement, the FSA made very substantial concessions in favour of the banks – indeed, the FSA itself referred to having made "*big concessions*" in relation to the Sophisticated Customer Criteria.<sup>1369</sup> In making these changes, it appears to have consulted primarily with the banks, carrying out insufficient impact analysis or wider stakeholder engagement.
40. Yet, in substance, the FSA was following the logic of the premise on which its original Sophisticated Customer Criteria had been based: that in order to limit the scope of the Scheme and avoid a case-by-case analysis of every contract with every Private Customer/Retail Client who had bought an IRHP in the Relevant Period, a boundary had to be set. It was unsurprising that the banks sought to raise the threshold for eligibility as much as possible, given that the greater the number of customers deemed "sophisticated",

---

<sup>1367</sup> In 2013, FCA employee P noted that ">35% of customers already excluded on the basis of the *sophistication test*"; FCA Records, *Email*, 1 November 2013, 006537, p. 1. Further, the FCA's Progress of sales through stages of the review as at 30 September 2016 shows that 34 per cent of customers were excluded from the Scheme on the basis of sophistication; see The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf>.

<sup>1368</sup> According to the final report of KPMG, Skilled Person 1 for Barclays, 18% of customers were excluded from the Scheme as a result of the Sophisticated Customer Criteria; FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 63 (REPORT 009). According to the final report of KPMG, Skilled Person 1 for RBS, 19 per cent of customers were excluded on this basis; FCA Records, Skilled Person report (RBS), 19 May 2016, p. 83 and p. 106 (REPORT 010). According to the final report of Deloitte, Skilled Person 1 for HSBC, 23 per cent of customers were excluded on this basis; FCA Records, Skilled Person report (HSBC), 10 November 2016 p. 26 (REPORT 005). According to the final report of EY, Skilled Person 1 for Lloyds, 70 per cent of customers were excluded on this basis; FCA Records, Skilled Person report (Lloyds), 9 September 2019, p. 3 (REPORT 006).

<sup>1369</sup> See Chapter 4, Section 5, para. 139(b).

the lower the cost of the Scheme would be for them.<sup>1370</sup> The FSA fell short, in my view, in failing to resist these efforts sufficiently, and in agreeing to significant additional restrictions on eligibility without proper justification, consultation, analysis, or safeguards.

*iv) The appropriateness of the criteria for eligibility to benefit from the Scheme*

41. It was never clear, nor obvious, why customers who fell on the wrong side of the quantitative criteria (whether as set out in the Initial Agreement or as amended subsequently) should be excluded from the Scheme in the first place. The FSA appears to have proceeded on an impressionistic view that certain kinds of Private Customers/Retail Clients were deserving of regulatory protection, whereas others were not, without ever expressly articulating or testing that approach. On that basis, it adopted and varied the eligibility criteria (often at the instigation of the banks), with only a vague understanding of the real-world impact these changes would have on businesses that had been mis-sold IRHPs. This was particularly problematic as customers deemed sophisticated under the objective test had no opportunity of disproving this under the Scheme. The built-in asymmetry gave the banks 'two bites of the cherry'; whereas customers faced failing either the quantitative or qualitative test, without any adequate means of challenge. Such customers had no opportunity to demonstrate that they were in fact non-sophisticated, no matter how arbitrary the result produced by the strict application of the eligibility criteria was in their case.
42. Overall, far from using the Pilot Stage to satisfy itself that only those with genuine knowledge and experience of IRHPs and their risks would be excluded, the FSA embarked upon a significant further narrowing of the eligibility criteria for the Scheme. Having made further concessions down to the last moment, it ended up with an untested, unsampled mix of criteria so complex they had to be set out in a diagram resembling an intricate ancestry chart.

---

<sup>1370</sup> In their representations to the Review, a number of the banks emphasised that their financial interests were not the primary, or indeed any, motivation for the design and implementation of the Scheme. See ToR 2, para. 7.

43. As a result, in respect of some 10,000 excluded sales to customers, the banks were relieved of any responsibility under the Scheme to provide redress.<sup>1371</sup> The affected customers had no opportunity of arguing that they were mis-sold IRHPs, and were unable to obtain redress either under the Scheme or through any other action of the FSA/FCA. For the reasons explained above, I have concluded that this was not appropriate.
44. I do not consider that the permission decision of the Administrative Court in R (Jenkinson and ors.) v FCA<sup>1372</sup> ("R (Jenkinson)") alters this conclusion. The applicants in that case sought judicial review of a number of aspects of the eligibility requirements under the Scheme, including on irrationality grounds. In an order refusing permission to apply for judicial review, Silber J. gave only brief written reasons. No oral renewal hearing was sought. The issue before the High Court, however, was one of legality on a rationality review and in that context the judge emphasised the high threshold the claimants had to meet in that context and expressed hesitation about interfering with the exercise of discretion by a specialist regulator. In contrast, the issues in the ToR are much broader and relate to what was appropriate, not just rational. Moreover, the judge did not have before him the vast majority of the extensive evidence considered by this Review. Further, the Applicants did not challenge the critical distinction between 'sophisticated' and 'non-sophisticated' customers within the same category. That being the case, it is unsurprising that the £10 million value test – the only aspect of the challenge in relation to which the applicants were not out of time – was not seen by the judge as irrational, but as an exercise of discretion as to how the test might be applied. In the circumstances, I am not persuaded that R (Jenkinson) is relevant to my conclusions.

The scope of the Scheme in respect of the products covered

45. My starting point is, again, the regulatory context surrounding the status of IRHPs. In summary, my view is that the inclusion of stand-alone IRHPs and the exclusion of

---

<sup>1371</sup> The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf>.

<sup>1372</sup> Judicial review case in 2013 (unreported; CO/5140/2013).

embedded IRHPs was appropriate in light of the statutory limits to the FSA's jurisdiction, also referred to as its regulatory perimeter.

46. As described in Chapter 2,<sup>1373</sup> at all times during the Relevant Period, the RAO determined what activities constituted regulated activities and established what instruments were regarded as "Specified Investments". These included "Contracts for differences etc".<sup>1374</sup> Stand-alone IRHPs are and were during the Relevant Period regarded for regulatory purposes as contracts for differences. As a result, aa regulated firms (including the banks) were placed under certain obligations by the FSA/FCA when selling those products to Private Customers/Retail Clients.
47. However, TBLs or loans with embedded swaps or hedging (as opposed to stand-alone IRHPs) were not specified investments under the RAO. As such, entering into contracts for the sale of such products did not constitute a regulated activity. It follows that, even though many of these products had almost identical economic characteristics for customers, they were not regulated products and fell outside the FSA/FCA's regulatory perimeter. In other words, the FSA/FCA was not lawfully able to regulate them.
48. During its oversight of the Scheme, the FSA/FCA was aware of these limitations: it had powers over the sale of stand-alone IRHPs but not commercial loans with embedded IRHP characteristics.<sup>1375</sup> It made that position clear to the TSC in its review into SME banking.<sup>1376</sup> The FCA also took advice from Leading Counsel on its powers in respect of TBLs,<sup>1377</sup> as did the TSC, both of whom confirmed such products fell outside the FCA's regulatory perimeter.<sup>1378</sup>

---

<sup>1373</sup> See Chapter 2, Section 3, paras. 34-7.

<sup>1374</sup> See Chapter 2, Section 3, para. 35.

<sup>1375</sup> See Chapter 5, Section 3, paras. 143-8.

<sup>1376</sup> See House of Commons Treasury Committee, "*Voluntary redress schemes for SMEs*", 26 October 2018, paras. 111-112, accessible at [https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/805/80506.htm#\\_idTextAnchor064](https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/805/80506.htm#_idTextAnchor064).

<sup>1377</sup> See Chapter 5, Section 3, para. 147; FCA Records, *Instructions to Counsel*, 17 May 2014, 485829; FCA Records, *Email*, 4 June 2014, 005385.

<sup>1378</sup> See Chapter 5, Section 3, para. 147; The TSC instructed its own Leading Counsel to review the advice that the FCA received from Leading Counsel on its powers in respect of TBLs; see FCA Records, *Treasury Committee Opinion*, 7 January 2015, 1328013.

49. Although the TSC was critical of aspects of the FCA's supervision of the sale of IRHPs, it made no criticism of the FCA's acceptance of the perimeter of its statutory powers, or of the limited steps it took to intervene in respect of TBLs. Neither do I. Given the applicable regulatory framework, it would not have been appropriate to include embedded IRHPs or TBLs within the Scheme or to have sought to design some other bespoke scheme for such products.<sup>1379</sup>
50. Overall, I am therefore satisfied that the FSA acted appropriately in confining the scope of the Scheme to stand-alone IRHPs, i.e. those products that were regulated. It is not for me as the Independent Reviewer to conclude that, without any statutory authority and in circumstances in which the FCA had itself drawn this lacuna in its powers to the attention of HMT and the TSC, it should nevertheless have included unregulated products in the Scheme. To have done so without agreement would have been *ultra vires* and therefore unlawful. Moreover, to embark on a process of seeking a voluntary agreement from all the banks, in a context in which there were no FSA rules and no powers of enforcement in the event of a refusal by the banks to enter into such a scheme, would have stretched the legitimacy of regulatory conduct to its limits and beyond. It was not for the FSA to assume powers it did not possess. Where appropriate, the answer lies in an extension of statutory powers, not an assumption that they already exist. These are matters for Parliament.

**(b) The different approach to remediation based on the complexity of the products.**

51. I have reached the view that the Scheme's different approach to remediation based on the complexity of the products was broadly appropriate. In particular, I agree that the FSA was right, at least in the first instance, when it had little knowledge of the scale of the issue, to draw a distinction between the three categories of products, and to require proactive redress only for Category A products. It was also right, in my view: (i) to

---

<sup>1379</sup> I note that the FSA did agree with NAGE to include certain commercial loans it had sold within the scope of the Scheme. The fact that it did so, and did not do so with the other banks, in my view cannot be viewed as a regulatory error. It was a one-off arrangement, in the special circumstances of NAGE engaging in the sale of certain products, which it then ceased to market. To put that limited agreement in perspective, over 80 per cent of NAGE's commercial loans were still excluded from the Scheme, and the type of TBL being sold by NAGE appeared not to have been sold by the first-tier banks.

require a PBR for Category B products, where redress would depend upon proof of breach of the Regulatory Requirements, including the Sales Standards (unlike Category A products), and (ii) to separate Category C products from Category A and Category B products, but still require compliance with the same Sales Standards, albeit with a review triggered only by a specific complaint.

52. It is arguable that the distinction between structured collars (Category A products) and simple collars (one of the Category B products) was more one of degree and may not have justified such different treatment. Nevertheless, when the FSA first formulated the structure of the Scheme, it considered that structured collars entailed an extra element of complexity compared to other IRHPs and thus not suitable for customers it classed as non-sophisticated. I consider that was a reasonable distinction to draw.
53. Category A products also had a separate status, in that: (i) the banks agreed to cease marketing structured collars to Retail Clients as part of the Initial Agreement,<sup>1380</sup> and (ii) for remedies, structured collars were ruled out as a suitable replacement product, whereas the substitution of other IRHPs could constitute fair and reasonable redress. In the course of the implementation of the Scheme, however, the FCA's approach changed to encouraging the banks and Skilled Persons to use caps over other products where redress took the form of a replacement product.<sup>1381</sup> Again, I consider that this difference in the approach to remediation was appropriate.

---

<sup>1380</sup> See Chapter 3, Section 5, para. 78(f).

<sup>1381</sup> See Chapter 5, Section 3, para. 113. See also ToR 3, para. 52.



### ToR 3

"3) Whether overall, the scheme delivered fair and consistent outcomes for SMEs within the scope of the scheme in a proportionate and transparent way, including:

- (a) *The approach to technical issues, such as but not limited to break cost, contingent liability, application of the sophistication criteria and alternative products as redress (swaps for swaps)*
  - (b) *The approach to consequential losses including the appropriateness of guidance given by the FSA, both formal and informal*
  - (c) *The treatment of SMEs in financial difficulty or insolvency*
  - (d) *Whether the involvement of the skilled persons appointed under s166 FSMA provided adequate assurance that the banks acted fairly in discharging their obligations under the IRHP agreements to achieve consistent outcomes*
  - (e) *The extent and effectiveness of the FSA's and later the FCA's oversight of the scheme, including the level of reliance on skilled persons and approach to ensuring consistency across firms and skilled persons*
  - (f) *Whether the agreements provided adequate mechanisms to allow SMEs within the scope of the scheme to challenge proposed redress offers*
  - (g) *The impact of SMEs' ability to refer their case to the Financial Ombudsman Service before their case has been resolved via the redress scheme*
  - (h) *The approach to monitoring firms' progress and the work of the skilled persons, including the production of management information"*
1. This section of the Report will address the outcomes of the Scheme, considering whether they were fair and consistent, and whether the FSA/FCA, in particular when engaged in their delivery, acted in a proportionate and transparent manner. The objective of the Scheme was to put customers within its scope (including, but not limited to, SMEs) back in the position in which they would have been, absent a breach. In my view that was fair and in line with sound principles of compensation for loss. It was fair to the banks, as a breach by itself would not necessarily have caused loss. It was also fair to the customers,

not least because the redress could lead to the rescission of the contract and full repayment if, for example, absent the breach they would never have entered into any hedging contract. In essence, the issues are whether fair outcomes were indeed delivered, as the Scheme provided for, and whether outcomes were delivered consistently for different customers of the same bank and across the different banks.

2. The ToR, however, impose a limit on the extent to which I can give a complete answer to the questions posed in ToR 3 (in my view for good reason): it is outside the scope of the ToR to "*assess the appropriateness and reasonableness of individual offers*" or to reopen individual cases and accordingly the Review has not done so.<sup>1382</sup> Nevertheless, the outcomes referred to in ToR 3 are the aggregate of individual decisions in relation to around 16,500 IRHP sales to customers.<sup>1383</sup> Given that none of these customers' cases could be reopened or considered in any detail in this Review, I am limited in my conclusion to what can be deduced from the wider evidence.
3. I have had the benefit of reviewing the reports of the Skilled Persons and I have met with some of their representatives, as well as with representatives of some of the banks. This has enabled me to form a clearer and broader view than that available only from the perspective of the FCA's records and the evidence provided by its personnel. The results, broken down by bank, reveal differences in the outcomes across the banks in terms of the type of redress accepted or not by customers.<sup>1384</sup> Given the number of cases involved, however, it is not possible for me to say whether they were fairly decided, even if the offers were accepted. Similarly, I have no audit function to review the reports of the Skilled Persons, each of whom reported to the FCA their conclusions as to the banks' compliance with the terms of the Scheme and the methodologies they had agreed to. No

---

<sup>1382</sup> The Financial Conduct Authority, "*Terms of Reference*", 20 June 2019, accessible at <https://www.fca.org.uk/publication/corporate/terms-of-reference-interest-rate-hedging-products.pdf> (ARTICLE 010), para. 4.

<sup>1383</sup> The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf>.

<sup>1384</sup> See Figure 5 at para. 6 of Chapter 6 which sets out the differences between the banks with respect to the number of redress outcomes that were either full tear-ups or caps.

doubt this is why the Board has asked me for a view as to "*whether the scheme overall delivered fair and consistent outcomes ...*".<sup>1385</sup>

4. Subject to that reservation, I go on to address the questions in order.

**Whether overall, the scheme delivered fair and consistent outcomes for SMEs within the scope of the scheme in a proportionate and transparent way, including:**

**(a) The approach to technical issues, such as but not limited to break costs, contingent liability, application of the sophistication criteria and alternative products (swaps for swaps)**

5. Even after the Scheme Terms had been finalised, a number of technical issues remained critical to the outcomes for customers under the Scheme.

*i) Break costs*

6. Within the scope of the Scheme, Sales Standard 2 – on the adequacy of disclosure of potential break costs – was the fulcrum on which fair redress for customers largely depended. It had been the focus of sustained discussions between some of the banks and the FSA during the Pilot Review.<sup>1386</sup> The FSA insisted that disclosure of break costs required an explanation of what break costs were, whether and how they might apply to the customer, and an indication of their potential size.<sup>1387</sup> The last could be achieved through, for example, providing an indicative figure, or an explanation of how break costs could be calculated.<sup>1388</sup> It may be open to question whether these requirements went beyond the applicable regulatory rules. Ultimately, however, that question is not of material relevance to the fairness of the Scheme. Customers benefited from any such extension, while the banks expressly agreed to the inclusion of Sales Standard 2 in the

---

<sup>1385</sup> The Financial Conduct Authority, "*Terms of Reference*", 20 June 2019, accessible at <https://www.fca.org.uk/publication/corporate/terms-of-reference-interest-rate-hedging-products.pdf> (ARTICLE 010), para. 3; emphasis added.

<sup>1386</sup> See, for example, Chapter 3, Section 5, para. 64; and Chapter 4, Section 3, paras. 69-72.

<sup>1387</sup> FCA Records, *FAQs for Skilled Persons*, 18 September 2012, 347285, p. 1

<sup>1388</sup> See Chapter 4, Section 2, para. 48(b)(ii).

Scheme, and did not challenge the way it was developed in the FAQs issued by the FSA.<sup>1389</sup>

7. A key issue at the implementation stage of the Scheme was whether the practical application of these requirements would be robust enough to secure fair results. The banks had a financial incentive to argue on a case-by-case basis that disclosure had been sufficient.<sup>1390</sup> The evidence in the reports of the Skilled Persons, however, is that the banks' methodologies appropriately assessed Sales Standard 2.<sup>1391</sup> Applying the Scheme Terms, as supplemented by the FAQs, a breach of Sales Standard 2 was found in the large majority of cases. This applied across all of the banks, although with some differences.<sup>1392</sup>
8. The approach to break costs under the Scheme therefore appears to have been undertaken appropriately and in a broadly consistent manner. Beyond this, I am not in a position to comment further, given that this Review has not reopened individual cases.

*ii) Contingent liability*

9. The concept of 'contingent liability' relates to an internal risk-monitoring calculation made by banks to estimate their potential exposure to a customer in an extreme case scenario. Some customers and representative groups have argued that the Scheme failed to take into account the impact of the banks' calculation of the contingent liability of IRHPs and the impact it had on a customer's creditworthiness and credit lines.<sup>1393</sup> This

---

<sup>1389</sup> See Chapter 4, Section 2, para. 48(b); Chapter 4, Section 3, para. 101; and Chapter 4, Section 4, para. 134.

<sup>1390</sup> In their representations to the Review however, a number of the banks argued that they were not motivated by any such financial incentives, but that their primary interest was to ensure fair outcomes for customers. See further footnote 1456.

<sup>1391</sup> For instance, EY, Skilled Person 1 for Lloyds, concluded that "*The final methodology, as amended during the Review, and its application by the Firm was considered appropriate*", including for the bank's classification of "*its application of the sales standards and regulatory requirements applicable to the Review*", FCA Records, Skilled Person report (Lloyds), September 2019, pp. 6-7 (REPORT 006).

<sup>1392</sup> For instance, KPMG, Skilled Person 1 for RBS, identified that Sales Standard 2 was breached in 70 per cent of RBS's trades; FCA Records, Skilled Person report (RBS) 19 May 2016, p. 130 (REPORT 010). By contrast, Deloitte, Skilled Person 1 for HSBC, identified that Sales Standard 2 was breached in 97 per cent of Category A and B products; FCA Records, Skilled Person report (HSBC), 10 November 2016, p. 69 (REPORT 005).

<sup>1393</sup> See Chapter 5, Section 3, para. 149.

might arise, for example, where an unrealised potential exposure was factored into a customer assessment undertaken by a bank, that then resulted in a detrimental effect on that customer (for example because they were unable to borrow additional funds, were required to provide additional security, or were prevented from re-mortgaging with another bank).<sup>1394</sup>

10. The question of contingent liability was brought to the FCA's attention late in the process, and only properly surfaced during the implementation of the Scheme.<sup>1395</sup> It was not covered under FSMA, nor the Principles and rules made under it, and was not addressed in the Sales Standards. A number of court cases found that at the time there was no specific requirement for a bank to disclose its internal credit limits to IRHP customers at the point of sale.<sup>1396</sup>
11. The legal and regulatory background meant there could have been no reasonable expectation on behalf of customers for such a requirement to appear in the Sales Standards. Moreover, in practice, the breadth of the Sales Standard relating to the disclosure of break costs would often have had an equivalent effect, at least in establishing breach. Adequate disclosure would generally have alerted the buyer of an MTM IRHP to the existence of a contingent liability in respect of the costs of early termination, and the concomitant potential impact on, for example, their credit lines.
12. To the extent that the purchase of an IRHP had a verifiable detrimental impact on a customer, the Scheme in relation to consequential loss could be applied to compensate them for any losses. It is less clear, however, how contingent liability issues were addressed in practice as an element of consequential loss – especially where customers had not been provided with information on this by the banks.<sup>1397</sup> This is not addressed in the Skilled Persons reports and there appears to have been no general FCA guidance to help the banks and Skilled Persons understand and deal with situations where a customer,

---

<sup>1394</sup> See Chapter 5, Section 3, para. 149. See further Chapter 5, Section 3, paras. 155-6.

<sup>1395</sup> See Chapter 5, Section 3, paras. 149-54.

<sup>1396</sup> See Chapter 5, Section 3, para. 154; and Property Alliance Group Limited ("PAG") -v- RBS PLC [2018] EWCA Civ 355, paras. 78-81; and Fine Care Homes Limited -v- (1) National Westminster Bank Plc (2) Natwest Markets Plc [2020] EWHC 3233 (Ch), 125-138

<sup>1397</sup> See Chapter 5, Section 3, paras. 155-6. In addition, the advice obtained from leading counsel on consequential loss did not address other issues such as contingent liability. FCA Records, *Re: Review of IRHPs – Consequential Loss*, 21 June 2013, 006731.

for example, suffered loss because they were unable to re-bank, refinance or draw upon further facilities in light of contingent liability (whether known to them or not).<sup>1398</sup> As a result, it may well be that customers did not receive consistent outcomes in this respect.

iii) *Application of the sophistication criteria*

13. As set out in ToR 2, I have concluded that the FSA acted inappropriately in respect of the criteria for eligibility to benefit from the Scheme.
14. Focusing on the practical application of the Sophisticated Customer Criteria, however, the evidence suggests that both the objective and the subjective tests presented only limited difficulties in application in practice. The Scheme required the banks to establish to the satisfaction of the Skilled Persons that the criteria had been applied in accordance with the terms of the Supplementary Agreement (which amended the criteria in the Initial Agreement). The Skilled Persons' reports support the view that, for the most part, this was done to their satisfaction and produced consistent results within the population of each bank.<sup>1399</sup>

iv) *Alternative products as redress ("swaps for swaps")*

There were three possible outcomes arising out of a sale found to have been in breach of the Regulatory Requirements, including the Sales Standards:<sup>1400</sup>

- a. full tear-up of the IRHP, with repayment plus 8 per cent interest and any (additional proven) consequential loss;
- b. an alternative product; or
- c. no redress.

---

<sup>1398</sup> Osborne Clarke, Skilled Person 2 for HSBC, took into account contingent liability when assessing consequential loss. However, the FCA did not require Skilled Persons to report specifically on this point and it is unclear whether every bank and Skilled Person approached these claims in the same way. See Chapter 5, Section 3, para. 156; and Meeting Transcript Osborne Clarke (P51:L12-25).

<sup>1399</sup> For instance, KPMG, Skilled Person 1 for RBS, notes that "*SPI considers that the Bank's classification of customers as sophisticated was appropriate and consistent with the approach prescribed by the FCA*". FCA Records, Skilled Person report (RBS), 19 May 2016, p. 28, para. 2.3.27 (REPORT 010).

<sup>1400</sup> See Chapter 4, Section 3, paras. 104-5.

15. This sub-issue deals with alternative products as redress. A bank could limit redress in this way if, applying the counterfactual, it was reasonable to conclude that the customer would have bought an IRHP but not the one actually bought (the latter case resulting in a 'no redress' outcome).<sup>1401</sup>
16. The risk inherent in this option was that banks might be incentivised to offer an alternative IRHP with a lower cost to themselves. To pre-empt this, the Supplemental Agreement and the Exchange of Letters required that in such cases the bank should presume, in the absence of evidence to the contrary, that: (i) the customer would have purchased a simple product (a cap, vanilla swap or vanilla collar), without any callable or extendable elements,<sup>1402</sup> and (ii) in respect of Sales Standard 2 the so-called 7.5% Rule applied, which stipulated that a customer should be presumed not to have taken an IRHP of a duration/tenor with a potential break cost greater than 7.5 per cent of the notional value of the IRHP in a pessimistic but plausible scenario.<sup>1403</sup> The latter caused significant confusion amongst both Skilled Persons and customers.<sup>1404</sup> Despite this, and its considerable complexity, the Skilled Persons' reports suggest that overall the 7.5% Rule was applied as intended.<sup>1405</sup> I have no reason to believe that either rule operated inconsistently or unfairly, and both are likely to have contributed to delivering fair and consistent outcomes for customers.
17. More problematic was whether an alternative product had to be a cap or whether it could be a Category B product such as a swap. Different Skilled Persons for the same bank were arriving at different conclusions on equivalent facts, as to whether a 'swaps for swaps' approach was permissible, or whether it had to be 'caps for swaps'.<sup>1406</sup> These differences were potentially material in terms of customer outcomes. Eventually, the FCA intervened to address the inconsistent approaches and give advice on how the Scheme should be interpreted in a customer-centric way.<sup>1407</sup> While this illustrates how

---

<sup>1401</sup> The approach taken in respect of that assessment is described in Chapter 5.

<sup>1402</sup> See Chapter 4, Section 3, para. 105(b).

<sup>1403</sup> See Chapter 4, Section 3, para. 105(b).

<sup>1404</sup> See Chapter 5, Section 1, paras. 33-4.

<sup>1405</sup> See, for example, FCA Records, Skilled Person report (RBS), 19 May 2016, p. 140, para. 12.2.16 and p. 144, para. 12.5.3 (REPORT 010).

<sup>1406</sup> See Chapter 5, Section 3, paras. 106-12.

<sup>1407</sup> See Chapter 5, Section 3, paras. 112-3.

elements of the Scheme allowed for inconsistent and potentially unfair outcomes, it also shows the positive role the FCA was able to play in many instances in addressing such concerns. There are, however, lessons to be learned for the FCA on trying to keep solutions simple and easy to implement, avoiding excessive complexity and thus potential inconsistency and unfairness.

18. The same applies in respect of the use of a counterfactual more generally. The speculation this required as to what a customer would have done had the mis-selling never occurred<sup>1408</sup> inevitably entailed significant complexity and potential for controversy.<sup>1409</sup> The FCA's encouragement of fast-track redress<sup>1410</sup> helped limit these issues and undoubtedly delivered more redress outcomes of full tear-ups than if the 'swaps for swaps' exercise had been followed in every case.
19. Overall, I consider that while 'swaps for swaps' had the potential to create unfair and inconsistent outcomes, these were largely averted through sensible action by the FCA in the implementation phase.

**(b) The approach to consequential losses including the appropriateness of guidance given by the FSA, both formal and informal**

20. The decision to include consequential loss within the Scheme and the approach to its assessment are described in Chapter 4.<sup>1411</sup> Although consequential loss was included only at a late stage, in my view that decision was appropriate. It gave effect to the principle that foreseeable losses attributable to a breach should generally be compensated, ensuring customers were put in the position they would have been in absent the breach.
21. However, the late inclusion of consequential loss gave rise to serious confusion in the implementation of the Scheme, adversely affecting banks and Skilled Persons as well as the customers eligible under the Scheme. The failure to have any consequential loss

---

<sup>1408</sup> Including whether the customer would have bought the same product but for the breach.

<sup>1409</sup> For a recent analysis of the difficulties of counterfactual analysis see, for example, the Supreme Court decision in Manchester Building Society v Grant Thornton UK LLP [2021] UKSC 20 [26].

<sup>1410</sup> The fast-track redress of "low lens" customers is explored further at Chapter 5, Section 3, paras. 116-122.

<sup>1411</sup> See further Chapter 4, Section 2, paras. 48(b)(iii) and 106; and Chapter 4, Section 4, paras. 114 and 136. The incorporation of consequential loss and interest payments into the Scheme is considered further at Chapter 5, Section 3, paras. 130-142.



determinations as part of the Pilot Review meant that there was no 'test run' during which some of the practical issues could be identified and addressed. This was compounded by: (i) the late modification of the approach, to align it with principles of tort law and introducing further complexity,<sup>1412</sup> and (ii) the piecemeal, confusing and equally late public guidance on what elements of consequential loss the 8 per cent interest rate on basic redress payments was/was not intended to cover.<sup>1413</sup> Even without any sample exercises on how consequential loss should be calculated, these issues ought to have been identified by the end of the Pilot Review and should have been addressed in the Pilot Findings Paper. If that had been done, I have little doubt that there would have been fewer claims, less stress on the resources of the banks and the Skilled Persons, and overall less delay in the settlement of the claims.

22. The FCA argued in its representations that it took reasonable steps to progress consequential loss issues during the Pilot Review, that consequential loss is intrinsically complex, and that any further work including 'test runs' would likely have caused a delay to the conclusion of the Pilot Review.<sup>1414</sup> While some work was done during the Pilot Review and the legal principles are of some complexity, such an important add-on to the redress principles could and should nevertheless have been properly tested before implementation. There is no evidence that the FSA considered and rejected carrying out any such tests at the time.
23. To highlight a few of the wider issues that arose in respect of consequential loss:
  - a. Both the Skilled Persons and the FCA felt compelled to seek separate legal advice from leading counsel on how consequential loss should be assessed.<sup>1415</sup>
  - b. The FCA found it necessary to put out further guidance well after the start date of the Main Scheme.<sup>1416</sup>

---

<sup>1412</sup> See Chapter 5, Section 3, paras. 132 and 138.

<sup>1413</sup> See Chapter 5, Section 3, paras. 137-8.

<sup>1414</sup> FCA representations dated 30 March 2021, paras. 4.3 - 4.5.

<sup>1415</sup> See Chapter 5, Section 3, paras. 132 and 135.

<sup>1416</sup> See Chapter 5, Section 3, paras. 135-8. Guidance in relation to consequential loss was issued by the FCA as late as April 2014. See Chapter 5, Section 3, para. 138.

- c. There was plainly widespread confusion and/or ignorance as to the limits of the types of loss that could be claimed under the legal principles that were meant to be applied.<sup>1417</sup>
  - d. A decision had to be made as to whether basic redress should be paid out before any claim for consequential loss was considered.<sup>1418</sup>
  - e. One Skilled Person had to decline to act on the ground of a lack of familiarity with the relevant tortious principles, and had to be substituted by a law firm.<sup>1419</sup>
24. Cumulatively, these issues may call into question whether the benefits of including this element of the Scheme outweighed its drawbacks. Nevertheless, I agree with the view expressed to this Review by one of the Skilled Persons:

*"I think more customers will have got recoverable consequential loss because it was kept within the review than would have been the case if it had been outwith the review because I think there were customers that got the benefit of some sizeable sums of money within the review who would not have had the means or the mechanism or the desire to go to court."*<sup>1420</sup>

25. As for the substance of the guidance given by the FCA (both formal and informal):
- a. In respect of the principles of assessment, it was broadly appropriate, even if overly complex and late.
  - b. In respect of the explanation of what the 8 per cent interest was intended to cover, it was so confusing as to cause a lot of unnecessary expense and serious misunderstandings as to the scope of the Scheme. Indeed, when the FCA itself published the results of the Scheme, it drew attention to the sizeable percentage accounted for by claims for consequential loss. Yet, that was only because the FCA included as consequential loss the £500 million accounted for by the 8 per cent

---

<sup>1417</sup> See Chapter 5, Section 3, paras. 134-7.

<sup>1418</sup> See Chapter 5, Section 3, para. 139.

<sup>1419</sup> See Chapter 5, Section 3, para. 140.

<sup>1420</sup> Meeting Transcript GQ, (P59:L5-11).

interest payments.<sup>1421</sup> The actual payments made specifically for consequential loss (i.e. over and above the £500 million in generic interest payments) amounted to only £50 million.<sup>1422</sup>

26. I have concluded that even though the inclusion of consequential loss in the Scheme was right in principle, key aspects of the FCA's approach in this respect were flawed and could have been improved significantly, had the relevant issues been identified earlier. The FCA's approach regarding consequential loss caused considerable confusion and delay, raised false hopes amongst many customers and led to unnecessary costs being incurred. A prompt, less complex and more consistent approach to consequential loss may well have avoided, or at least reduced, many of these adverse consequences. However, its eventual inclusion provided additional redress for a subset of customers, thereby improving the fairness of their specific outcomes.

**(c) The treatment of SMEs in financial difficulty or insolvency**

27. The provisions of the Scheme intended to assist customers in financial difficulty arose incrementally, as the scale and severity of the financial impact of IRHPs became more apparent. They are described in Chapters 3 and 4,<sup>1423</sup> and the manner in which they were implemented, including the issues that arose during implementation, is addressed in Chapter 5.<sup>1424</sup>

*i) Customers in financial difficulty*

28. As concerns customers in financial difficulty, the main provisions put in place were: (i) banks agreeing not to foreclose or adversely vary existing lending facilities (save in exceptional circumstances) without giving prior notice to the customer and obtaining their prior consent, pending final redress determination, (ii) moratoria on IRHP payments for customers that requested a suspension of payments and where the bank considered that the customer was in financial distress, and (iii) payment of basic redress before

---

<sup>1421</sup> The Financial Conduct Authority, "*Interest rate hedging products (IRHP)*", 14 May 2020, accessible at <https://www.fca.org.uk/consumers/interest-rate-hedging-products> (ARTICLE 039).

<sup>1422</sup> See Chapter 5, Section 3, para. 142.

<sup>1423</sup> See Chapter 3, Section 3, para. 28; Chapter 3, Section 5, para. 78g.; and Chapter 4, Section 3, para. 108.

<sup>1424</sup> See Chapter 5, Section 1, paras. 39-52.

determination of consequential loss claims.<sup>1425</sup> These measures were important in delivering fair outcomes overall, even if they were introduced only throughout the operation of the Scheme and a relatively small number of customers were able to benefit from the first two provisions.<sup>1426</sup>

ii) *Foreclosure*

29. The genesis of the foreclosure provisions is found in each of the banks' CEO attestations, which formed part of the Initial Agreement. Each CEO was required to personally ensure that their respective bank "*prioritises any Customers who are in financial difficulty and, except in exceptional circumstances, such as, for example, where this is necessary to preserve value in the Customer's business, will not foreclose on or adversely vary existing lending facilities (without giving prior notice to the Customer and obtaining their prior consent) until [the bank] has issued a final redress determination and, if relevant, provided redress to that Customer*".<sup>1427</sup> That attestation, however, did not expressly form part of the banks' review process as outlined in the Initial Agreement,<sup>1428</sup> or the Requirement Notices, until March 2013.
30. The FSA wrote to the banks during January 2013 outlining (amongst others) concerns from consumer groups that not all banks were adequately applying moratoria. That led to the amendment of the Requirement Notices requiring the Skilled Persons to assess the effectiveness of the banks' procedures for considering moratoria in individual cases.
31. At this stage, the FSA took the opportunity to include similar provisions to deal with foreclosures, in particular:
  - a. as regards the banks' responsibilities, the requirement stated banks "*will not (except in exceptional circumstances) foreclose on or adversely vary the existing lending facilities of Customers without giving prior notice to the relevant Customer and*

---

<sup>1425</sup> See Chapter 5, Section 1, para. 44; and Chapter 5, Section 3, para. 139.

<sup>1426</sup> See Chapter 5, Section 1, paras. 39-52.

<sup>1427</sup> See Initial Agreement and Appendix, FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, p. 7.

<sup>1428</sup> See Initial Agreement and Appendix, FCA Records, *Initial Agreement*, June 2012, FCA-ADD-002-0001, Terms of Proactive redress exercise and PBR, clause 3.

*obtaining their prior consent, until the Firm has issued a final redress determination and, if relevant provided redress to the Customer"; and*<sup>1429</sup>

b. as regards the Skilled Persons, the scope of their responsibilities was extended to "*provide independent oversight*" of the banks' approach to the undertakings they had given in relation to not foreclosing in certain circumstances.<sup>1430</sup>

32. As outlined in Chapter 5, the evidence from the final Skilled Persons reports suggests that foreclosure was considered in a small number of cases and the reports generally indicated that the first-tier banks put in place appropriate measures.<sup>1431</sup>

*iii) Moratoria*

33. The BBA announced in late 2012 that IRHP payments would be suspended on a case-by-case basis, at the customer's request, if banks determined that meeting the ongoing swap payments was causing financial distress.<sup>1432</sup> At the time, payments were suspended pending the outcome of the review.

34. Belatedly and under external pressure, the FSA concluded that this did not go far enough. As a result, the Requirement Notices issued around March 2013 were amended to include (amongst other things) moratoria for customers in financial distress.<sup>1433</sup> The evidence shows that banks granted 82 per cent of customer requests for a moratorium, as at April 2014 representing more than 1,500 customers.<sup>1434</sup>

35. It is unclear how fairly or consistently moratorium requests were determined. A Skilled Person for one of the banks, for example, concluded that: "*the Bank did not have a sufficient process in place for identifying, assessing and recording customer requests for*

---

<sup>1429</sup> FCA Records, *Requirement Notice*, 5 March 2013, 822094, p. 3.

<sup>1430</sup> See, for example, FCA Records, *Requirement Notice*, 5 March 2013, 822094, p.4.

<sup>1431</sup> For instance, EY, Skilled Person 1 for Lloyds, concluded that "*Overall the Firm's treatment was considered appropriate*"; FCA Records, Skilled Person report (Lloyds), 9 September 2019, p.7 (REPORT 006).

<sup>1432</sup> BBA, *Interest Rate Swaps: Businesses in Financial Distress (major banks review process)*, 11 December 2012, accessible at <https://www.bba.org.uk/news/statistics/sme-statistics/interest-rate-swaps-businesses-in-financial-distress-major-banks-review-process/#.XtIdglVKiUk> (ARTICLE 038).

<sup>1433</sup> See paras. 28-30 above; see further Chapter 5, Section 1, para. 44(b).

<sup>1434</sup> FCA Records, *Internal Document*, 15 April 2014, FCA-C-009-0013, p.3

*a suspension of existing IRHP payments in accordance with the agreement it had made with the FSA under the BBA initiative.*"<sup>1435</sup> While such evidence suggests that the process may have been applied inconsistently in practice, without reopening or reviewing individual cases, I am unable to reach a definitive conclusion on how widespread such issues were or what more could have been done to address them. Therefore, in my view, the inclusion of moratoria was an important aspect of helping customers in financial difficulty, contributing to fair outcomes for such customers.<sup>1436</sup>

*iv) Basic redress payments before determination of consequential loss claims*

36. The FCA and all but one of the banks agreed that basic redress should be paid before consequential loss claims were considered.<sup>1437</sup> While this was not specifically intended to assist those in financial difficulty, it provided an effective way of expediting redress and was therefore of considerable assistance to such customers.

37. A material weakness of this measure was that it was not included in the Scheme Terms. Instead, the FCA relied on the goodwill of the banks to implement it and, one of the first-tier banks declined to do so.<sup>1438</sup> As a result, there was an inconsistent approach among the banks in this respect.<sup>1439</sup>

*v) Speedier redress process for certain customers*

38. One further measure may have had a particular impact on customers in financial difficulty. The FCA and certain banks agreed to procedures designed to speed up the redress process for customers whom the banks and Skilled Persons perceived as having limited ability to understand IRHPs.<sup>1440</sup> While this may have led to inconsistencies regarding the speed with which redress was determined, depending on the customer's relative knowledge of IRHPs, I consider that this was nonetheless a proportionate and fair approach in the circumstances.

---

<sup>1435</sup> FCA Records, Skilled Person report (HSBC), 10 November 2016, p. 106 (REPORT 005).

<sup>1436</sup> By 15 April 2014, more than 1,500 customers had their payments suspended. FCA Records, *Internal Document*, 15 April 2014, FCA-C-009-0013, p. 3.

<sup>1437</sup> See Chapter 5, Section 3, para. 139.

<sup>1438</sup> See Chapter 5, Section 3, para. 139.

<sup>1439</sup> See Chapter 5, Section 3, para. 139; and FCA Records, *Email*, 22 October 2013, 1317419.

<sup>1440</sup> See Chapter 5, Section 3, paras. 116-22.

vi) *Dissolved companies*

39. The FCA introduced measures to enable dissolved companies, or more accurately their former owners and creditors, to secure redress.<sup>1441</sup> I agree with what the FCA noted at the time, namely that it would have been unfair simply to omit such companies from the Scheme.<sup>1442</sup> The measures effectively prevented this undesirable result<sup>1443</sup> and I therefore consider that the FCA took appropriate and proportionate steps to ensure that the Scheme delivered fair outcomes for dissolved companies. As regards consistency of outcomes, the Skilled Person reports suggest that, in general, the measures were successfully implemented.<sup>1444</sup>

vii) *Overall conclusions on the treatment of SMEs in financial difficulty or insolvency*

40. These measures by the FSA/FCA were of significant assistance to the customers benefitting from them. They offered relief for those in financial difficulty and prevented unfair exclusions from the Scheme. As noted above, in some instances the measures were not applied consistently, whether at a specific bank (for example, in relation to moratoria) or as between the banks (for example, in relation to redress payments before determining any consequential loss). Overall, however, I still consider that they were effective and contributed to fairer outcomes for a significant number of customers.

**(d) Whether the involvement of the skilled persons appointed under s166 FSMA provided adequate assurance that the banks acted fairly in discharging their obligations under the IRHP agreements to achieve consistent outcomes.**

41. Chapters 3 and 4 describe how the Skilled Persons were selected and how their role developed.<sup>1445</sup> Chapter 5 describes their involvement in the implementation of the

---

<sup>1441</sup> See Chapter 5, Section 1, paras. 39-42.

<sup>1442</sup> See Chapter 5, Section 1, para. 39.

<sup>1443</sup> See Chapter 5, Section 1, paras. 39-42.

<sup>1444</sup> KPMG, Skilled Person 1 for Barclays, noted that "*The Bank developed and implemented appropriate procedures with respect to dissolved entities*"; FCA Records, Skilled Person report (Barclays), 11 April 2016, p. 59, para. 6.5 (REPORT 009).

<sup>1445</sup> See Chapter 3, Section 4, paras. 37, 43-46; Chapter 3, Section 5, para. 69; and Chapter 4, Section 1, paras. 14-27.

Scheme, including the delineation of roles as between the banks, the Skilled Persons and the FSA/FCA.<sup>1446</sup>

42. The terms of appointment for Skilled Persons under the Scheme provided some assurance that the banks would be monitored in such a way as to ensure they acted fairly in discharging their obligations.<sup>1447</sup> There were also a number of notable safeguards built into the process:
- a. The Skilled Persons were selected from established professional services firms who were subject to professional conduct obligations and with measures taken to manage any conflicts of interest.
  - b. The FSA gave significant input on the selection of the Skilled Persons, reviewing each appointment in respect of competence, capability and independence.<sup>1448</sup>
  - c. On the substantive decisions, the Sales Standards (and in particular Sales Standard 2), were sufficiently rigorous that the vast majority of sales failed the test.<sup>1449</sup> Moreover, the principles of redress, both originally and as amended (with significant input from the Skilled Persons), further narrowed the opportunities for abusing the process.
  - d. No offer or refusal of redress could be processed without the Skilled Person concurring, so that any disagreement had to be addressed and resolved.
43. Nonetheless, I have three major structural concerns regarding the level of assurance that the Skilled Persons were able to provide under the Scheme:
- a. First, the banks were the primary decision-makers, whereas the role of the Skilled Persons was only one of secondary review. At an earlier stage in the development of the Scheme, the intention was that the Skilled Persons would be the primary

---

<sup>1446</sup> See Chapter 5, Section 2.

<sup>1447</sup> See Chapter 4, Section 1, para. 25.

<sup>1448</sup> See Chapter 4, Section 1, paras. 14-24.

<sup>1449</sup> For instance, KPMG, Skilled Person 1 for RBS, noted in its final Skilled Person report that "*The Bank identified that SS2 [i.e. Sales Standard 2] was breached in 70% of trades thus demonstrating that the disclosure of break costs was a common sales process failing.*" FCA Records, Skilled Person report (RBS) 19 May 2016, p. 34 (REPORT 010).



decision-makers,<sup>1450</sup> but that decision was reversed shortly before the end of June 2012.<sup>1451</sup> Their eventual role was a complex one. It was not limited simply to checking: (i) whether a bank had complied with the applicable rules and, if not, (ii) whether it was offering the right kind of redress. Rather, redress under the Scheme depended on a counterfactual, which introduced significant additional complexity and judgment in determining what was necessarily a speculative question. In applying the counterfactual, the Skilled Persons had to form a view as to whether they agreed with the bank's view on what a customer would have done if the bank had not mis-sold the IRHP.<sup>1452</sup> If the Skilled Persons had been the primary decision-makers, they might have taken a different view in such cases. Restricted to a secondary role of independent monitor, however, certain decisions might have been left to stand where the Skilled Persons considered they were reasonably open to the bank, even if the relevant Skilled Person might have taken a different view on the facts if itself making the initial decision.

- b. Second, the Skilled Persons would not actively participate in meetings between customers and the banks to discuss redress decisions/offers but would attend only as silent observers.<sup>1453</sup> This process failed to reassure customers that the banks

---

<sup>1450</sup> See Chapter 3, Section 4, para. 43.

<sup>1451</sup> A 31 May 2012 CSRC Summary Paper states that "*We recommend that we require firms to fund an independent review (by a skilled person, under s166) of past sales to retail clients*". FCA Records, *CSRC Summary Paper*, 31 May 2012, 285827, p. 3; A supporting May 2012 presentation lists an "*independent past business review (under s166)*" as part of "*The range of options available to us*". FCA Records, *Presentation – "Annex: Interest rate swaps – findings and recommendations for next steps"*, May 2012, 285149, p. 11. An 11 June 2012 presentation includes an "*independent review (s166) of past sales of swaps and simple collars*" with a "*focus on suitability*" as part of the FSA's "*Proposal for approach on past sales for all banks*". FCA Records, *Presentation - Interest rate swaps – initial findings and next steps*, 11 June 2012, 264671, p. 7; However, the 25 June 2012 draft initial agreement includes the banks as the primary decision-makers. Draft Initial Agreement and Appendix, FCA Records, *Email attachment*, 25 June 2012, 263743.

<sup>1452</sup> See Chapter 5, Section 1, para. 33.

<sup>1453</sup> EY, Skilled Person for a number of banks, gave evidence to the Review that on remaining silent during these meetings "*[We were] there to observe and...make sure that the process of the meeting was properly conducted rather than just to be an advocate for the bank or for the customer. And I think that was quite difficult for some customers to understand...It's just a weird situation for them [the customer] to find themselves in and they want to appeal to someone who is not the bank, who is the person who is giving them maybe the answer that they don't want to hear. The obvious person to appeal to was the independent person in the room who is overseeing it, but they can't respond to you.*" Meeting Transcript EY, (P68:L22-P69:L3).

were being kept in check and undermined trust in the effectiveness of the Skilled Persons.

- c. Third, the FCA decided that there should be no appeal from the redress decisions of the banks (as reviewed by the Skilled Persons) to any independent tribunal or other body. In the circumstances, the only assurance that the FCA could give to stakeholders was that it had satisfied itself as to the competence and impartiality of each of the Skilled Persons and that they would act in conformity with their appointment and associated requirements. The judgment of the Court of Appeal in Holmcroft<sup>1454</sup> confirmed the lacuna in the Scheme. There was no way of challenging the FCA in respect of redress decisions under the Scheme, no means of judicially reviewing the decision of the banks as confirmed by the Skilled Persons, and no right of appeal to an independent tribunal from these decisions – thus leading to a lack of accountability for what was ultimately a regulatory intervention. This was compounded by the limited prospects for all customers, eligible or not, of success in pursuing private law claims.<sup>1455</sup>
44. Each of these issues risked causing unbalanced and potentially unfair decisions. Moreover, in practice the FCA did not allocate sufficient capacity during the implementation phase to oversee the decision-making process in respect of individual decisions, or to review the interaction between the respective Skilled Persons and their banks in any detail. For the most part, the FCA left it to the Skilled Persons and the banks to proactively raise any issues with it. Subject to the points made in paragraph 52 below, it did not carry out the task of mediating in the case of specific disagreements, but mostly restricted itself to giving general guidance on what it considered to be the proper interpretation of the Scheme. Neither did the FCA review samples of individual decisions in any systematic manner, thus limiting its ability to identify issues potentially affecting the decision-making under the Scheme.
45. In the circumstances, I conclude that the appointment of the Skilled Persons alone could not, by itself, give adequate assurance that the banks would act fairly and/or arrive at

---

<sup>1454</sup> [2018] EWCA Civ 2093.

<sup>1455</sup> See footnote 930.

consistent outcomes.<sup>1456</sup> Much therefore depended on the specific role and approach taken by the Skilled Persons appointed. As noted above, there were considerable safeguards in place, and the Skilled Persons appear to have played a very significant role in holding the banks to account. Given the scope of this Review, it is impossible for me to go behind the assurances the Skilled Persons gave to the FCA in their final reports that, subject to any qualifications in the respective reports, the banks complied with the methodology.

46. In terms of lessons learned, however, the actual and perceived level of assurance provided by Skilled Persons could be improved considerably by: (i) ensuring their exact role in the decision-making process is more expressly articulated in the Scheme from the outset, including in respect of the standard of review to be applied by them; (ii) providing for them to have a more transparent and visible role vis-à-vis customers; (iii) putting in place an appeal process which allows for the review of Skilled Persons' decisions in appropriate cases, and/or (iv) the FCA playing a more proactive and systematic supervisory role throughout the process.

**(e) The extent and the effectiveness of the FSA's and later the FCA's oversight of the scheme, including the level of reliance on skilled persons and approach to ensuring consistency across firms and skilled persons**

47. It is appropriate to start this section with some observations on the role of the Board, generally and not limited to its activity during the oversight of the Scheme. This Review concludes that the Board played no effective part in the formulation of any of the key decisions preceding the Scheme, or in its constituent parts, or in any of the choices left to the FCA during implementation. It was a body to whom reports were made, including for discussion, but the Board was not, and was not expecting to be, involved in those

---

<sup>1456</sup> In their representations to the Review however, a number of the banks argued that they were motivated to act fairly and arrive at consistent outcomes for customers in order to maintain consumer confidence. For example, one bank stated in interview that *"I can absolutely guarantee you that there was never a single moment in which we had any conflict or compromise or concern about the choice between the right thing for the customer and the right thing for the shareholder. And actually I believe very seriously that they are one and the same, because having agreed to run it, being found out short-changing customers would do more longstanding damage to the bank's profits than treating the customer correctly in the first place."* Meeting Transcript RBS (P82:L13-21).]

critical exercises of judgment as to what decisions should be made: probably the most significant and contentious being the scope of the Scheme itself.

48. This finding is based on the evidence in the documents and in oral evidence from former employees. Nevertheless, the FSA's decision to review the conduct of the banks in their sale of IRHPs to thousands of Private Customers/Retail Clients was a major regulatory intervention and, as should have been clear from the start, one likely to give rise to reputational risk, not least because of the FSA's inertia in failing to detect and remedy the scale of the mis-selling when it was taking place. In those circumstances, I would have expected that the Board, while recognising the need to delegate, would have impressed upon the Executive the importance of its being engaged in decision-making before, as well as after, key decisions were taken. In Chapter 5, I have referred to an internal memorandum from the then CEO recording a view expressed by a member of the Board of the FCA to that effect.<sup>1457</sup> That seems to me to be in accordance with what I would have expected of the Board, neither impairing efficiency nor at odds with delegation. Putting it simply, the fact of delegation cannot relieve the Board of its responsibility for the consequences of that delegation. It remains the body accountable for compliance with statutory duties and has to be vigilant in ensuring that it does so. In respect of the supervisory conduct of IRHPs, this Review concludes that the Board should have been more engaged in this regulatory intervention.
49. As to the quality of the supervision itself, the effectiveness of the FSA/FCA's oversight of the Scheme during the implementation phase was limited by the level of resources it committed, and by the narrow functions it had reserved to itself under the Scheme.<sup>1458</sup>
50. In respect of this, the Pilot Findings Paper stated:<sup>1459</sup>

*"We will continue to monitor the banks' progress and results for the full duration of the review. We will also closely monitor the effectiveness of the independent*

---

<sup>1457</sup> See Chapter 5, Section 2, para. 68.

<sup>1458</sup> See Chapter 5, Section 3, paras. 157-161.

<sup>1459</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, January 2013, FCA-ADD-0267, p. 16.

*reviewers in scrutinising the banks' reviews, and will not hesitate to take action if we have any concerns."*

51. It thus indicated that the FCA would remain actively involved in an oversight capacity. Yet, the Pilot Findings Paper also expressed the view that redress would be delivered within six months, and twelve months for the more complex cases.<sup>1460</sup> That implied the Scheme would be simple to operate, without much being required in the way of FCA resource. The FCA appears to have allocated its internal resources on that basis, assigning only a limited number of staff to the oversight of the implementation phase and moving experienced personnel previously involved in the development of the Scheme into other roles.<sup>1461</sup> In the event, the implementation process took about three years, with the personnel assigned to dealing with the Scheme extremely stretched in dealing with the problems that emerged<sup>1462</sup> – and the FCA becoming reliant on the exercise of judgment and discretion by just a few FCA individuals to oversee, and help ensure consistency for a scheme examining many thousands of cases.<sup>1463</sup>
52. Given the paucity of allocated resource and lack of wider institutional support, I was impressed with what certain (relatively junior) FCA personnel, including in particular FCA employee I, were able to contribute towards the objective of achieving fair and consistent outcomes throughout the implementation phase. In summary:
- a. bringing about the greater incidence of caps as alternative products;<sup>1464</sup>
  - b. encouraging the banks to provide "fast track" redress, in the form of a tear-up and full repayment, for so-called "low lens" customers with limited understanding of the products they bought;<sup>1465</sup>

---

<sup>1460</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, January 2013, FCA-ADD-0267, p. 4.

<sup>1461</sup> See Chapter 5, Section 3, paras. 157-161.

<sup>1462</sup> See Chapter 5, Section 3, paras. 164-5.

<sup>1463</sup> See Chapter 5, Section 3, paras. 160-161.

<sup>1464</sup> As set out in Chapter 5, Section 3, para. 106, the FCA had "*an expectation that a cap is given full consideration.*" FCA Records, *Email*, 15 May 2013, 385060.

<sup>1465</sup> See Chapter 5, Section 3, para. 116.

- c. taking a more central role in clarifying expectations in respect of claims for consequential loss<sup>1466</sup> (although, as I have concluded above, the lack of earlier clarification was itself a regulatory error);<sup>1467</sup>
  - d. acting as an intermediary between the banks, Skilled Persons, and customers in specific cases brought to the FCA's attention, where it appeared that the offer might not be fair, while continuing to acknowledge the independent judgment of the Skilled Persons;<sup>1468</sup>
  - e. acting in a coordinating role for Skilled Persons forums, so as to allow discussions on matters of concern in the application of the redress rules;<sup>1469</sup> and
  - f. encouraging the banks and the Skilled Persons to speed up the process of delivery of the outcomes in terms of communications of results and making regular announcements of progress on the implementation of the Scheme.<sup>1470</sup>
53. I consider that, together these efforts made an important contribution towards improving the outcomes of the Scheme. Yet, by becoming more involved in the implementation of the Scheme on an ad hoc, working-level basis, while remaining concerned not to encroach on the role of the Skilled Persons, the FCA put itself in a difficult strategic position. The FSA/FCA could have averted this and, overall, had a much more significant impact in ensuring fairness and consistency, if: (i) the Scheme had expressly designated a clearer oversight role for the FSA/FCA from the outset, (ii) the FCA had allocated greater resource to overseeing the implementation phase, and (iii) its senior leadership had remained more involved in that task.
54. In its representations to this Review, the FCA emphasised that "*for a fair and balanced evaluation of the FSA/FCA's oversight of the Skilled Persons it is first necessary to determine the nature and extent of any duty upon the FCA to conduct such oversight*" and that "*any duty of oversight towards the Skilled Persons was very limited*". Leaving

---

<sup>1466</sup> See Chapter 5, Section 3, paras. 130-139.

<sup>1467</sup> See ToR 3, paras. 21 and 25.

<sup>1468</sup> See Chapter 5, Section 2, paras. 61-3.

<sup>1469</sup> See Chapter 5, Section 2, para. 61.

<sup>1470</sup> See Chapter 5, Introduction, para. 3; Chapter 5, Section 3, para. 122 .

aside whether that is technically correct, and moreover was a consequence of the decision taken by the FSA/FCA itself, the FSA/FCA was nonetheless prepared to involve itself to a significant extent in the implementation of the Scheme at the working level. There was no good reason why that involvement could not have been coupled with a more proactive strategic role, which would have improved the delivery of fair and consistent outcomes under the Scheme.

55. In practical terms, I consider that the FSA/FCA should have exercised more effective oversight in the following three ways (and should have allocated resource accordingly). First, the FSA/FCA should, in my view, have done more to ensure consistency of outcomes as between customers of different banks from the outset. While it engaged with the Skilled Persons in forums and bilateral discussion,<sup>1471</sup> it appears to have chosen not to review and approve the different banks' final methodologies following the Pilot Review.<sup>1472</sup> Once the Scheme Terms had been agreed, it left this task to the various Skilled Persons under the terms of the Requirement Notices issued in 2012 and revised in early 2013. Unlike the FSA/FCA (who could have had oversight of the methodologies in the round), the Skilled Persons had no effective means of ensuring consistency of methodology amongst themselves and across their respective banks. This left a gap in oversight. While the FSA/FCA was understandably keen to avoid duplicating the work of the Skilled Persons, there were strong reasons to take steps to fill, or at least reduce, that gap. The changes from the Initial Agreement to the final Scheme Terms were significant and the risks of inconsistency of approach, and thus outcomes, remained high.
56. In its representations to this Review, the FCA has emphasised that the FSA/FCA was "*actively involved in setting the banks' methodologies.*" It noted that, in the course of the Pilot Review, the FCA had "*reviewed each bank's and [Skilled Person]'s approach to the pilot,*" and that "*has allowed us to test the effectiveness of each bank's approach to the review.*"<sup>1473</sup> The FCA did not, however, review the *final* methodologies developed by the banks and Skilled Persons for the purposes of the full implementation of the Scheme from early 2013. It left that task to the Skilled Persons. In the context of a Scheme

---

<sup>1471</sup> See Chapter 5, Section 3, para. 61.

<sup>1472</sup> See Chapter 5, Section 1, paras. 12-3.

<sup>1473</sup> Emphasis added.

designed by the FSA, in respect of which the FSA/FCA was uniquely placed to provide high-level oversight (given that the Skilled Persons were restricted to the 'silos' of their own banks), it could and should have done more to achieve that, and thus help minimise inconsistency.

57. Second, as implementation progressed, the FCA remained in the unique position of possessing knowledge that no single Skilled Person had. As discussed below, the mass of information made available to it does not appear to have been adequately examined with a view to achieving consistency of outcomes across the banks and Skilled Persons. The latter had to operate within their bank-specific silos and apply the Scheme Terms to the eligible population within these. The Skilled Persons did not undertake any subsequent monitoring of consistency of outcomes from bank to bank, nor were they mandated to do so.
58. Throughout the implementation of the Scheme, the FCA required monthly management information from each of the banks in a form which would have enabled it to identify any differences in the outcomes between the banks, including as to the level of compliant sales and the type of redress offered. However, this Review has seen no evidence to suggest that the FCA carried out any systematic analysis of this information to identify the causes of the differences.<sup>1474</sup> The Review accepts that the FCA took some steps to "*[monitor] the banks' and Skilled Persons' output during the operation of the Scheme, making use of data received from them. In so doing, the FCA monitored for consistency between the banks.*"<sup>1475</sup> The concerns identified in the Review relate to the scale and effectiveness of that monitoring, given the limited resource utilised by the FCA for this purpose.
59. If fair outcomes in certain cases were not being replicated in other equivalent cases across the eligible population, the FCA may reasonably be considered to have failed in helping to secure those outcomes. There is no evidence, for example, of the FCA undertaking systematic sampling of cases across the different banks. The FCA would have been well

---

<sup>1474</sup> Such as the differences identified by this Review and tabled in Chapter 6.

<sup>1475</sup> FCA representations dated 30 March 2021, para. 4.33(d).



placed to do this, or alternatively it could also have been carried out by a 'Super Skilled Person' appointed to take on this role.

60. At a very late stage of this Review, as part of its right to make representations under the Protocol, the FCA disclosed, for the first time, an email sent by one of its employees to the CEO in early 2015. That email, prepared in response to a request from the CEO, offered explanations for the differences in outcomes observed at the time, such as differences in the mix of businesses across the banks, the timing of the sales, and the level of breaches as between the banks.<sup>1476</sup> It was not, however, supported by any more in-depth analysis.

61. As such, the evidence still falls short of establishing the causes of the different outcomes as between different banks. The author of the email has since offered to this Review a further explanation, namely that "*variances were inevitable because the underlying redress methodology [was] highly subjective.*"<sup>1477</sup> I accept this view that differences in outcomes may have been caused, at least in part, by different methodological approaches, which was reinforced by other evidence considered by the Review. One bank, for example, stated:

*"Obviously the Sales Standards were the same for each of the banks but how they were applied, I think it was partly your relationship with your skilled person, and partly how tough a stance the bank wanted to take. We very much took the view that we wanted to be fair and reasonable. We took the view that if there was anything in doubt, we took the customer's side. And that's the way we went about it, and that's probably why we had a higher percentage of full tear-ups."*<sup>1478</sup>

62. Third, as further described below, the FSA/FCA should have ensured that the Scheme provided for a final right of appeal or equivalent decision-making function for cases in which customers disagreed with their redress offer (or with the failure to make them any offer). Such appeals could have been determined either by itself, or through the FOS.<sup>1479</sup>

---

<sup>1476</sup> Chapter 6, Section 1, para. 8.

<sup>1477</sup> Chapter 6, Section 1, para. 8 and Written Representations I, 17 May 2021, para. 2.6.3.

<sup>1478</sup> Meeting Transcript PB, (P31:L24-P32:L7).

<sup>1479</sup> ToR 3, paras. 64-69.

63. Overall, it is difficult to avoid the conclusion that, had greater resources been made available and clearer objectives been set beyond a reactive and advisory function, the FSA/FCA's oversight role could have been significantly more effective – not least in its objective of achieving consistency of outcomes across the banks in equivalent cases.

**(f) Whether the agreements provided adequate mechanisms to allow SMEs within the scope of the scheme to challenge proposed redress offers**

64. There was no formal mechanism under the Scheme which gave customers the right to appeal a redress offer or other decision to a person or body not directly connected to the Scheme. The consequences of this were adverse to the interests of customers. The FSA had considered a potential bespoke appeal system under the auspices of the FOS which would be available to review redress determinations (including as to eligibility to participate under the Scheme) and offers with which customers disagreed.<sup>1480</sup> Following discussions, the FOS was willing to implement such a system.<sup>1481</sup> However, this was ultimately not implemented for reasons which I find unconvincing.<sup>1482</sup>

65. Customers were able to challenge a bank's initial decision and ask for a review at a meeting. I cannot reopen individual cases to ascertain the approach taken in individual reviews. I note, however, that there were no strict rules governing such reviews and I am not aware of any adequate procedural guidelines governing them.<sup>1483</sup> As no offer could be put to a customer without it having been signed off by the responsible Skilled Person, in many cases there would have been only a limited prospect of a subsequent review by that Skilled Person being successful. Even a rigorous internal review process by the bank and/or the Skilled Person (such as a redetermination by separate more senior personnel with no previous involvement in the case) cannot hope to replicate the actual and perceived advantages of a review by an entirely independent party. Moreover, the courts have held that customers also had no right to challenge redress offers by way of judicial review nor by alleging a private law duty of care.<sup>1484</sup>

---

<sup>1480</sup> Chapter 4, Section 1, paras. 39-40.

<sup>1481</sup> Chapter 4, Section 2, paras. 49 and 51.

<sup>1482</sup> Chapter 4, Section 2, paras. 50-52.

<sup>1483</sup> Chapter 5, Section 2, paras. 57-8.

<sup>1484</sup> See ToR 3, para. 43(c) and footnote 930.

66. In the circumstances, I conclude that there were no adequate mechanisms to allow customers within the scope of the Scheme to challenge redress offers.

67. Indeed, the FCA has confirmed in the course of this Review that:<sup>1485</sup>

*"One of the lessons from the IRHP scheme is that we would now generally consider that an independent appeal element is important in a redress scheme (not just a review by a Skilled person) whether that appeal be provided through the FOS (where the customer is eligible) or some other mechanism".*

**(g) The impact of SMEs' ability to refer their case to the Financial Ombudsman Service before their case has been resolved via the redress scheme.**

68. This was a route available to SMEs small enough to qualify as micro-businesses, as indeed it always had been before the Scheme was put in place. Some eligible customers may well have chosen to avail themselves of this alternative route, given delays in having their cases resolved and/or any perceived unfairness under the Scheme.

69. Overall, however, the maximum award for cases that could be referred to the FOS was, at the time, so low, and numbers of cases so limited, that I question whether the option to refer a case to the FOS before it had been resolved via the Scheme had any impact on the overall operation of the Scheme.<sup>1486</sup> This Review has seen no evidence of decisions under the Scheme being influenced by developments in the handling of cases by the FOS.

**(h) The approach to monitoring firms' progress and the work of the skilled persons, including the production of management information.**

70. There is little I can add to the observations I have made above, in particular under sub-issues (d) and (e). As explained there, the FCA remained involved throughout the implementation of the Scheme and made broadly positive contributions towards the objectives of fair and consistent outcomes for eligible customers.<sup>1487</sup> Yet, while the FCA received regular detailed information in relation to both the banks' progress and the work

---

<sup>1485</sup> Confidential work package 5, 4 September 2020, p. 4, para. 17 (WORK PACKAGE 005).

<sup>1486</sup> As noted in Chapter 5, eligibility to refer cases to the FOS was extended, and the size of the maximum award were later increased, but that came too late for many of the relevant customers; see Chapter 5, Section 4, para. 182.

<sup>1487</sup> ToR 3, paras. 42 and 52-53.

of the Skilled Persons, it made only limited use of these.<sup>1488</sup> This appears to have been partly due to the limited resources made available at the FCA for these purposes, and partly due to the absence of a sufficiently clear mandate as to the FCA's oversight role.

71. I would have expected the FCA to carry out a prompt internal evaluation and lessons learned exercise in relation to the implementation phase of the Scheme, much as it did in 2012 to 2013 in relation to its creation.<sup>1489</sup> Obtaining and analysing formal feedback from the banks and Skilled Persons would likely have revealed some of the concerns highlighted by this Review and would have allowed the FCA to address these while the process was still ongoing.

**Summary of my conclusions on ToR 3 – whether overall, the Scheme delivered fair and consistent outcomes for SMEs within the scope of the Scheme in a proportionate and transparent way**

72. The objective of the Scheme was to provide fair and consistent outcomes for all eligible customers of the nine banks, in accordance with the Scheme Terms. The Scheme being essentially compensatory, it provided for customers to be put into the position they would have been in but for the breach.
73. I reiterate that this Review was not mandated to – and did not – reopen individual cases. As such, I am in no position to assess the individual redress decisions made in respect of each of the customers who participated in the Scheme.

*i) Fairness*

74. Overall, I consider that the evidence before this Review justifies a finding that, as a whole, the Scheme delivered fair outcomes for those customers within its scope. It led to just over 20,000 IRHP sales to customers being examined over a period of several years and around 14,000 offers of basic redress and interest being accepted, with £2.2 billion paid in compensation for losses (including a generous rate of interest), and the great majority

---

<sup>1488</sup> See, for example, the FCA's consideration of the final Skilled Person reports; Chapter 5, Section 4, paras. 178-9.

<sup>1489</sup> See Chapter 4, Section 2, paras. 53-5. To view the lessons learned report, see FCA Records, *SOF Lessons Learned Review*, 27 March 2013, 006425.

of the IRHP contracts torn up or replaced with affordable caps.<sup>1490</sup> The large majority of eligible customers obtained redress that met the objective of the Scheme and in all likelihood was 'better' from their perspective than any outcome they could have achieved outside the Scheme.<sup>1491</sup>

75. That broad conclusion, however, is subject to some serious qualifications. I have made a number of criticisms of the Scheme and of the FSA/FCA's role in its creation and implementation. Cumulatively, these issues may have impacted on the outcomes for customers/clients, rendering the overall outcome less fair than it might otherwise have been. Learning the lessons from these criticisms will be critical to ensuring fair outcomes in any future situations of this kind.

*ii) Consistency*

76. In my view the evidence justifies a conclusion that the Scheme delivered broadly consistent outcomes for the customers within each bank.<sup>1492</sup> A particular concern in this respect, however, is that the FCA's lack of a clear 'mission statement' for implementation, along with its ad hoc approach to dealing with individual cases, may in fact have undermined consistency. The approach taken meant that customers who raised a complaint with the FCA may well have obtained improved outcomes, which would not automatically have been applied in respect of other customers.<sup>1493</sup>

77. As discussed above, I have reservations as to whether the Scheme delivered consistent outcomes across customers of different banks. On that issue, I find that the quantitative evidence from the Skilled Persons, so far as it goes, does not support that objective having

---

<sup>1490</sup> The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016 – All banks*", 4 November 2016, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf>.

<sup>1491</sup> See Chapter 2, Section 4, paras. 102-4. Some customers may have achieved successful outcomes outside the boundaries of the Scheme, often in settlements reached in the context of litigation. It is unlikely, however, that this could have been replicated by all of those who obtained redress through the Scheme.

<sup>1492</sup> For instance, evidence in the reports of the Skilled Persons indicate that the first-tier banks applied the Sophisticated Customer Criteria in an appropriate manner that was consistent with the approach prescribed by the FCA. See Chapter 5, Section 1, para. 25.

<sup>1493</sup> See Chapter 5, Section 2, para. 63.

been met.<sup>1494</sup> The differences in outcome as between the different banks are of a magnitude that would have merited a further inquiry into the underlying causes of these differences, an inquiry well beyond the scope and capacity of this Review. Indeed, it is a cause of concern that the FCA, despite being in a far better position than myself as the Independent Reviewer, has not itself undertaken such an assessment. Ultimately, the failure to make such an assessment and to verify the consistency of outcomes across the different banks is one of the elements that goes to the wider fairness of any scheme - and lessons will need to be learned in this respect.

*iii) Proportionality*

78. Proportionality is a well-established regulatory tenet, both under FSMA and in public law more generally.<sup>1495</sup> Each of the different elements of the Scheme could be considered under the framework of a proportionality assessment. In practice, I doubt that such an assessment would add much to my earlier consideration of whether the Scheme, and its individual components, were 'appropriate' and 'fair' in all the circumstances. The FSA/FCA was required to ensure that the Scheme struck an appropriate balance between the interests of customers and the banks, and was delivered in a fair and balanced way. Undertaking a proper proportionality assessment carried out at the various stages of the creation and implementation of the Scheme may well have helped the FSA/FCA to step back and identify the shortcomings I have set out in this Review. The evidence suggests that this was not done in any sufficient way.<sup>1496</sup> This failure thus represents a lost opportunity to avoid at least some of the issues affecting the Scheme and its implementation, or at least address them in a timely manner.

*iv) Transparency*

79. The most troubling aspect in respect of transparency is that it took the FCA about two years after the commencement of the Scheme before, under pressure from the TSC, all

---

<sup>1494</sup> See, for example, Chapter 5, Section 3, paras. 85, 134b and 155-156. See also Chapter 6. Section 1, para. 4.

<sup>1495</sup> See section 3B(1)(b) FSMA.

<sup>1496</sup> The Review has seen evidence that GCD flagged that certain decisions and amendments needed to be proportionate. For instance, see Chapter 4, Section 3, para. 98.

of the Scheme's component elements were fully put into the public domain.<sup>1497</sup> Not only was the Scheme presented as a *fait accompli*, in respect of which there had been no consultation, but the intended beneficiaries (and the wider public) were not even informed about its full components. In the course of this Review, the FCA acknowledged that the Scheme Terms did allow it to publish information about the Scheme.<sup>1498</sup> As discussed above, neither do I consider that section 348 FSMA necessarily provided a valid reason for the failure to disclose the full Scheme Terms in a prompt and effective manner. The failure to do so led to an unfair information imbalance between the customers and the banks, causing damage to the FCA's credibility in respect of its accountability for the operation of the Scheme.

80. Information asymmetry remained a problematic feature of the Scheme throughout its implementation. Customers were frequently not privy to all of the material and/or reasoning underpinning the decisions by the banks and Skilled Persons. In my view, stricter and more consistently applied rules on transparency and disclosure would have improved the fairness of the Scheme overall and would likely have significantly reduced customer dissatisfaction with the outcomes.

---

<sup>1497</sup> See Chapter 5, Section 3, paras. 99.

<sup>1498</sup> Confidential work package 4, p. 2, para. 7. (WORK PACKAGE 004).

## ToR 4

***" 4) Whether the redress exercise was delivered in an effective and timely way, including the effectiveness of the FSA's and later the FCA's oversight of the timeliness of redress, and communications about timescale."***

1. In ToR 3 I have considered the effectiveness of the delivery of the redress under the Scheme, including the effectiveness of the FSA/FCA's oversight of the implementation phase. I am, therefore, limiting my comments under ToR 4 to the timeliness of delivery.
2. That the FSA and later the FCA were unduly optimistic as to the time it would take to deliver the redress scheme is a matter of record.<sup>1499</sup> As early as June 2012, the FSA was expressing confidence that its agreements with the first-tier banks would bring early relief.<sup>1500</sup> The banks had agreed the criteria for the identification of eligible customers (the Sales Standards) and to pay fair and reasonable redress. In respect of Structured Collars, they had agreed what kind of redress would be appropriate. For other IRHPs, there would have to be a case-by-case enquiry before a customer might receive redress, although the FSA/FCA does not appear to have seen that as an obstacle to achieving early redress where appropriate.
3. That assessment changed, however, when the FSA decided to carry out the Pilot Review. It required that redress be postponed until the Initial Agreement had been updated to reflect the outcomes of the Pilot Review. That process took from July 2012 to the end of January 2013,<sup>1501</sup> at which point the FSA stated:<sup>1502</sup>

*"We expect the [first-tier] banks to aim to complete their review within six months, although the priority must be delivering fair and reasonable outcomes for customers. We accept that for banks with larger review populations this may take*

---

<sup>1499</sup> See, for example, Chapter 4, Section 2, para. 54.c.vi; and Chapter 5, Section 1, paras. 1-4.

<sup>1500</sup> See Chapter 3, Section 5, para. 75 and the Financial Services Authority, "FSA agrees settlement with four banks over interest rate hedging products", 29 June 2012, accessible at <https://webarchive.nationalarchives.gov.uk/20120818030500/http://www.fsa.gov.uk/library/communication/pr/2012/071.shtml>.

<sup>1501</sup> See Chapter 4.

<sup>1502</sup> FCA Records, *Interest Rate Hedging Products – Pilot Findings*, January 2013, FCA-ADD-0267, p. 16.



*up to 12 months. We have made sure that the banks will prioritise cases where customers are in financial difficulty."*

4. There then followed a further period of about three months to agree some of the more technical aspects of the Scheme with the banks.<sup>1503</sup> The first redress offers were made around that time and continued into 2014 and 2015.<sup>1504</sup> On the evidence of the FCA in Holmcroft, redress offers had been largely completed by the autumn of 2015, although several cases, including in particular claims for consequential loss, took significantly longer to resolve.<sup>1505</sup>
5. The initial expectations of the FSA on timing were more like exhortations to the banks and were never formalised in the Scheme Terms. Timely (as well as fair) redress was an important aim of the Scheme. Yet, the FSA/FCA knew, or ought to have known, that in the absence of a defined and agreed project plan with each of the banks, it had no means to secure the delivery of the ambitious timetable it had set out. Moreover, the Skilled Persons were required to provide independent oversight over the redress for each individual customer on a case-by-case basis.<sup>1506</sup> This meant that the timeline also depended on the competence, commitment and resources of these Skilled Persons to complete that assignment. The expectations the FCA created were thus unrealistic and reflected poorly on its credibility.
6. I take the view that the FSA/FCA acted reasonably in seeking to remind the banks and the Skilled Persons of the importance of ensuring that redress was prompt as well as fair. It effectively clarified the terms of the Scheme where uncertainty was adding to delays. Once the Scheme Terms were agreed, however, the timing of redress (both generally and for individual customers) was largely out of the hands of the FSA/FCA and dependent on the application of the Scheme Terms by the banks and the Skilled Persons. In the circumstances, while the FCA faced mounting criticism about the delay in the delivery of redress,<sup>1507</sup> at that stage it had limited options to address this. In my view, the delay

---

<sup>1503</sup> See Chapter 5, Section 1, paras. 7-52.

<sup>1504</sup> See Chapter 5, Section 2, para. 67(a); and Chapter 5, Section 4, paras. 168-71.

<sup>1505</sup> See Chapter 5, Section 4, para. 171.

<sup>1506</sup> See, for example, Chapter 5, Section 2, para. 79. For the overall number of redress offers that fell to be reviewed under the Scheme, see Chapter 6, Section 1, paras. 2-3.

<sup>1507</sup> See, for example, Chapter 5, Section 1, para. 29.

was an inevitable consequence of the scale and complexity of the Scheme, rather than inaction by the FCA during this period.

7. As to the communications about timescale, the FCA published regular updates about the implementation of the Scheme. That published material, however, failed to address why its confident expectations regarding the timescale for redress turned out to be so wide of the mark, much less provide any adequate explanation for this.

## Chapter 8

### Lessons Learned/Recommendations

1. This Review has identified several recommendations for the FCA. Each is considered in greater detail below. Broadly speaking, the recommendations can be categorised into five topics:
  - a. general recommendations;
  - b. good regulatory practice in the development and use of voluntary redress schemes;
  - c. greater willingness to use statutory powers;
  - d. implementation/oversight and the importance of retaining ownership and control over regulatory interventions; and
  - e. FCA decision-making and processes, including the principles of transparency and regulatory independence.

#### A. General recommendations

##### **A1: More proactive regulation**

*The FCA should regulate more proactively to prevent harm to consumers as well as taking remedial action after harm has occurred.*

2. A key requirement of efficient regulatory oversight is for the regulator to have a comprehensive and informed understanding of the markets and business activities which it regulates. Implementation of the FCA's statutory objectives requires a proactive approach to the detection of conduct that damages the interests of consumers (whether directly through exploitation of their vulnerability, or indirectly through the distortion of markets). To achieve those objectives, the FCA's market surveillance and intelligence-gathering function must be 'on the front foot'; inquisitive rather than reactive, well

informed, and operated in a coordinated and joined-up manner, so as to avoid a "*blind spot*".<sup>1508</sup>

3. An important element of the Review's conclusions in respect of the FSA/FCA's conduct is that there had been largely no relevant regulatory action or intervention prior to 2012. There was a lack of interest in IRHPs and, as a result, a limited knowledge base in respect of them. Regulated firms had engaged in what the FSA described as "*poor selling practices*"<sup>1509</sup> and had been allowed to carry them on undetected and unrestrained by the regulator. The IRHP case is a classic example of where a regulatory failure to identify the risks and put out a few fires at the outset left the FSA with a conflagration.
4. In order to prevent similar issues in the future, the FCA must take a more proactive approach. The FCA should heed the recommendation made in its internal Lessons Learned Review<sup>1510</sup> and consider the available sources of intelligence that can be used to identify emerging risks and issues.<sup>1511</sup> Utilising that intelligence, the FCA must be ready to intervene promptly and effectively, ideally before any serious harm is caused.

**A2: No departure from equal protection for all persons in the same category without proper justification**

*The FCA should aim to ensure that persons within the same category are treated consistently: where rules exist for the protection of all within a defined class, regulatory intervention should not be restricted to benefit only a subset of that class unless there is an objective justification founded on strong evidence and tested through consultation.*

5. The FSA started off in the right way, but then it went wrong. At the outset, it recognised that there was a designated class of persons to whom the banks owed duties under the COB/COBS rules: Private Customers/Retail Clients. Yet, rather than ensuring protection and redress for all those within that class, the FSA then agreed to subdivide it into

---

<sup>1508</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 3.

<sup>1509</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-B-0010, p. 1.

<sup>1510</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 12.

<sup>1511</sup> See ToR 1, paras. 5-10.

sophisticated and non-sophisticated categories by reference first to a simple but flawed criterion and later through add-ons of considerable complexity. Moreover, the FSA appears to have been unclear about where SMEs (as opposed to individuals) should fall within the scope of its regulatory oversight, supervision and risk tolerance.<sup>1512</sup>

6. Absent cogent and well-evidenced reasons, the FSA should not treat persons within the same class differently – but that was effectively what it did.<sup>1513</sup> In the event, the Scheme excluded about one-third of all Private Customers/Retail Clients with IRHPs, limiting those entitled to benefit from it to 'non-sophisticated' customers/clients. Others were left to pursue compensation through the banks' complaints processes and/or the courts, even though the regulatory requirements were the same for all customers/clients within the class. At a minimum, the decision taken to introduce a qualification for Scheme eligibility based on prior knowledge and experience of the products (and their risks), and the decisions as to the criteria to be applied in excluding such customers/clients, were of such significance as to justify consultation and full explanation as to why they were justified.<sup>1514</sup>
7. The lesson for the FCA is that, without well-evidenced objective justification, it should apply its Principles and rules without distinction to all who qualify for their protection. Where the FCA considers that there is an objective justification for limiting the scope of a remedy to only certain persons within the same class, there should be proper consultation with stakeholders before any such action is approved. In that context, the FCA should explain its intended approach and the reasons for it (for instance that that group alone has suffered detriment and/or that the wider scope would be disproportionate) and allow affected persons and other stakeholders a proper opportunity to make representations in respect of the proposed restriction.

---

<sup>1512</sup> By the FSA's own description, Small and Medium Enterprises were "*a blind spot*", in relation to which the FSA's risk tolerance was not clear or adequately articulated prior to March 2012. The FSA found, in its 2012 Lessons Learned Review, that this was one of the factors which negatively affected the likelihood of an earlier intervention. See Chapter 4, Section 2, para. 54.a; and FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 3.

<sup>1513</sup> See ToR 2, paras. 41-43.

<sup>1514</sup> See ToR 2, paras. 21-22 and 28; see also ToR 3, para. 79.

### **A3: Sufficiently clear rules**

*The FCA should ensure its rules are sufficiently clear and detailed to permit effective compliance.*

8. The rule of law demands clarity of regulatory rules and requirements. They must also be applied consistently, and regulated firms must be able to foresee readily the consequences of their acts and omissions.
9. This threshold was not always met in the IRHP context, as exemplified by the issue regarding what constituted adequate disclosure of break costs in the event that an IRHP was terminated before its scheduled maturity.<sup>1515</sup> Until the promulgation of the Sales Standards and the second series of Skilled Persons' FAQs, the FSA had not made it clear to the banks that the general obligation to provide comprehensible, clear, fair and not misleading information, in the context of break costs, was likely to require an explanation of what a break cost is and how any might apply to the customer, as well as an indication of the potential size (or scale) of any applicable break costs.<sup>1516</sup> In practice, this was often applied in the Scheme so as to entail a requirement to provide a worked example of the potential break costs in determining whether there was a breach.<sup>1517</sup> While not every possible scenario can be anticipated by rules, requirements of such significant impact should have been sufficiently precise from the outset, and capable of straightforward and consistent application by the regulated firms bound by them at the time when relevant IRHP sales were made.
10. There is an opportunity for a reappraisal by the FCA, in consultation with regulated firms and other stakeholders, of the fitness for purpose of its rules, in particular in regulated product markets, including whether for some products there is a justification for a greater degree of granularity. By way of example, conduct of business rules applicable across multiple products (such as over-broad and generic risk warnings) can dilute the effectiveness that more granular and targeted rules might have.

---

<sup>1515</sup> See Chapter 3, Section 4, para. 42; and Chapter 4, Section 3, paras. 69-72.

<sup>1516</sup> FCA Records, *Email and attachment*, 18 September 2012, 347284 and 347285. See also ToR 1, para. 14.b; and ToR 3, paras. 6-7.

<sup>1517</sup> Meeting Transcript E (P26:L9-13); Meeting Transcript ZP (P25:L11-14).

## **B. Voluntary redress schemes**

### **B1: Strengthened decision-making process**

*The decision-making function to approve voluntary redress agreements should be reserved to the FCA's senior leadership.*

11. The FCA is required to follow rigorous procedures when making decisions about settlement of enforcement cases, the exercise of compulsory powers to require a regulated firm to pay restitution, or whether to issue Supervisory Notices such as an OIVOP or OIReq.<sup>1518</sup> Similar rigour should be applied in relation to voluntary redress schemes.<sup>1519</sup> The decision-making function to approve voluntary redress agreements, at least those of material scope and significance, should therefore be exercisable by, and reserved to, the FCA's senior leadership, potentially via the ExCo.<sup>1520</sup>
12. Such decision-making should be supported by a full explanation of the relative advantages and disadvantages of the proposed agreements (or relevant aspects thereof), including:
  - a. the rationale for adopting this approach and discounting any alternative options;
  - b. a comprehensive impact assessment in relation to the regulated firms, eligible customers, any customers excluded under a scheme, and any other stakeholders; and
  - c. any formal or informal consultation exercises to be carried out, or the rationale for dispensing with consultation.

---

<sup>1518</sup> See Chapter 2, Section 3, paras. 68-88.

<sup>1519</sup> See Chapter 2, Section 3, paras. 89-96.

<sup>1520</sup> Decisions to approve voluntary redress agreements should be taken at a level commensurate with the scope and significance of the agreement. The Scheme, involving thousands of customers, certainly should have been dealt with at the highest levels.

## **B2: Use of statutory safeguards for the enforcement of voluntary agreements**

*Before entering into a voluntary agreement, the FCA should consider formalising the agreement through the use of a VVOP or a VReq.*

13. The agreements underpinning the Scheme took the form of a contract, including "boilerplate" clauses in respect of confidentiality and third-party rights provisions.
14. Any breach of the Scheme Terms, and any subsequent attempt to enforce the Scheme's contractual provisions, would require the FSA/FCA to bring an action for breach of contract or specific performance, limited to the principles and remedies under contract law.<sup>1521</sup> In the future, such a risk should be mitigated, where possible, through the use of, and embodying the agreed terms in, for example, a VVOP or a VReq.
15. Doing this in the context of the Scheme would have enabled the FSA/FCA to take direct enforcement action in the event of non-compliance with the Scheme Terms.<sup>1522</sup> It would have avoided some of the foreseeable consequences flowing from the mere contractual nature of the agreements, such as questions regarding enforceability, available remedies in contract, and confidentiality.<sup>1523</sup> In the future, the FCA should consider whether to formalise any such agreement in this manner before doing so simply on a contractual basis.

---

<sup>1521</sup> Arguably, the FSA/FCA could also rely on 55J or 55L FSMA, or bring an action on the basis of a breach of the Principles. However, it is far from clear that any of these powers would provide a viable enforcement route. Whether any of them could be relied upon to enforce contractual rights between the banks and the FCA remains uncertain and untested.

<sup>1522</sup> Indeed, there is evidence to suggest that the FSA contemplated encompassing the terms of the Initial Agreement in the form of a VVOP, see Chapter 3, Section 5, para. 62.

<sup>1523</sup> See ToR 1 paras. 31-32 and para. 44c.



### **B3: Avoiding unnecessary complexity**

*To the greatest extent possible, redress schemes should be simple, clear and easy to implement, to ensure rapid and consistent results. Any redress scheme should be designed to avoid unnecessary complexity so that those implementing the scheme, and its beneficiaries, are able to readily understand its terms and conditions and that the scheme can operate quickly and easily.*

16. As is apparent from this Report, the Scheme included multiple elements of significant complexity,<sup>1524</sup> which made it more difficult to implement, and which undermined the aim of rapid and consistent results. For example, initially several different Skilled Persons were arriving at different conclusions on equivalent facts as to whether an alternative product had to be a cap or whether it could be a Category B product, such as a swap.<sup>1525</sup> Eventually, by late 2013, the FCA intervened and advised that, in the absence of clear evidence that a customer would have chosen an alternative swap or a collar, the banks would generally be expected to offer a cap as an alternative product.<sup>1526</sup> The Scheme became simpler and easier to implement as a result, reducing excessive complexity and thus potential inconsistency and unfairness. Other examples of significant complexity raised by stakeholders were the so-called 7.5% Rule<sup>1527</sup> and the rules on the recovery of consequential loss.<sup>1528</sup> Moreover, the use of the counterfactual also undoubtedly added to the Scheme's complexity.<sup>1529</sup>
17. Insofar as a degree of complexity remains inevitable, the FCA should ensure that all participants are properly informed of significant points of detail from the outset. For those administering a scheme, there should be clear and consistent guidance as well as a readily available means of resolving any issues consistently across cases. Similarly, those entitled to benefit from redress schemes should be able to understand the process, so as to allow them to make informed decisions in relation to their participation.

---

<sup>1524</sup> See ToR 2, paras. 1 and 29.

<sup>1525</sup> See ToR 3, para. 17.

<sup>1526</sup> See Chapter 5, Section 3, para. 113.

<sup>1527</sup> See Chapter 5, Section 1, paras. 33-4 and ToR 3, para. 16.

<sup>1528</sup> See Chapter 5, Section 3, paras. 132-8 and ToR 3, paras. 20-23.

<sup>1529</sup> See ToR 3, para. 18.

**B4: Improved oversight role of Skilled Persons where they are used as part of a redress scheme**

*In future redress schemes, the FCA should strengthen the oversight role of the Skilled Persons, including a starting point that they (and not the regulated firms) should be the primary decision-makers.*

18. Under the Skilled Persons' terms of appointment the banks would be monitored in respect of discharging their obligations fairly. There were considerable safeguards in place and the Skilled Persons appear to have played a very significant role in ensuring adherence to the terms of the Scheme. Nonetheless, as explained in ToR 3, the Scheme had several structural issues, including the fact that banks were the primary decision-makers.<sup>1530</sup> Necessarily, that meant that the Skilled Persons' role was secondary.
19. In any future scheme, the FCA should improve both the actual and the perceived level of independence, assurance and monitoring provided by Skilled Persons. In particular, the FCA should ensure that:
  - a. the Skilled Persons' exact role in the decision-making process is more expressly articulated from the outset;
  - b. the role of the Skilled Persons should not be limited to secondary review/re-consideration, even a power of veto, of the decision of the relevant authorised firm. Instead, the Skilled Person should have the primary decision-making responsibility;<sup>1531</sup> and
  - c. the Skilled Persons play a more active role vis-à-vis the customers.
20. Furthermore, where several regulated firms are subject to the same scheme terms, the FCA should consider appointing a "Super Skilled Person", if the regulator cannot itself perform that role. This would promote more consistent application and implementation between the various Skilled Persons and their respective firms.

---

<sup>1530</sup> See ToR 3, para. 43.

<sup>1531</sup> There is no inherent limitation under s.166 FSMA which would preclude such an arrangement.

## **B5: Inclusion of an independent appeal mechanism**

*Future redress schemes should include an independent appeal element allowing beneficiaries to challenge outcomes (including eligibility determinations) with which they disagree.*

21. As set out in ToR 3, the Scheme did not provide any adequate mechanism to allow customers to challenge proposed redress offers and other decisions affecting them.<sup>1532</sup> The FCA has confirmed in the course of this Review that one of the lessons from the Scheme is that the FCA "*would now generally consider that an independent appeal element is important in a redress scheme (not just a review by a Skilled Person).*"<sup>1533</sup>
22. In line with that conclusion, any future redress scheme should provide for a right of appeal (including in relation to eligibility determinations) to an independent person or body. Such an appeal system would not only contribute towards ensuring just outcomes in individual cases, but would also improve the overall perception of the Scheme's fairness and promote wider consistency of outcomes.

## **B6: Adequate consultation**

*The FCA should improve consultation with all stakeholders.*

23. A key finding of this Report is the lack of adequate, broad-based consultation at different stages of the Scheme, either in its initial or final form or while specific components (such as eligibility, breach, and redress) were under consideration. While the FSA did hold discussions with "*relevant third parties*",<sup>1534</sup> including the APPG and organisations such as Bully-Banks, these were selective and did not provide all stakeholders with an opportunity to comment. Moreover, with some limited exceptions,<sup>1535</sup> these discussions

---

<sup>1532</sup> See ToR 3, para. 62.

<sup>1533</sup> See ToR 3, para. 67.

<sup>1534</sup> FCA Records, *Letter and annexed FCA representations on the Draft Report*, 30 March 2021, p.9 (REPORT 016).

<sup>1535</sup> For example, the decision to reappraise the eligibility criteria so as to provide for the inclusion of certain businesses such as farmers and B&Bs in the Scheme.

did not provide a meaningful way for affected customers to influence the Scheme Terms.<sup>1536</sup>

24. Prior consultation at all stages of the decision-making process has significant advantages. It is likely to lead to more effective scrutiny of the proposals and gives the FCA a wider and more balanced range of views. Potentially this allows for the identification of subsequent issues before they arise. It is also likely to result in greater stakeholder 'buy-in' and an improvement in the – real and/or perceived – fairness of the process. An example of this in the IRHP context is the FSA's concession to allow a bank to exclude a customer from the Scheme on the basis of evidence that the customer had, applying a subjective test, relevant knowledge and experience of the IRHP, even if they would otherwise have been eligible under the quantitative test. Yet, there was no corresponding right for a customer to claim eligibility on the basis of such a subjective test, if they were otherwise ineligible under the quantitative test.<sup>1537</sup> It is difficult to conclude that such a disparity would have survived public scrutiny in the context of a proper consultation exercise.
25. This recommendation is closely connected with the principle of proportionality – the degree of consultation before a decision is taken depends on the nature of that decision. In some cases, limited, or even no, consultation may be appropriate, especially where such consultation would threaten the outcome. That, however, should be the exception rather than the default and was neither necessary nor appropriate in relation to the Scheme.
26. It could be argued that: (i) the urgency of addressing the issue and the adverse consequences of any delay in securing the banks' agreement to redress for non-sophisticated customers, which would have resulted from such a process of consultation; and (ii) the confidentiality of the discussions with the banks as well as the confidentiality clause in the Scheme Terms would prevent consultation. In considering whether and how to consult on a proposed voluntary scheme in the future, the FCA should consider carefully whether such grounds provide a good reason for not listening in advance of a decision to those likely to be affected by it, with an open mind to their representations. It

---

<sup>1536</sup> See ToR 2, paras. 21-23.

<sup>1537</sup> See ToR 2, para. 18.

should be slow to assume that such a process would jeopardise the possibility of reaching agreement or would be in breach of transparency obligations.

27. Given the benefits of broad-based consultation, there is no inherent reason why it would necessarily be resisted by the firms involved in the negotiations. Above all, the FCA has to avoid a situation in which the interests of retaining confidentiality in discussions with regulated firms outweigh the principle of ensuring that its decisions are evidence-based and reflect the concerns of all stakeholders.
28. There is no need for consultation to be an excessively formal or drawn-out process; where appropriate, very tight timelines for responses could be set. What is required is simply a meaningful opportunity for all those potentially affected to review proposals and make representations. Rather than being presented with a *fait accompli*, stakeholders should be given an opportunity to contribute to and shape the decision-making process.

### C. Greater use of statutory powers

#### **C1: Use of statutory powers to obtain compensation and restitution**

*The FCA should give due consideration to its statutory powers to obtain compensation and restitution.*

29. Where the FCA is exercising its jurisdiction for the primary purpose of obtaining redress, it should look first to the most relevant sections of the FSMA: sections 382/384 (restitution) and 404 (consumer redress schemes).<sup>1538</sup>
30. Under sections 382 and 384 FSMA, the FCA has the power, respectively, to apply to the court for restitution orders and to require regulated firms to make compensation/restitution. In the case of IRHPs, it appears that only relatively cursory consideration was given to the use of these powers.<sup>1539</sup> The rationale for rejecting this route to redress included the FSA's view that the burden of proof was onerous, requiring proof of rule breaches, causation and quantification of loss to court standards.<sup>1540</sup>

---

<sup>1538</sup> See Chapter 2, paras. 85-7 and 89-96.

<sup>1539</sup> See ToR 1, paras. 20-22.

<sup>1540</sup> See Chapter 3, Section 3, para. 40d.

31. Yet, those powers seem designed and intended precisely for the purposes of administering the type of redress applied under the Scheme. A somewhat higher investigatory and administrative burden on the regulator should not too readily be assumed to outweigh the benefits of operating under a clear statutory framework, with concomitant powers.
32. In the context of IRHPs, it also became clear to the FSA that section 404 powers were likely to be of limited assistance in their current form, being restricted to compensation for loss or damage in respect of which a remedy or relief would be available in civil proceedings.<sup>1541</sup> If section 404 FSMA were amended to remove the limitation to remedies and relief available to the relevant customers/clients in civil proceedings (in particular given the limitations upon the availability of claims under section 138D FSMA), it would be a much more effective tool in the FCA's armoury.

## **C2: Concurrent use of regulatory powers, including enforcement**

*Even where a voluntary redress agreement has been reached, the FCA should give careful consideration to the concurrent use of regulatory powers, including exercising its enforcement powers alongside the agreed redress scheme.*

33. The FCA ought not to consider the various regulatory options available to it as mutually exclusive. In particular, enforcement powers should not be discounted too readily just because a voluntary redress agreement has been reached – especially in circumstances where root causes are not fully investigated, and the redress scheme is unlikely on its own to remedy the relevant failures and address any wrongdoing. FCA intervention should not be restricted to providing redress, but must also ensure accountability of regulated firms and their senior management and seek to prevent similar incidents in the future.
34. In particular, a decision not to pursue enforcement (and especially disciplinary) options may mean that elements of possible misconduct, other than those appropriate to be dealt with by way of a redress scheme, escape regulatory action. For example, in the IRHP

---

<sup>1541</sup> As discussed in Chapter 2, Section 3, paras. 99-101, the direct cause of action for breach of COB/COBS rules under section 138D FSMA is limited to "private persons", and therefore would not have been available to many of the businesses affected by IRHP mis-selling.

context, potential issues such as inappropriate sales incentives and shortcomings in systems and controls may not fall within the scope of the Scheme but will also not be addressed by any other means.<sup>1542</sup> The FSA identified the "root causes" of the sale of the IRHPs as an issue to be followed up.<sup>1543</sup> But it never was, and throughout its intervention the FSA/FCA appears to have lacked such further evidence it might have needed had it decided to pursue enforcement against either a firm, or individuals, or both.<sup>1544</sup>

35. In the future, the FCA should give greater consideration to pursuing a dual or multi-track approach, with other regulatory actions being implemented in parallel, or sequentially. Concurrent use of regulatory powers is likely to engender a more well-rounded approach, which does not just provide redress but also ensures accountability and addresses the root causes of the conduct so as to prevent it from reoccurring. In particular, the requirements of the SMCR should enhance the FCA's ability to hold individuals (and especially senior managers) to account.

#### **D. Implementation/oversight**

##### **D1: Monitoring of consistency of outcomes**

*In future schemes, the FCA should implement high-level monitoring of outcomes to ensure consistency across firms.*

36. Achieving consistency of outcomes across multiple banks and Skilled Persons required systematic and comprehensive analysis of all the information made available to the FCA. In the IRHP context, there appears to have been inadequate resources to undertake such monitoring.<sup>1545</sup>
37. In the context of any future redress scheme, a dedicated mechanism should be put in place to monitor consistency of outcomes across firms, identify any divergences, and facilitate prompt intervention to address these. This might be achieved, for example, by

---

<sup>1542</sup> See ToR 1, para. 32.

<sup>1543</sup> See Chapter 3, Section 3, para. 19. See also Chapter 4, Section 2, para. 55; and ToR 1, para. 8.

<sup>1544</sup> See Chapter 3, Section 4, paras. 40.b and 41.c.

<sup>1545</sup> See Chapter 5, Section 3, paras. 158-160; and ToR 3, paras. 52-56.

systematic sampling of cases across different firms. Such a role could be performed by the FCA itself or through the appointment of a "Super Skilled Person".

## **D2: Set realistic timelines**

*Timescales and deadlines for the delivery of different stages of a redress scheme should be realistic and reasonably achievable.*

38. One of the FSA/FCA's key priorities was to achieve speedy redress.<sup>1546</sup> Perhaps driven by that objective, however, the deadlines it set itself and the banks were often unduly optimistic and unachievable.<sup>1547</sup> The timelines set lacked realism, leading to missed deadlines, very considerable and avoidable pressure on those implementing the Scheme, and to disappointment and frustration amongst its beneficiaries. In the course of the Review, it was plain that various expectations and requirements regarding the completion of different stages of the redress exercise were never achievable in practice.<sup>1548</sup> In the end, it was not until 30 September 2016 that the FCA confirmed that all eligibility, compliance, and basic redress outcomes had been assessed and communicated to customers.<sup>1549</sup>
39. The FSA's internal Lessons Learned Review recognised that in some instances forcing the pace can result in errors and problems which ultimately take even longer to address and correct.<sup>1550</sup>
40. In the future, the FCA would be well advised to take a more pragmatic approach to the timescales it sets, stipulating realistically achievable targets. Where initial timelines turn out to be impracticable, they should be formally revised, with corresponding management of customer expectations.

---

<sup>1546</sup> See ToR 4.

<sup>1547</sup> See ToR 4, paras. 5-7.

<sup>1548</sup> For example, the indication that the implementation process would take approximately six to twelve months: see Chapter 5, Introduction, para. 1.

<sup>1549</sup> See Chapter 5, Introduction, para. 3.

<sup>1550</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, p. 4.



### **D3: Ensure adequate resourcing**

*FCA interventions should be adequately resourced at both the operational and the senior level, throughout the duration of the project.*

41. As set out in ToR 3,<sup>1551</sup> the effectiveness of the FCA's oversight of the Scheme during the implementation phase was limited by, inter alia, the level of resources it committed to the Scheme at that stage. This included two distinct elements: operational resources and oversight/guidance by senior leadership. In respect of both of these, the Scheme would have benefited from greater capacity being available within the FCA. Such increased resourcing would not just have improved the implementation of the Scheme, and hence its overall effectiveness and fairness, it would also have reduced the pressure on individual staff members who had to deal with extraordinary demands without sufficient support over prolonged periods of time.
42. In the future, the FCA should plan carefully to ensure that adequate resources are available throughout the project – not just in the early stages leading up to an initial announcement, but also for subsequent guidance and monitoring of implementation. Resourcing requirements should be monitored on an ongoing basis and, where the initial estimates turn out to be inaccurate, the allocation of resources should be adjusted. In most scenarios, it is unlikely to be appropriate (or possible) to reduce regulatory involvement to a skeletal minimum after the initial announcement of a scheme. The requisite resourcing includes both a sufficient number of qualified staff at the operational level and enough dedicated capacity amongst senior personnel and the FCA's leadership to ensure proper oversight and accountability.

---

<sup>1551</sup> See ToR 3, paras. 49-59.

**E. FCA decision-making and processes, including the principles of transparency and regulatory independence**

**E1: Prioritise transparency as a regulatory imperative**

*The FCA should commit to greater transparency (not limited to consultation) in the exercise of its powers and its policies.*

43. As the FCA argued in its representations to this Review,<sup>1552</sup> the FSA put itself into a position in which any of the nine banks could lawfully veto the publication of key documents which formed the matrix of the Scheme – either on the ground that the Initial and Supplemental Agreements, and the Exchange of Letters, were confidential or by seeking to rely on section 348 FSMA. While this Review does not accept that the FSA/FCA was necessarily so constrained, the FSA/FCA's view at the time was determinative of the steps it felt it could or could not take.<sup>1553</sup> This situation contributed to a lack of transparency and wider consultation throughout the development and implementation of the Scheme.<sup>1554</sup> Even where consensual compromises are reached with regulated firms, the regulator should ensure that it is as close to fully transparent as possible. In certain instances, obligations of confidentiality will arise and prevent full disclosure, but this should be the exception rather than the norm.
44. The FCA should enable affected customers to understand the protections and the expectations it has secured for them as well as the process by which the Scheme is implemented. In the IRHP context, the imbalance of information as to the mechanics of obtaining redress between the banks and Skilled Persons on the one hand, and customers on the other, was a striking failure in the process.

---

<sup>1552</sup> FCA representations dated 30 March 2021, para. 3.8.

<sup>1553</sup> See ToR 1, para. 44.b.

<sup>1554</sup> See ToR 1, paras. 34-45.

## **E2: Maintain an appropriate audit trail**

*The FCA should maintain a detailed, comprehensive and reasoned audit trail in relation to its decisions, which goes beyond just recording headline decisions. The audit trail should also cover the way the decisions made are followed through and actioned.*

45. The FSA's decision-making in relation to the Initial Agreement, the Supplemental Agreement and the Exchange of Letters, including their specific terms and parameters, are described in Chapters 3 and 4. This Review found that the written record and audit trail of that process was at times insufficient to properly determine: (i) how decisions were made, (ii) by whom, and (iii) on what information and analysis such decisions were based.
46. The findings of this Review emphasise the importance of an appropriate audit trail of decisions which also documents the way in which they are followed through (or, if not, the reasons for failing to do so). An example of this not being implemented properly is the remuneration proposal to apply *malus*, amongst other remuneration actions,<sup>1555</sup> in respect of which the Review has found no evidence that it was followed through, but also no explanation as to why it was not pursued.<sup>1555a</sup>
47. Moreover, the papers and minutes prepared in relation to the meetings of senior decision-making committees in the IRHP context often do not sufficiently articulate the advantages and disadvantages of particular courses of action, any changes made in the course of negotiations, and the impact of those changes. Minutes of important decisions, and discussions in respect of those decisions, are generally sparse and lacking in granularity.<sup>1556</sup> The FSA's internal Lessons Learned Review identified this weakness in

---

<sup>1555</sup> See Chapter 4, Section 1, para. 38.

<sup>1556</sup> See, for example, Chapter 5, Section 3, para. 133. The latter (i.e. granularity) is a requirement under FCA's own SMCR. The Financial Conduct Authority, "*Senior Managers and Certification Regime*", 1 April 2021, accessible at <https://www.fca.org.uk/firms/senior-managers-certification-regime> (ARTICLE 041).

<sup>1555a</sup> Since publication, the Review has identified some evidence of steps that were taken by the FSA/FCA to implement remuneration actions. Having considered that documentation, the Review has concluded that it does not alter any of the conclusions under the Terms of Reference.

recording decision-making,<sup>1557</sup> but the subsequent decision records suggest that this remained an issue.<sup>1558</sup>

48. The FCA increasingly requires of those whom it regulates that detailed records of responsibilities and decision-making are maintained.<sup>1559</sup> Continuing efforts should be made to ensure that also within the FCA better decision-making is accompanied by better recording of that decision-making, consistent with the objectives of the SMCR.<sup>1560</sup> Indeed, the FCA has chosen to apply a version of the SMCR regime to itself even though it is not a regulated firm.<sup>1561</sup>

### **E3: Strengthen Board engagement and accountability**

*To ensure Board accountability, the FCA should improve processes for engaging its Board, including non-executive directors, in any major interventions.*

49. The evidence considered by this Review makes it clear that the FSA/FCA Board engagement in the development and implementation of the IRHP Scheme was limited,<sup>1562</sup> with decisions delegated to CEO/CSRC/ExCo and the wider Executive (whether outright or in practice).<sup>1563</sup> Given the nature and impact of the relevant FSA/FCA decisions, greater involvement by the respective Boards would have been desirable and appropriate. The scale, complexity, novelty and importance of the

---

<sup>1557</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425, pp. 6 and 20. See also Chapter 4, Section 2, para. 54.d.iv.

<sup>1558</sup> See, for example, Chapter 4, Section 3, para. 73; Chapter 5, Section 3, para. 133; and ToR 2, para. 14.

<sup>1559</sup> See, for example, some of the requirements under the SMCR. The Financial Conduct Authority, "*Senior Managers and Certification Regime*", 1 April 2021, accessible at <https://www.fca.org.uk/firms/senior-managers-certification-regime> (ARTICLE 041).

<sup>1560</sup> See, for example, the Financial Conduct Authority, "*Senior Managers Regime*", July 2021, accessible at <https://www.fca.org.uk/publication/corporate/applying-smr-to-fca.pdf> (ARTICLE 043).

<sup>1561</sup> "*We are not formally subject to the Regime, but we uphold the highest professional values and our stakeholders including Parliament and the Treasury Select Committee rightly expect us to do so. In line with this, we have decided to apply the fundamental principles of the Regime to our senior staff*", The Financial Conduct Authority, "*Senior Managers Regime*", July 2021, accessible at <https://www.fca.org.uk/publication/corporate/applying-smr-to-fca.pdf> (ARTICLE 043).

<sup>1562</sup> See, ToR 1, para. 29; ToR 2, para. 21; and ToR 3, paras. 47-48.

<sup>1563</sup> See Chapter 5, Section 2, para. 65.

intervention required a much closer connection between the Executive and the Board before major strategic decisions were taken at critical milestones in the process.

50. In respect of each such intervention by the regulator, there should be a clear and explicit objective as to the role the Board is expected to play and an effective process by which it can input into critical decision-making at a formative stage.

#### **E4: Retain ownership and public law accountability over interventions**

*Whether using Skilled Persons or not, the FCA should ensure future schemes are designed so that it retains sufficient control over any intervention and remains accountable in public law for the results of the exercise of its jurisdiction.*

51. Two striking aspects of the FSA/FCA's role in the Scheme are: (i) its assignment of independent oversight of the banks' compliance with the Scheme to Skilled Persons, while exempting itself from taking responsibility for the outcomes in individual cases; and (ii) the absence of any right of appeal against the redress decisions of the banks and/or Skilled Persons to the FCA (or any independent body or tribunal, including the High Court<sup>1564</sup>). Similar to the decision to forgo wider consultation on the Scheme, this appears to have been done to facilitate the implementation of the Scheme in a timely and effective manner.
52. However, it left a serious gap in the FCA's accountability for the implementation and outcomes of the Scheme, both substantive and in terms of fair process. There was no way of challenging the FCA in respect of decisions under the Scheme, no means of judicially reviewing the decision of the banks as confirmed by the Skilled Persons, and no right of appeal to an independent tribunal from these decisions – thus leading to a lack of accountability in respect of what was and remained an exercise of regulatory powers.<sup>1565</sup> Agreeing, as the FCA has now done, that for future schemes there should be an

---

<sup>1564</sup> See ToR 3, para. 42(c) and footnote 930.

<sup>1565</sup> In their representations, the FCA argued that it was inaccurate to state that the FSA's approach left an "accountability lacuna" on the basis that the *Holmcroft* decision indicated that the underlying claim was fundamentally a private law matter and that the decision taken not to allow KPMG's role to be judicially reviewed had no effect on any private law claim being pursued by *Holmcroft*. For the reasons set out in Chapter 5 para. 55 and in ToR 3, para. 43(c), that argument is not accepted.

independent right of appeal goes only part of the way to secure appropriate accountability in its exercise of powers. The successful implementation of any scheme is as much the ultimate responsibility of the FCA as the design of its component parts. In future interventions of this kind, the FCA should ensure it retains sufficient control over all stages of the process to ensure there is proper public law accountability for the results of the exercise of its jurisdiction.

#### **E5: Internal review**

*Following any major regulatory interventions, the FCA should conduct full internal reviews to establish lessons learned and achievements in a timely manner.*

53. The absence of any internal review of the extent and effectiveness of regulatory supervision during the implementation of the Scheme – the question posed in ToR 3(e) – is notable. It would likely have been beneficial for the FCA to consider internally (with or without assistance of experts) matters such as the merits of entering into a voluntary agreement as compared with use of statutory powers, how it might ensure that its knowledge of the activities of regulated firms was appropriate to detect potential risks to consumers, and other matters of the kind raised with the Independent Reviewer, appointed some three years after most of the redress decisions had been taken.
54. The FCA should have done more to utilise the information it received from banks and Skilled Persons, in order to form a view as to how it might have done things better.<sup>1566</sup> The internal Lessons Learned Review conducted at an early stage is a good example of how useful such an exercise can be – a similar exercise should also have been undertaken in respect of the subsequent stages of the Scheme.<sup>1567</sup>
55. For example, the evidence before the Review suggests that the FCA never carried out an internal investigation or audit of the final reports of the Skilled Persons for the purposes of establishing whether or not the Scheme had indeed achieved the objective of consistency across firms and/or whether adequate steps were taken to identify and address the root causes of the mis-selling.

---

<sup>1566</sup> See ToR 3, paras. 70-71.

<sup>1567</sup> See Chapter 4, Section 2, paras. 53-5.

56. Any such review should be carried out promptly, to ensure that any further steps or lessons learned are identified before it is too late to implement them due to passage of time. In the IRHP context, the FCA indicated to the TSC that an independent review would be carried out, but that it could not be commenced until the conclusion of the Holmcroft proceedings.<sup>1568</sup> In the event, that led to a delay of several years. In practice, a detailed independent review such as the present supplements, but does not replace, a prompt internal lessons learned exercise such as that initially conducted by the FSA's Supervisory Oversight Function.
57. Where possible, internal lessons learned exercises of this kind should be informed by input from all affected stakeholders, including customer perspectives. For example, the FCA may wish to carry out a systematic customer satisfaction survey, to ascertain whether those impacted were satisfied with the way their complaints were handled, and to reflect the conclusions of this as part of its internal assessment.

**E6: Consider including post-termination cooperation obligations on senior FCA personnel**

*The FCA should consider including post-termination cooperation obligations in the employment contracts of all senior FCA personnel.*

58. The Preface makes reference to this Review's unsuccessful attempts to secure the cooperation of Martin Wheatley, who was CEO of the FCA until July 2015.<sup>1569</sup> Martin Wheatley's account of events would have been valuable evidence for the purposes of the Review, given his seniority and his material involvement in the Scheme. The benefits to the FCA of a review of this nature are reduced when the Independent Reviewer is deprived of the opportunity to speak to the organisation's most senior executive at much of the relevant time.
59. As a result, the FCA should consider introducing a post-departure cooperation obligation into the employment contract and/or termination agreements of outgoing senior personnel. Such a provision would require the leaver to make themselves available to the

---

<sup>1568</sup> Chapter 5, Section 4, para. 181.

<sup>1569</sup> See Preface, para. 7.

FCA for any future internal investigation or lessons learned review, and to provide evidence to the extent necessary. Post-departure cooperation obligations of this sort are not uncommon and would ensure that future independent reviewers have the opportunity to speak to all relevant FCA decision-makers.

### **E7: Protect actual and perceived regulatory independence**

*The FCA should ensure it acts, and is seen to act, as a fully independent regulator.*

60. As set out in the section on ToR 1,<sup>1570</sup> there was some evidence that HMT sought to influence the FSA in connection with the likely cost of the Scheme to the banks. Despite this, the evidence suggests that the creation and development of the Scheme remained under the control of the FSA/FCA, and that its decisions were those of an independent body.
61. Nevertheless, in order to protect the practice and public perception of the system of independent regulation, both the executive and the regulator have to be keenly alert to ensuring the FCA's independence is maintained and seen to be maintained at all times. This applies especially where HMT has a direct financial interest in the outcome of decisions taken by the FCA. In practice, the FCA should be cautious as to the way in which it engages with HMT, and HMG more generally, in the context of decision-making on individual interventions, including by ensuring a fair, balanced and transparent route for access and representations by all stakeholders.

---

<sup>1570</sup> See ToR 1, paras. 46-47. See also Chapter 4, paras. 116-124.



## Appendix 1 – Chronology

1. This Appendix sets out some of the events which occurred between February 2010 and June 2019 which this Review considers to be key to its report.

Date	Event
February 2010	The first substantive complaint about IRHPs is raised with the FSA. Further complaints are received during the remainder of 2010 and in 2011. <sup>1571</sup>
May 2010	Barclays agrees with the FSA to undertake the 'Project Aries' review of the appropriateness of IRHP sales between January 2007 and July 2010. <sup>1572</sup> The resulting report provided to the FSA in September 2010 concludes that the bank's " <i>end to end sales processes have complied with the regulatory requirements</i> " save for a handful of cases which it found did not meet the bank's " <i>usual standards</i> ", but which it considered did not " <i>represent a systemic issue with our processes</i> ". <sup>1573</sup>
January 2011	The FSA asks Barclays for an update on outstanding FOS cases and complaints. Barclays responds: " <i>The proportion of substantive decisions on cases within the FOS in favour of Barclays has continued to be around 90%</i> " <sup>1574</sup> . The FSA decides not to undertake further work " <i>based primarily on the Barclays' report, FOS outcomes and other work priorities</i> ". <sup>1575</sup>
August 2011	The FSA requests information from Lloyds about its sales of IRHPs. The FSA is assured that the bank has " <i>reviewed the allegations around the risk warnings given to customers on the risk of interest rate decreases and are comfortable</i> ". <sup>1576</sup>
November 2011	Formation of Bully-Banks, a campaigning pressure group seeking to co-ordinate complaints from small and medium sized businesses against banks regarding IRHP sales.
March 2012	The FSA learns that HSBC commenced an internal review into its sales of interest swaps to customers in October 2011.

---

<sup>1571</sup> FCA Records, *Letter and attachments*, 26 February 2010, 360731.

<sup>1572</sup> FCA Records, *Terms of Reference Project Aries*, 21 July 2010, 270129.

<sup>1573</sup> FCA Records, *Project Aries Final Report*, 21 September 2010, FCA-ADD-011-0656, Executive Summary, p. 4.

<sup>1574</sup> FCA Records, *Email*, 15 February 2011, FCA-ADD-011-0785.

<sup>1575</sup> FCA Records, *ESRC Summary Paper*, 21 March 2012, 261617, Annex 3, para. 21.

<sup>1576</sup> FCA Records, *Email*, 30 August 2011, FCA-ADD-011-0669.

March 2012	A series of newspaper articles between 10 and 13 March 2012 detail allegations of IRHP mis-selling. <sup>1577</sup>
12 March 2012	The FCA starts compiling information on the position of the first-tier banks in respect of the alleged mis-selling of IRHPs. <sup>1578</sup>
13 March 2012	Clive Adamson asks for the sale of IRHPs to be considered by the ESRC. <sup>1579</sup>
14 March 2012	The FSA's GCD is contacted with a view to providing legal advice concerning the FSA's jurisdiction over IRHPs and the applicable rules. <sup>1580</sup>
21 March 2012	An FSA internal memorandum sets out an initial plan for a more detailed information-gathering exercise. Its recommendation to the ESRC involves " <i>a further intensive piece of discovery (one month)</i> ". <sup>1581</sup>
22 March 2012	The ESRC approves the initial information-gathering exercise with the aim of identifying the nature, size and scale of potential issues. Information requests are sent to the first-tier banks for, amongst others, information on the scale and number of relevant sales as well as complaint volumes. <sup>1582</sup>

<sup>1577</sup> See, for example, The Telegraph, "*Bank mis-selling victims: from the chippy to the small hotel*", 10 March 2021, accessible at <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9135986/Bank-mis-selling-victims-from-the-chippy-to-the-small-hotel.html> (ARTICLE 030). See also, The Telegraph, "*This product was not right for my business*", 10 March 2021, accessible at <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9135947/This-product-was-not-right-for-my-business.html> (ARTICLE 034); The Telegraph, "*Treasury acts on interest rate swap claims*", 12 March 2012, accessible at <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9139606/Treasury-acts-on-interest-rate-swap-claims.html> (ARTICLE 035); and The Telegraph, "*Farmers 'hit hardest' in rate swaps scandal*", 13 March 2012, accessible at <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9141788/Farmers-hit-hardest-in-rate-swaps-scandal.html> (ARTICLE 031).

<sup>1578</sup> FCA Records, Email, 12 March 2012, 266298.

<sup>1579</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.1.

<sup>1580</sup> FCA Records, *Email*, 14 March 2012, 272702.

<sup>1581</sup> FCA Records, *Internal Document*, 21 March 2012, FCA-B-0003.

<sup>1582</sup> FCA Records, *ESRC Minutes*, 22 March 2012, 281154, p. 2; see also FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, paras. 6.1-6.2; See, for example, the 26 March 2012 information requests sent to HSBC: FCA Records, *Cover email and letter*, 26 March 2012, 267201 and 267202, and to Barclays: FCA Records, *Letter*, 26 March 2012, 289215.

25 April 2012	Results of the initial information-gathering exercise are presented to the ESRC. This includes a presentation which indicates that over 13,000 IRHPs (excluding caps) have been sold between 2005 and 2008. <sup>1583</sup> The Summary Paper notes that, " <i>we do not have 'evidence' of how widespread the breaches are</i> ", " <i>detriment is likely to be greater than initially estimated (at the March ESRC meeting)</i> ". It concludes that " <i>there is sufficient prima facie evidence (of inappropriate or unsuitable products, poor practices and poor consumer outcomes) that we cannot walk away from this problem at this stage</i> ". It proposes to undertake further work before returning to the ESRC one month later with more detailed preliminary findings and options for regulatory intervention. The ESRC approves this proposal and states " <i>that interest rate caps and fixed rate loans had been excluded from this piece of work as the presenting team wanted to focus its resources on the riskiest products.</i> " <sup>1584</sup>
26 April 2012	The Board meeting notes " <i>the FSA's work reviewing whether there had been cases of mis-selling products that were designed to allow small businesses borrowing funds to hedge against interest rate fluctuations.</i> " <sup>1585</sup>
2 May 2012	The FSA extends its information-gathering exercise to a larger number of banks, including AIB, Santander and the Co-Op Bank. <sup>1586</sup>
19 May 2012	The FSA produces an internal memorandum entitled " <i>Options For Action On Interest Rate Derivatives</i> ". This outlines the advantages and disadvantages of the various options available to the FSA in respect of IRHPs, including enforcement action and imposing a PBR through an OIVOP or VVOP. <sup>1587</sup>
31 May 2012	The outcome of the further information-gathering and a recommended response is presented to the CSRC. The Summary Paper states that the FSA believes it has evidence to suggest a number of poor selling practices for some IRHPs amongst the first-tier banks but cautions that " <i>we do not yet believe we have sufficient evidence to exercise our statutory powers to require firms to pay</i>

<sup>1583</sup> FCA Records, *Internal Document*, April 2012, 268304, slide 19.

<sup>1584</sup> FCA Records, *ESRC Minutes*, 25 April 2012, 276316, p. 2.

<sup>1585</sup> FCA Records, FSA and FCA Board Papers and Minutes, 14 May 2013, 371428, p. 1 (the meeting took place on 26 April 2012).

<sup>1586</sup> See, for example, 2 May 2012 information requests sent to Santander: FCA Records, *Email*, 2 May 2012, 265233; FCA Records, *Email*, 2 May 2012, 265238. See also a note of FSA's call with AIB FCA Records, *Minutes of the call with AIB*, 4 May 2012, 264603.

<sup>1587</sup> FCA Records, *Memorandum – Options For Action On Interest Rate Derivatives*, 19 May 2012, FCA-B-0009.

	<p>redress."<sup>1588</sup> The paper further suggests that there is "a range of alternative options within a spectrum of: negotiating a settlement with the banks (which could lead to a speedier resolution, but potentially less redress for consumers); and referring the matter to Enforcement (which may send out a strong signal, but is likely to be a slow route to a public outcome and redress)".<sup>1589</sup> The recommended response put forward is to "require firms to fund an independent review (by a skilled person, under s166) of past sales to retail clients." The CSRC decides to adopt an approach focused on reaching a voluntary agreement with the banks, and to appoint Skilled Persons to conduct a PBR at each bank.<sup>1590</sup> It decides that "preparatory work should commence on a S.166 report and an Enforcement review" and the FSA should "commence negotiations with firms on securing redress for customers."<sup>1591</sup></p>
11 June 2012	<p>Discussions with the first-tier banks on securing redress for customers begin.<sup>1592</sup> In a meeting between the FSA and Barclays, the FSA explains that proactive redress is sought where the FSA believes there is prima facie evidence to suggest a product was mis-sold, but "exceptions might exist where the customer was sufficiently sophisticated. If this is the case, this will have to be established on a case by case basis".<sup>1593</sup></p>
20 June 2012	<p>The CSRC is updated on the FSA's engagement with the banks to date. The CSRC agrees that: (i) efforts should continue "to work with the four banks to agree a uniform heads of terms on voluntary redress and past business reviews before the public statement at the end of June 2012"; (ii) "the public statement should state the findings on mis-selling and state which banks had agreed to a redress scheme and which had not" and "the four banks involved should be informed of this approach"; (iii) the FSA should also "contact [other] firms</p>

<sup>1588</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.6.

<sup>1589</sup> FCA Records, *ESRC Summary Paper*, 31 May 2012, FCA-B-0010, p. 4.

<sup>1590</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 6.6. While the witness statement provided on behalf of the FCA and the Summary Paper refer to the ESRC, the minutes of the Committee meeting suggest that it was in fact the CSRC; see FCA Records, *CSRC Minutes*, 31 May 2012, 285893. Z explained in their evidence that "it was a similar level committee, it was just one that was focused on conduct issues rather than any prudential issues reflecting the fact that around now we'd been split into the internal twin peaks model of prudential and conduct": see Meeting Transcript Z (P61:L5-9).

<sup>1591</sup> FCA Records, *CSRC Minutes*, 31 May 2012, 285893, p. 2.

<sup>1592</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 8.1; FCA Records, *Letter*, 20 June 2012, 342568.

<sup>1593</sup> FCA Records, *Internal Document*, 11 June 2012, 262847, p. 4, para. 18.

	<i>involved in mis-selling and encourage them to agree to the voluntary heads of terms".</i> <sup>1594</sup>
21 June 2012	Parliamentary debate on IRHPs, in which several MPs express concerns regarding IRHP mis-selling. <sup>1595</sup>
25 June 2012	The FSA sends the first drafts of the proposed Initial Agreement, Initial Written Undertaking and Initial Appendix to the first-tier banks. <sup>1596</sup>
26 June 2012	<p>Table summarising the banks responses to the first drafts of the proposed Initial Agreement, Initial Written Undertaking and Initial Appendix circulated within the FSA, including to Clive Adamson and Martin Wheatley. The table shows a number of the banks taking issue, amongst others, with the FSA's proposed requirements regarding disclosure of break costs (and, in particular, whether a worked numerical example showing indicative break costs had to be provided).<sup>1597</sup></p> <p>The CSRC is updated on the latest developments in the negotiations with the banks and "<i>considered the concerns of the various banks that they felt was preventing them from signing-up to the voluntary redress scheme</i>", "<i>noted the concerns that negotiations were moving slowly</i>". Martin Wheatley and Clive Adamson "<i>agreed to call the relevant senior figures [at the first-tier banks] to explain that a failure to reach a voluntary agreement by the deadline would lead to proceedings against the firms involved</i>".<sup>1598</sup></p>
27 June 2012	Revised version of draft Initial Agreement and draft Initial Undertaking is re-circulated to the first-tier banks containing several material changes, including amendments to the Sophisticated Customer Criteria. <sup>1599</sup>
28 June 2012	The FSA's preferred approach is summarised to the Board on 28 June 2012, coalescing around the following three key elements: " <i>firstly for the banks to agree to redress customers who have been mis-sold, as this will provide a robust and earlier resolution. We</i>

<sup>1594</sup> FCA Records, *CSRC Minutes*, 20 June 2012.

<sup>1595</sup> House of Commons Debate, "*Interest Rate Swap Products*", 21 June 2012, volume 546, cols. 1047-1088, accessible at <https://hansard.parliament.uk/Commons/2012-06-21/debates/12062137000003/InterestRateSwapProducts>.

<sup>1596</sup> See, for example, FCA Records, *Cover email and attachments*, 25 June 2012, 263741-263743. See also FCA Records, *Cover email and attachments*, 25 June 2012, 350753-5. See further, Meeting Transcript G (P53:L19-25).

<sup>1597</sup> FCA Records, *Email*, 26 June 2012, FCA-C-010-0007.

<sup>1598</sup> FCA Records, *CSRC Minutes*, 26 June 2012, 289471, p. 5.

<sup>1599</sup> See, for example, *FCA Records, Email and attachments*, 27 June 2012, 349361-3 and FCA Records, *Minutes of FSA and RBS meeting*, 27 June 2012, 267548.

	<i>would require a fast track review of sales of the most complex products as we see a stronger presumption of mis-sale; secondly to use skilled persons to ensure a degree of independent oversight; and thirdly considering requesting firms to stop marketing any or all of these products to retail customers until they have fixed sales and systems and controls failings".</i> <sup>1600</sup>
29 June 2012	Agreements with the first-tier banks are reached and publicly announced. <sup>1601</sup>
June to September 2012	The banks develop review methodologies in consultation with their Skilled Persons.
3 July 2012	Discussions between Martin Wheatley and the Chief Financial Ombudsman begin regarding the potential role of the FOS in the IRHP mis-selling investigation and redress scheme. <sup>1602</sup>
4 July – 13 July 2012	Guto Bebb MP and Vince Cable MP (the latter at the time the Secretary of State for BIS) write to the FSA raising a number of issues with the Initial Scheme. <sup>1603</sup>
10 July 2012	The FSA internally circulates a document entitled: " <i>Options for using FOS in the Interest Rate Hedging Products Redress Scheme</i> " which contemplates making changes to the FOS jurisdiction rules. <sup>1604</sup>
12 July 2012	The decision is taken to conduct a Pilot Review. <sup>1605</sup> The Requirement Notices for the first-tier banks' Skilled Persons stipulate tight timeline for the completion of the Pilot Review.
19 July 2012	FOIA request addressed to the FSA seeking disclosure of the Initial Agreement. <sup>1606</sup>

<sup>1600</sup> FCA Records, *FSA and FCA Board Papers and Minutes*, 14 May 2013, 371428, p. 3. Please note that the relevant meeting took place on 28 June 2012.

<sup>1601</sup> FCA Records, Email, 26 June 2012, FCA-C-010-0007, p. 2. See also FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc*, 11 September 2015, FCA-C-008-0000, para. 8.9. See also a final draft of the FSA's public statement in relation to their initial review into IRHPs; FCA Records, *Internal Document*, 29 June 2012, 266180. See further an internal FSA document summarising the key communications for the end of June: FCA Records, *Internal Document*, 28 June 2012, 274551.

<sup>1602</sup> FCA Records, *Internal Document*, 3 July 2012, 296924.

<sup>1603</sup> FCA Records, *Letter*, 4 July 2012, 1130702; FCA Records, *Letter*, 23 July 2012, 318083.

<sup>1604</sup> FCA Records, Memorandum – *Options for using the FOS in Interest Rate Hedging Products Redress Scheme*, 10 July 2012, 004608.

<sup>1605</sup> FCA Records, *Email*, 12 July 2012, 291866.

<sup>1606</sup> See FCA Records, *Email*, 1 October 2012, FCA-C-003-0007. See also Chapter 4, Section 1, para. 8.

24 July 2012	All of the second-tier banks have signed up to the Initial Agreement by 24 July 2012. <sup>1607</sup>
26 July 2012	The Board receives " <i>an update on the work on interest rate swaps, which would involve an independent reviewer scrutinising the work of each bank to provide redress. The FSA was now agreeing who the reviewer would be in each case</i> ". It noted that the " <i>exercise for each bank will be scrutinised by an independent reviewer and overseen by the FSA</i> " and that the Initial Scheme was expected to lead to " <i>prompt redress</i> ". <sup>1608</sup>
9 August 2012	The ESRC meets to consider whether to take remuneration actions in relation to IRHP mis-selling. <sup>1609</sup>
15 August 2012	The FSA meets with the FOS to further discuss possible FOS involvement, in particular the proposal for a stand-alone FOS scheme dealing with IRHPs. <sup>1610</sup>
Late August 2012	The FSA continues to develop its approach to carrying out the Pilot Review. <sup>1611</sup>
3 September 2012	The FSA publishes a progress report on its website. <sup>1612</sup> It deals with matters including consequential loss, with FAQs in the progress report providing that fair and reasonable redress should " <i>take into account the potential direct impact and consequences of such impacts (consequential loss) of the mis-sale on the customer and ensure that the customer is no worse off</i> ". <sup>1613</sup>
5 September 2012	First FAQ document addressed to the Skilled Persons and the banks is issued by the FSA. <sup>1614</sup> Amongst other things, this sets out the FSA's view that the Skilled Persons cannot take a sampling approach to the sophistication test, i.e. determining which customers are to be classified as sophisticated. <sup>1615</sup>

<sup>1607</sup> FCA Records, *Undertaking*, 11 July 2012, 811399; FCA Records, *Agreement*, 11 July 2012, 847906; FCA Records, *Undertaking*, June 2012, 446898; FCA Records, *Email and Undertaking*, 12 July 2012, 342971-2; FCA Records, *Agreement*, 11 July 2012, FCA-C-010-0015; FCA Records, *Undertaking*, 24 July 2012, FCA-B-0036.

<sup>1608</sup> See FCA Records, *FSA Board Minutes*, 14 May 2013, 371428, p. 3.

<sup>1609</sup> FCA Records, *Internal Document*, 7 August 2012, 823903.

<sup>1610</sup> FCA Records, *Email and attachment*, 16 August 2012, 352697 and 352698. See also FCA Records, *Internal Document*, 29 August 2012, 001863.

<sup>1611</sup> FCA Records, *Email*, 24 August 2012, 319881.

<sup>1612</sup> FCA Records, *Paper to Board*, September 2012, 354590.

<sup>1613</sup> FCA Records, *FAQs for Skilled Persons*, 18 September 2012, 347285, p. 2.)

<sup>1614</sup> FCA Records, *Witness statement on behalf of the FCA in R (Holmcroft Properties Limited) v KPMG LLP and (1) Financial Conduct Authority (2) Barclays Bank plc, 11 September 2015, FCA-C-008-0000, para. 12.4.*

<sup>1615</sup> FCA Records, *Email and attachment*, 5 September 2012, FCA-C-003-0006, pp. 1-4.

18 September 2012	Second FAQ document issued by the FSA addressed to the Skilled Persons and the banks. <sup>1616</sup>
20 September 2012	Newspaper articles state that the Pilot Review would commence the next day <sup>1617</sup> and that " <i>Rate swap victims could get compensation within weeks</i> ". <sup>1618</sup>
21 September 2012	The FSA's Conduct Business Unit Supervision Oversight Function (" <b>SOF</b> ") initiates a " <i>Lessons Learned Review</i> " in respect of the FSA's intervention on IRHPs. It considers: (i) if the FSA could have intervened on IRHPs earlier, (ii) whether it was appropriate to intervene on IRHPs over other issues, (iii) whether the approach, extent and timescales for the intervention were appropriate, and (iv) to identify any lessons learned. <sup>1619</sup>
Late September 2012	The FSA seeks bank consent to disclose the Initial Agreement in response to the FOIA request, which two first-tier banks decline. <sup>1620</sup>
Late September to early October 2012	The FSA gives approval for each of the first-tier banks to begin the Pilot Review. <sup>1621</sup>
15 October 2012	The FSA takes part in a roundtable meeting with representatives of the BBA, BIS, Bully-Banks and the first-tier banks. <sup>1622</sup>
17 October 2012	Third FAQ document issued by the FSA addressed to the Skilled Persons and the banks. <sup>1623</sup> Amongst others, this clarifies the Initial Sophisticated Customer Criteria. The FSA explains that both the

<sup>1616</sup> FCA Records, *Email and attachment*, 18 September 2012, 347284-5.

<sup>1617</sup> The Evening Standard, "*Banks shouldn't run mis-selling compensation scheme, say small businesses*", 20 September 2012, accessible at <https://www.standard.co.uk/business/business-news/banks-shouldnt-run-mis-selling-compensation-scheme-say-small-businesses-8159195.html>.

<sup>1618</sup> The Telegraph, "*Rate swap victims could get compensation within weeks*", 20 September 2012, accessible at <https://www.telegraph.co.uk/finance/rate-swap-scandal/9553976/Rate-swap-victims-could-get-compensation-within-weeks.html>.

<sup>1619</sup> FCA Records, *Email*, 21 September 2012, 437717.

<sup>1620</sup> See FCA Records, *Emails*, 26 September 2012, 408852; and FCA Records, *Emails*, 28 September 2012, 537701.

<sup>1621</sup> See for example, FCA Records, *Email*, 1 October 2012, 332125, confirming approval for RBS to begin its Pilot Review on 1 October 2012. Lloyds was also approved to begin its Pilot Review on 24 September 2012, with strong caveats in place with regards to the application of the Initial Sophistication Customer Criteria and break costs: see FCA Records, *Email*, 24 September 2012, 290216 and FCA Records, *Email*, 27 September 2012, 332174. HSBC were approved on 20 September 2012; see FCA Records, *Email*, 21 September 2012, FCA-B-0062. Barclays was approved on 24 September 2012; FCA Records, *Email*, 24 September 2017, 290216.

<sup>1622</sup> FCA Records, *Email*, 16 October 2012, FCA-ADD-0311, pp. 65-66.

<sup>1623</sup> FCA Records, *Email and attachment*, 17 October 2012, 324034-5.



	"objective" and "subjective" customer criteria cannot be applied on a group basis if the customer was part of a group. <sup>1624</sup>
17 October 2012	The FSA writes to the first-tier banks inviting comments on a proposal to extend the FOS's voluntary jurisdiction to cover cases where customers remain dissatisfied after their redress determination. <sup>1625</sup>
31 October 2012	A Board meeting is held at which it is updated on the IRS Steering Group's proposed next steps. Amongst others, it is informed that the Main Scheme is expected to last six months. <sup>1626</sup>
2 November 2012	Barclays expresses concern to the FSA in relation to the Initial Sophisticated Customer Criteria. <sup>1627</sup>
9 November 2012	The FOS writes to the FSA indicating that its board in principle supports the proposal for a stand-alone ombudsman scheme to consider complaints about the sale of IRHPs. <sup>1628</sup>
9-28 November 2012	Skilled Persons for three of the banks produce a report on its findings from the Pilot Review. <sup>1629</sup>
12 November 2012	An IRS Steering Group Committee meeting is held which notes certain banks' views in relation to a voluntary FOS scheme. <sup>1630</sup>
Mid-November 2012 to end of January 2013	The FSA focuses on: <ul style="list-style-type: none"> <li>• continuing to review the cases considered by the banks as part of the Pilot Review and reporting findings;</li> <li>• considering whether amendments or adjustments should be made to the terms of the Initial Written Undertaking for the purposes of the Scheme; and</li> <li>• negotiating and finalising the Supplemental Agreement and the Exchange of Letters with the banks to commence the Scheme.</li> </ul>
16 November 2012	The FSA issues the fourth FAQ document addressed to the Skilled Persons and the banks. <sup>1631</sup> It notes that the ' <i>subjective</i> ' sophisticated customer criteria require the bank to demonstrate that the customer had the necessary experience and knowledge of derivatives, which

<sup>1624</sup> FCA Records, *FAQs for Skilled Persons*, 17 October 2012, 324035, pp. 1-2.

<sup>1625</sup> FCA Records, *Letter*, 17 October 2012, 1104823.

<sup>1626</sup> FCA Records, *Internal Document*, 14 May 2013, 371428.

<sup>1627</sup> FCA Records, *Email*, 5 November 2012, 361227.

<sup>1628</sup> FCA Records, *Letter*, 9 November 2012, 328234.

<sup>1629</sup> See FCA Records, Skilled Person report (Barclays), 28 November 2012, 334179; FCA Records, Skilled Person report (HSBC), 9 November 2012, 445499; FCA Records, Skilled Person report (Lloyds), 15 November 2012, 808273.

<sup>1630</sup> FCA Records, *Email*, 12 November 2012, 329937.

<sup>1631</sup> FCA Records, *Email and attachment*, 16 November 2012, 329224-5.

		<i>means it may be difficult for a customer without prior experience in derivative products to meet this criteria".</i> <sup>1632</sup>
20	November	The FSA provides its preliminary view from its review of the Pilot Review cases that there has been inadequate disclosure of break costs across the board. <sup>1633</sup>
23	November	Clive Adamson writes to IRHP customers providing information about the Initial Scheme. <sup>1634</sup>
	November	The first-tier banks conclude their respective Pilot Reviews. <sup>1635</sup>
Late	November	The FSA seeks the views of the banks on how the Initial Sophisticated Customer Criteria could be improved, to ensure they capture only the subset of SME customers intended to be the target of the Scheme.
	December	The FSA begins formulating a process for banks to base decisions on whether the IRHP(s) in a given case fell within Category A, B or C, and identifying various potential appropriate alternative products. <sup>1636</sup>
6	December	Martin Wheatley meets with the FOS to discuss a stand-alone FOS scheme as a potential addition to the Scheme. <sup>1637</sup>
10	December	An ExCo quarterly meeting refers to political pressure the FSA may encounter in January 2013 as a key risk. <sup>1638</sup>
11	December	The BBA announces that the banks have agreed to consider whether to apply a moratorium of IRHP payments on a case-by-case basis. <sup>1639</sup>
Around	14	The FSA's SOF Lessons Learned Review concludes. <sup>1640</sup>
	December	

<sup>1632</sup> FCA Records, *FAQs for Skilled Persons*, 16 November 2012, 329225, p. 1.

<sup>1633</sup> FCA Records, *Email attachment*, 20 November 2012, 329904.

<sup>1634</sup> FCA Records, *Letter and attachment*, 23 November, FCA-A-0009

<sup>1635</sup> See, for example, FCA Records, Skilled Person report (Barclays), 28 November 2012, 334179, pp. 3 and 5; FCA Records, Skilled Person report (RBS), 19 May 2016, pp. 13-14, para. 1.2.2 (REPORT 010); FCA Records, Skilled Person report (Lloyds), 15 November 2012, 808273; and FCA Records, Skilled Person report (HSBC), 10 November 2016.

<sup>1636</sup> FCA Records, *Cover email and attachment*, 4 December 2012, 001245 and 001248, paras. 4-6.

<sup>1637</sup> FCA Records, *Memorandum – Notes for meeting with Natalie Ceeney*, 5 December 2021, 32664.

<sup>1638</sup> FCA Records, *CBU ExCo Quarterly Minutes*, 10 December 2012, 357476.

<sup>1639</sup> BBA, "*Interest Rate Swaps: Businesses in Financial Distress (major banks review process)*", 11 December 2021, accessible at <https://www.bba.org.uk/news/statistics/sme-statistics/interest-rate-swaps-businesses-in-financial-distress-major-banks-review-process/#.XtIdglVKiUk>.

<sup>1640</sup> FCA Records, *Email*, 14 December 2012, 491985.

18 2012	December	<p>Meeting of the CSRC takes place in which it is informed of the initial findings of the Pilot Review. The supporting Summary Paper notes that:</p> <ol style="list-style-type: none"> <li>1. The banks found significant non-compliance with the provisions of the FSA's Handbook. The FSA's own review of the pilot exercise found that over 90% of sales across all four banks were non-compliant with its Principles, rules and guidance.</li> <li>2. A number of significant issues need to be resolved including: <ol style="list-style-type: none"> <li>a. Ensuring that the sophistication test includes the customers that the FSA believes should be in scope, and excluding those that should not;</li> <li>b. Finalising the FSA's internal view on sufficient break cost disclosure; and</li> <li>c. Ensuring that the banks agree the key elements of the approach to fair and reasonable redress.</li> </ol> </li> <li>3. The CSRC Summary Paper states that its purpose is only to "<i>update the CSRC on the progress made</i>" and that "<i>No decision is sought at this stage</i>".</li> </ol> <p>In relation to the issue of "<i>sophistication</i>", Annexure 1 of the meeting paper notes that "<i>The issue of whether or not customers are deemed to be sophisticated is sensitive and has attracted the attention of a range of stakeholders</i>". It sets out a number of potential amendments to the Initial Sophisticated Customer Criteria:</p> <ul style="list-style-type: none"> <li>• "<i>Amending the Objective Test so that a sophisticated customer would instead be anyone who had taken out an underlying loan of £10m or more;</i></li> <li>• "<i>Retaining the existing Objective Test but classing as sophisticated any customer that is a 100% owned subsidiary of an entity that does meet the Objective Test; and/or</i></li> <li>• "<i>Defining a 'group' more widely, including common control or common partners, and then aggregating the turnover, balance sheet, and number of employees of companies or entities in a group for the purposes of the Objective Test</i>".<sup>1641</sup></li> </ul>
21 2012	December	The High Court hands down its judgment in <u>Green and Rowley</u> . <sup>1642</sup>
	January 2013	Skilled Persons for the fourth first-tier bank provide their report on the Pilot Review.
	15 January 2013	A CSRC meeting takes place at which it is:

<sup>1641</sup> FCA Records, *CSRC Summary Paper*, 18 December 2012, FCA-B-0084.

<sup>1642</sup> John Green and Paul Rowley -v- Royal Bank of Scotland Plc [2012] EWHC 3661 (QB).

	<p>1. provided with options for the FSA in the event that the FSA and the banks cannot agree on the various "<i>issues of interpretation</i>" that are still outstanding.<sup>1643</sup></p> <p>2. informed about three "<i>potential weaknesses</i>" with the Initial Sophisticated Customer Criteria. To address these concerns, three proposals for new "<i>tests</i>" are put to the CSRC. The CSRC is provided with some information on the potential impact of these amendments on a representative sample taken from Barclays' customer population (1,427 customers). The CSRC agrees with the proposed changes and decides that:</p> <ul style="list-style-type: none"> <li>• the objective sophistication test should be amended to include a £7.5 million notional hedge overlay, which would result in those customers with a notional hedge value or values equal or greater than £7.5m being deemed sophisticated; and</li> <li>• firms should be allowed to determine sophistication based on group accounts rather than on the entity under dispute in isolation.<sup>1644</sup></li> </ul> <p>3. informed of developments in respect of <u>Green and Rowley</u> and agrees<sup>1645</sup> with the recommendation that the FSA should maintain its position, as set out in the FAQs addressed to the Skilled Persons.</p> <p>4. provided with the recommendation "<i>To accept the redress principles highlighted here as a fair and reasonable "baseline" for redress determinations in the review</i>".<sup>1646</sup> The key principle for redress was "<i>to put the Customer back into the position they would have been in had the breach of the Regulatory Requirements not occurred</i>".<sup>1647</sup> The CSRC accepts this recommendation.<sup>1648</sup></p> <p>5. provided with detail on the fair and reasonable redress which essentially includes two broad types of redress, being full tear-up and alternative product.<sup>1649</sup></p> <p>6. provided with information on consequential loss, indicating that, in certain circumstances, it is fair and reasonable to consider consequential loss by applying the general legal principles relevant to cases involving breaches of the FSA's rules.<sup>1650</sup></p>
--	--

<sup>1643</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 3.

<sup>1644</sup> FCA Records, *CSRC Minutes*, 15 January 2013, FCA-B-0090.

<sup>1645</sup> FCA Minutes, *CSRC Minutes*, 15 January 2013, FCA-B-0090, p. 2 and p. 4.

<sup>1646</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 22.

<sup>1647</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 22.

<sup>1648</sup> FCA Minutes, *CSRC Minutes*, 15 January 2013, FCA-B-0090, p. 3.

<sup>1649</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, pp. 23-25.

<sup>1650</sup> FCA Records, *CSRC Summary Paper*, 15 January 2013, FCA-B-0089, p. 26.

17 January 2013	The FSA communicates its proposed amendments to the Scheme to the first-tier banks. <sup>1651</sup> A draft Supplemental Agreement and a draft letter is provided to those banks setting out its position on and refinements to the Scheme. These cover the proposed Sophisticated Customer Criteria, Sales Standards, redress, consequential loss, the moratorium on payments, and offsetting. <sup>1652</sup> It seeks confirmation by 23 January 2013 that the banks would make the necessary changes to enable them to conduct the Scheme. <sup>1653</sup> The proposals are substantially similar to those outlined and approved by the CSRC, save that the " <i>feedback loop</i> " is amended and if a group meets any one of the three Small Group thresholds (rather than two, as envisaged in the 15 January 2013 version), that will be sufficient for a customer to qualify as sophisticated. <sup>1654</sup>
17 January 2013	The Board considers the outcome of the Pilot Review. It is not asked to make any decisions in respect of the Scheme. <sup>1655</sup>
24 January 2013	The FSA summarises in an internal paper the concerns of the banks regarding amendments to the Scheme and suggests proposals to address these. <sup>1656</sup>
24 January 2013	Clive Adamson and a team of other FSA staff meet with HMT officials. An HMT official states that " <i>the Treasury had been lobbied hard by the CEOs of the banks, particularly the two state-owned institutions (LBG and RBS). As a result, the Chancellor had come to the opinion that the total redress costs needed to be reduced, and that the purpose of the meeting was for HMT to understand the FSA's proposals in order to find ways to cut the cost</i> ". <sup>1657</sup>
24 January 2013	Meeting between Sajid Javid MP (then Financial Secretary to the Treasury), Martin Wheatley, and HMT officials. Sajid Javid explains his concern about where to " <i>draw the line</i> " in respect of sophistication. Both Sajid Javid and HMT press the FSA for " <i>flexibility</i> " and challenge the FSA's proposed timeline for redress, which they consider " <i>artificial</i> ". <sup>1658</sup>
26-27 January 2013	Media reports that " <i>Factions within the Treasury want the [FSA] to 'water down' the findings of a review of banks' mis-selling of complex financial products to small businesses ... [there was]</i>

<sup>1651</sup> FCA Records, *Letter*, 17 January 2013, FCA-B-0091.

<sup>1652</sup> See for example, FCA Records, *Letter*, 17 January 2013, FCA-B-0091.

<sup>1653</sup> See for example, FCA Records, *Letter*, 17 January 2013, FCA-B-0091.

<sup>1654</sup> FCA Records, *Letter*, 17 January 2013, FCA-B-0091, p. 4.

<sup>1655</sup> FCA Records, *Memorandum – paper to the FSA Board*, 17 January 2013, 354398. See also FCA Records, *FSA Board Minutes*, 17 January 2013, 815087.

<sup>1656</sup> FCA Records, *Internal Document*, 24 January 2013, 461392.

<sup>1657</sup> FCA Records, *FSA and HMT Minutes*, 24 January 2013, 359870.

<sup>1658</sup> FCA Records, *Email*, 25 January 2013, 756241.

	<p><i>[c]oncern within the Government that the scandal could "blow a hole" in the banks' balance sheets has resulted in the pressure on the FSA"<sup>1659</sup> And that the banks "mounted a coruscating attack on their new regulator as they brace for the outcome of a new mis-selling probe".<sup>1660</sup></i></p>
<p>28 January 2013</p>	<p>The CSRC meets to "<i>to decide how best to respond to the banks so that we can make an announcement on 31 January 2013 about which banks will be progressing to the Main Review</i>".<sup>1661</sup> It considers various aspects of the Scheme, including: (i) the proposed Sophisticated Customer Criteria, (ii) break costs, (iii) principles of redress, (iv) a potential FOS element to the Scheme, (v) whether to extend the Skilled Persons' responsibilities to give the FSA an assurance that banks were appropriately considering moratoria on payments, and (vi) possible actions the FSA could take against non-cooperating banks.</p> <p>The Summary Paper notes that the first-tier banks were concerned the proposed criteria would "<i>still result in large property companies and SPVs or common ownership structures being non-sophisticated (and therefore included within the review)</i>", adding that "<i>allowing these type [sic] of customer in the review ... will increase the time it takes to complete the review and typically these customers had larger hedges, so the overall cost of redress would be higher if they were included</i>".<sup>1662</sup></p> <p>The proposal put to the CSRC is that: "<i>We are persuaded that we should make further substantial changes to the criteria, to exclude more customers from the review which the banks say are sophisticated because they are SPVs or subsidiaries of offshore parents</i>".<sup>1663</sup> The CSRC subsequently resolves to remove the 'feedback loop' from the notional hedge test, include the "<i>groups of connected clients</i>" test and increase the notional hedge threshold from £7.5 million to £10 million. It notes that the higher threshold would reduce the number of in scope LBG customers from ~10,000 to ~4,500 (with a lesser impact on other firms).<sup>1664</sup></p> <p>Among other decisions, the CSRC decides that: (i) the assessment of consequential loss should be limited to "<i>reasonably foreseeable loss</i>"; (ii) the FSA should maintain its position on break costs; (iii) the FSA should maintain its position on redress, noting that "<i>careful</i></p>

<sup>1659</sup> The Sunday Telegraph, "FSA under pressure to 'water down' mis-selling findings", 26 January 2013, accessible at <https://www.telegraph.co.uk/finance/rate-swap-scandal/9829396/FSA-under-pressure-to-water-down-mis-selling-findings.html>.

<sup>1660</sup> Sky News, "Exclusive: Banks' Fury At Mis-Selling Probe", 27 January 2013, accessible at <https://news.sky.com/story/exclusive-banks-fury-at-mis-selling-probe-10456561>.

<sup>1661</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095.

<sup>1662</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 2.

<sup>1663</sup> FCA Records, *CSRC Summary Paper*, 28 January 2013, FCA-B-0095, p. 2.

<sup>1664</sup> FCA Records, *CSRC Minutes*, 28 January 2013, 359688.

	<i>messaging would be needed to ensure that this is not perceived as a policy stance"; (iv) there should be no amendment to the FOS's jurisdiction; and (v) 8% is a fair and reasonable interest rate.</i>
28 January 2013	Martin Wheatley informs HMT that the FSA has finalised its views on changes to the Scheme and would be communicating those views to the first-tier banks the following day. <sup>1665</sup>
29 January 2013	The FSA writes to the first-tier banks setting out its final position in relation to the terms of the Scheme. <sup>1666</sup> It outlines, amongst others, that a £10 million notional threshold has been selected in order to determine " <i>sophistication</i> ". One notable point of difference in the FSA's redress principles is that all Category A, B and C customers could be found to have a " <i>no redress</i> " outcome where they either suffered no loss or where it is determined that, even absent the mis-selling, they would have bought the same IRHP. Previously this only applied to Category B and C customers.
30 January 2013	All of the first-tier banks respond to the FSA confirming their agreement in principle to the amended terms. <sup>1667</sup>
30 January 2013	The CSRC meets and agrees that a press release should be issued on 31 January 2013, confirming the agreement of the first-tier banks to commence the Main Scheme. The CSRC confirms that the specific terms of the agreement reached with the first-tier banks should not be included in the press release. <sup>1668</sup>
31 January 2013	The FSA publishes its Pilot Findings Paper which summarises the work it has undertaken in respect of the Pilot Review and the various amendments to the Scheme. <sup>1669</sup> The report notes the FSA's expectation that the banks should aim to complete their reviews within six months (with some banks with larger review populations taking up to 12 months).
31 January 2013	The FSA confirms that all first-tier banks have agreed to the Supplemental Agreement
11 February 2013	The IRS Steering Group meets and discusses how the 7.5% Rule should be modelled and calculated.

<sup>1665</sup> FCA Records, *Email*, 28 January 2013, 819347.

<sup>1666</sup> FCA Records, *Email*, 28 January 2013, 819347.

<sup>1667</sup> Letter from RBS: FCA Records, *Letter*, 30 January 2013, 295425; Letter from HSBC: FCA Records, *Letter*, 30 January 2013, 446939; Letter from Lloyds: FCA Records, *Letter*, 30 January 2013, 816076; and Email from Barclays: FCA Records, *Email*, 30 January 2013, 373155.

<sup>1668</sup> FCA Records, *CSRC Minutes*, 30 January 2013, 292091.

<sup>1669</sup> The Financial Services Authority, "*Interest Rate Hedging Products – Pilot Findings*", January 2013, FCA-ADD-0267.

14 February 2013	All second-tier banks agree to sign the Supplemental Agreement. <sup>1670</sup>
18 February 2013	A CSRC Summary Paper considers the inclusion of fixed-rate loans in the suite of acceptable alternative products used by banks in calculating redress determinations. An initial recommendation is made to continue to exclude fixed-rate loans. <sup>1671</sup>
18 February 2013	The FSA requests that banks assess the number of 'in-scope' customers following the establishment of the Sophisticated Customer Criteria. <sup>1672</sup>
25 February 2013	The IRS Steering Group decides that the rollover of products should not be an option for banks in the calculation of customer redress. <sup>1673</sup>
27 February – 1 March 2013	The FSA receives further responses from several banks regarding the impact of the revised Sophisticated Customer Criteria on in-scope customer populations. <sup>1674</sup>
March 2013	The FSA begins to issue revised Requirement Notices to each of the banks ahead of the Main Scheme. These add two further requirements: <ul style="list-style-type: none"> <li>• each bank <i>"will not (except in exceptional circumstances) foreclose on or adversely vary the existing lending facilities of Customers without giving prior notice to the relevant Customer and obtaining their prior consent, until the Firm has issued a final redress determination and, if relevant provided redress to the Customer"</i>;</li> <li>• each bank <i>"will consider on a case by case basis whether to suspend the payments payable by a Customer under an [IRHP]"</i></li> </ul>

<sup>1670</sup> FCA Records, *Memorandum – Interest Rate Hedging Products (IRHP) – March 2013 Board update*, 6 March 2013, 450153. AIB confirmed its agreement on 12 February 2013; FCA Records, *Letter*, 12 February 2013, 820269. Bank of Ireland confirmed its agreement on 13 February 2013; FCA Records, *Letter*, 13 February 2013, 822193. NAGE confirmed its agreement on 13 February 2013; FCA Records, *Signed Supplemental Agreement*, 13 February 2013, 816939 and FCA Records, *Email*, 13 and 14 February 2013, 821237. Santander confirmed its agreement on 14 February 2013; FCA Records, *Signed Supplemental Agreement*, 14 February 2013, FCA-B-0106. Co-op Bank confirmed its agreement on 12 February; FCA Records, *Signed Supplemental Agreement*, 12 February 2013, FCA-B-0104.

<sup>1671</sup> FCA Records, *Internal Document*, 18 February 2013, 822196.

<sup>1672</sup> FCA Records, *IRS Steering Group Note of Meeting and attachment*, 18 February 2013, 371505 and 371508. The request was sent to the following banks: Lloyds, see FCA Records, *Email*, 18 February 2013, 818780; RBS, see FCA Records, *Email*, 18 February 2013, 821443; NAGE, see FCA Records, *Email*, 18 February 2013, 818228; AIB, see FCA Records, *Email*, 18 February 2013, 820261; Co-op Bank, see FCA Records, *Email*, 18 February 2013, 823224; and Barclays, see FCA Records, *Email*, 20 February 2013, 371866.

<sup>1673</sup> FCA Records, *Email*, 25 February 2013, 819860.

<sup>1674</sup> FCA Records, *Email*, 1 March 2013, 822329; FCA Records, *Email*, 1 March 2013, 371179; FCA Records, *Email*, 1 March 2013, 826830; and FCA Records, *Email*, 27 February 2013, 823224.



	<i>pending, the outcome of the review of the sale to the Customer, where the Firm determines financial distress to be present".</i> <sup>1675</sup>
March 2013	The FSA publishes an amended Pilot Findings Paper. <sup>1676</sup>
6 March 2013	The FSA publishes a flowchart on its website, outlining the Sophisticated Customer Criteria in detail. <sup>1677</sup>
27 March 2013	The FSA finalises its SOF Lessons Learned Review. <sup>1678</sup>
28 March 2013	The FSA shares with the banks the final decisions reached by its senior management on several aspects of redress. These include: <ul style="list-style-type: none"> <li>• rules for calculating the maximum term;</li> <li>• the provision of standard base-rate curves for banks to use in calculating outcomes for customers;</li> <li>• confirmation that fixed-rate loans can be used as alternative products for the purposes of redress, noting the implementation of the 7.5% Rule; and</li> <li>• the permissibility of, and approach to, the rollover of products in the calculation of redress.<sup>1679</sup></li> </ul>
1 April 2013	The FSA becomes the FCA/PRA and a new requirement to investigate and report on regulatory failure comes into force. <sup>1680</sup>
9 May 2013	Martin Wheatley writes to the Financial Secretary to the Treasury, Greg Clark MP, stating that customers with TBLs may be faced with similar issues to those who were sold stand-alone IRHPs. <sup>1681</sup>
15 May 2013	EY raises concerns that the FCA may have re-opened its approach to the way the banks are to deal with alternative products being offered by way of redress. <sup>1682</sup>

<sup>1675</sup> A pro forma version was finalised in February 2013; see FCA Records, *Requirement Notice*, 28 February 2013, 446160. This revised requirement notice was then circulated to the banks in March 2013. See, for example, FCA Records, *Requirement Notice*, 5 March 2013, 822094; and FCA Records, *Requirement Notice*, 1 March 2013, 821489.

<sup>1676</sup> The Financial Services Authority, "*Interest Rate Hedging Products – Pilot Findings*", March 2013, FCA-A-0011.

<sup>1677</sup> The Financial Conduct Authority, "Interest rate swaps flowchart", 6 March 2013, accessible at <https://webarchive.nationalarchives.gov.uk/20140902060442/http://www.fca.org.uk/yourfca/documents/fsa-irs-flowchart> (ARTICLE 021).

<sup>1678</sup> FCA Records, *FSA CBU, Supervisory Oversight Function Lessons Learned Review of Interest Rate Hedging Products*, 27 March 2013, 006425. See Chapter 4, Section 2, paras. 53-55.

<sup>1679</sup> FCA Records, *Email*, 28 March 2013, 379117.

<sup>1680</sup> Section 73 of the FS Act 2012.

<sup>1681</sup> FCA Records, *Letter*, 9 May 2013, 419253.

<sup>1682</sup> FCA Records, *Email*, 15 May 2013, 385060.

23 May 2013	The FCA issues an FAQ document to the Skilled Persons and the banks, providing guidance on the approach to be taken with regards to dissolved entities and those in financial distress. <sup>1683</sup>
27 June 2013	Bully-Banks writes to the FCA criticising the lack of clarity of the 7.5% Rule for customers and the absence of information from the FCA on this point. <sup>1684</sup>
28 June 2013	The FCA writes to the FOS to confirm that it will not be expanding the FOS' role to provide for an avenue of appeal for eligible customers under the Scheme. <sup>1685</sup>
July 2013	The FCA meets with the first-tier banks and their Skilled Persons. Concerns are raised that the volume and complexity of consequential loss claims would mean reviews would take significantly longer than 12 months to complete. <sup>1686</sup>
12 July 2013	The FCA issues an FAQ document to the Skilled Persons and banks regarding the reporting of MI and Category A customers. <sup>1687</sup>
August 2013	The High Court refuses permission to apply for judicial review in <u>R (Jenkinson)</u> relating to the exercise by the FSA/FCA of powers to establish a redress scheme for customers mis-sold IRHPs. <sup>1688</sup>
August 2013	The FCA issues a paper on consequential loss for the Skilled Persons. <sup>1689</sup>
By 1 September 2013	The FCA publishes guidance on its website for customers regarding how they can challenge their redress outcomes. <sup>1690</sup>
By 4 September 2013	The FCA publishes information on its website relating to claims for consequential loss. <sup>1691</sup>

<sup>1683</sup> FCA Records, *IRHP Reviews – FAQs for Skilled Persons*, 23 May 2013, 387259.

<sup>1684</sup> FCA Records, Letter and attachment, 27 June 2013, 405073-4.

<sup>1685</sup> FCA Records, *Letter*, 28 June 2013, 423832.

<sup>1686</sup> FCA Records, *Email*, 17 July 2013, 1317474.

<sup>1687</sup> FCA Records, *FAQs for banks and Skilled Persons*, 12 July 2013, 408029.

<sup>1688</sup> Permission decision (unreported; CO/5140/2013).

<sup>1689</sup> FCA Records, *IRHP Reviews – Expectations of the Skilled Persons in relation to consequential loss claims*, undated, FCA-C-009-0015.

<sup>1690</sup> The Financial Conduct Authority, "*Interest rate hedging product review – FAQs*", archived on 1 September 2014, accessible at <https://webarchive.nationalarchives.gov.uk/20140901210429/http://www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products/questions>.

<sup>1691</sup> The Financial Conduct Authority, "*Fair and reasonable redress*", archived on 4 September 2013, accessible at [https://webarchive.nationalarchives.gov.uk/20130904094655tf\\_/http://www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products/fair-and-reasonable-redress](https://webarchive.nationalarchives.gov.uk/20130904094655tf_/http://www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products/fair-and-reasonable-redress).

By 4 September 2013	The FCA publishes guidance on its website regarding the procedure to follow for businesses which are in financial distress. <sup>1692</sup>
10 September 2013	Martin Wheatley gives evidence to the TSC. <sup>1693</sup>
10 October 2013	Memorandum for the IRS Steering Group which, amongst others, considers the claim by external stakeholders that 40 per cent of private/retail IRHP customers have been excluded from the Scheme as a result of the Sophisticated Customer Criteria. The memorandum acknowledges that the number of those dropping out of the review is higher than expected. It goes on to note that " <i>There is no target number of customers who should be in or out of the review and therefore we do not agree that the number can be considered too high</i> ". <sup>1694</sup>
22 October 2013	The IRS Steering Group questions whether the CEDW is monitoring the quality of offers made by banks. <sup>1695</sup>
24 October 2013	Sajid Javid MP expresses frustration in the House of Commons at the delays and lack of clarity from the FCA associated with the implementation of the Scheme. <sup>1696</sup>
October 2013	Eight of the nine banks agree to separate basic redress and consequential loss payments. <sup>1697</sup>
4 November 2013	Agreement is reached between the banks, the BBA, and the FCA that the original provider of a novated loan and IRHP are responsible for the customers' redress. <sup>1698</sup>

<sup>1692</sup> The Financial Conduct Authority, "*Businesses in financial distress*", 4 September 2013, accessible at <https://webarchive.nationalarchives.gov.uk/20130904094641/http://www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products/businesses-in-financial-distress>.

<sup>1693</sup> FCA Records, *Oral evidence taken before Treasury Committee*, 10 September 2013, 1135205.

<sup>1694</sup> FCA Records, Memorandum – *Update from IRHP Project Steering Group*, 10 October 2013, 1324117.

<sup>1695</sup> FCA Records, *IRS Steering Committee Minutes*, 22 October 2013, 439925, para.12.

<sup>1696</sup> House of Commons Debate, "*Interest Rate Swap Derivatives*", 24 October 2013, Hansard volume 569, col. 503, accessible at <https://publications.parliament.uk/pa/cm201314/cmhansrd/cm131024/debtext/131024-0003.htm#13102453000788>.

<sup>1697</sup> FCA Records, *Internal Document*, 15 April 2014, FCA-C-009-0013, p.17.

<sup>1698</sup> FCA Records, "*British Bankers' Association: Principles on Novated Interest Rate Hedging Products (IRHPs)*", 4 November 2013, 005603.

12 November 2013	The ExCo discusses informally contacting banks to establish whether details of their agreement with the FCA can be published. <sup>1699</sup>
13 November 2013	The IRS Steering Committee identifies limited resources as a risk to the project. <sup>1700</sup>
19 November 2013	The FCA internally raises potential issues associated with contingent liabilities. <sup>1701</sup>
3 December 2013	The FCA provides further guidance to the banks and Skilled Persons on the determination of fair and reasonable redress in the calculation of customer outcomes. <sup>1702</sup>
January 2014 – May 2014	The FCA schedules " <i>challenge meetings</i> " with individual banks and their respective Skilled Persons.
February 2014	The FCA becomes aware of a potential issue in relation to break gains and begins investigating. <sup>1703</sup>
14 March 2014	The FCA argues that it is prohibited from releasing the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters before the Information Tribunal, which finds in favour of the FCA. <sup>1704</sup>
31 March 2014	The FCA confirms in an ERIC Summary Paper that the sale of TBLs is not a regulated activity and instead falls within the FOS's jurisdiction. <sup>1705</sup>
29 April 2014	The TSC holds a session to examine SME lending.
April 2014	The FCA has confirmed that interest payments and consequential loss should be considered together for the purposes of redress claims.
26 June 2014	The FCA confirms to Andrew Tyrie MP, chairman of the TSC, that TBLs are not regulated financial instruments. <sup>1706</sup>

<sup>1699</sup> FCA Records, *Extended ExCo Weekly Minutes*, 12 November 2013, 431095. See also, FCA Records, *Email*, 11 November 2013, 441771, which raises this point as an agenda item to be discussed at ExCo.

<sup>1700</sup> FCA Records, *IRS Steering Committee Minutes*, 13 November 2013, 429896.

<sup>1701</sup> FCA Records, *Email*, 19 November 2013, 428040.

<sup>1702</sup> FCA Records, *Email*, 3 December 2013, 423198.

<sup>1703</sup> FCA Records, *Email*, 26 November 2013, 1311600.

<sup>1704</sup> [Jonny Landau v IC EA/2013/0098 \[29\]](#).

<sup>1705</sup> FCA Records, *Internal Document*, 31 March 2014, 1276333.

<sup>1706</sup> FCA Records, *Letter*, 26 June 2014, 584652. The TSC subsequently instructed its own Leading Counsel to review the advice that the FCA received from Leading Counsel on its powers in respect of TBLs; see FCA Records, *Treasury Committee Opinion*, 7 January 2015, 1328013.

June 2014	The TSC asks to be provided with copies of the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters. <sup>1707</sup>
September 2014	The FCA contacts the banks to request permission to disclose their agreements. <sup>1708</sup>
7 October 2014	The FCA prepares a draft paper on unpaid " <i>in the money</i> " break gains which proposes that FCA supervisors should write to the banks to request they ensure there are robust policies and procedures in place to address this issue. <sup>1709</sup>
4 December 2014	House of Commons Backbench Business debate takes place. The motion resolved is that " <i>this House has considered the Financial Conduct Authority's redress scheme, adopted as a result of the mis-selling of complex interest rate derivatives to small and medium sized businesses, and has found the scheme's implementation to be lacking in consistency and basic fairness; considers such failures to be unacceptable; is concerned about lack of transparency of arrangements between the regulator and the banks; is concerned about the longer than expected time scale for implementation; calls for a prompt resolution of these matters; and asks for the Government to consider appointing an independent inquiry to explore both these failings and to expedite compensation for victims.</i> " Guto Bebb MP expresses concern during a Parliamentary debate that the agreements between the FCA and the banks have not been disclosed. <sup>1710</sup>
7 January 2015	An internal FCA document notes that Martin Wheatley would be writing to the banks to inform them that their agreements with the FCA would be disclosed to the TSC in early January 2015. <sup>1711</sup>

<sup>1707</sup> The Financial Conduct Authority, "Letter to Andrew Tyrie MP", 26 June 2014, accessible at [https://www.parliament.uk/globalassets/documents/commons-committees/treasury/140626\\_Sean\\_Martin\\_to\\_Andrew\\_Tyrie.pdf](https://www.parliament.uk/globalassets/documents/commons-committees/treasury/140626_Sean_Martin_to_Andrew_Tyrie.pdf).

<sup>1708</sup> For communication with HSBC on this point see FCA Records, Letter, 5 September 2014, 548965; for RBS see FCA Records, Letter, 5 September 2014, 1265972; for NAGE see FCA Records, Letter, 5 September 2014, 602578; for Bank of Ireland see FCA Records, Letter, 5 September 2014, 602582; for Co-op Bank see FCA Records, Letter, 5 September 2014, 647897; and for AIB see FCA Records, Letter, 5 September 2014, 602580.

<sup>1709</sup> FCA Records, Memorandum – Sub-DSRC Summary Paper – Interest Rate Hedging Products: Potential Overcharging/Misquoting of Break Costs/Break Gains, 7 October 2014, 005346.

<sup>1710</sup> House of Commons Debate, "Financial Conduct Authority Redress Scheme", 4 December 2014, Hansard volume 589, col. 481, accessible at <https://publications.parliament.uk/pa/cm201415/cmhansrd/cm141204/debtext/141204-0002.htm#14120439000007>.

<sup>1711</sup> FCA Records, Internal Document, 7 January 2015, 572555.

9 January 2015	The FCA shares with the TSC a pro forma version of the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters. <sup>1712</sup>
12 January 2015	The IRS Steering Group sets a final date of 31 March 2015 for Category C customers to join the Scheme. <sup>1713</sup>
20 January 2015	An ExCo Summary Paper recommends investigating whether there had been failings by senior management at the banks. <sup>1714</sup>
11 February 2015	Martin Wheatley confirms that the FCA should stand down from any further work on potential enforcement. <sup>1715</sup>
12 February 2015	The TSC publishes the pro forma versions of the Initial Agreement, the Supplemental Agreement, and the Exchange of Letters. <sup>1716</sup>
26 February 2015	The Board is informed that the FCA is considering with HMT whether to set up a full independent inquiry on the FCA's conduct in relation to the Scheme. The Board requests a review of the FCA's handling of IRHP correspondence to be undertaken by the FCA's Risk and Compliance Oversight Division. <sup>1717</sup>
10 March 2015	The House of Commons Treasury Committee publishes Conduct and Competition in SME lending. <sup>1718</sup>
23-24 March 2015	The Board is informed that the high volumes of IRHP correspondence being received by the FCA and its limited resources to process this correspondence are impacting its ability to carry out its primary oversight role. The Board also decides that " <i>it would be appropriate to wait</i> " until any ongoing/potential legal action related to the Scheme is completed prior to continuing with any lessons learned exercise related to the FCA's intervention in the mis-selling of IRHPs. The Board requests that the ExCo consider the next steps

<sup>1712</sup> FCA Records, *Letter*, 9 January 2015, 006680.

<sup>1713</sup> FCA Records, *Meeting Minutes*, 12 January 2015, 600634.

<sup>1714</sup> FCA Records, *Internal Document*, 20 January 2015, 1324751, p.4.

<sup>1715</sup> FCA Records, *Email*, 16 February 2015, 583347.

<sup>1716</sup> House of Commons Debate, "Conduct and competition in SME lending – Treasury Contents", accessible at <https://publications.parliament.uk/pa/cm201415/cmselect/cmtreasy/204/20406.htm>.

<sup>1717</sup> FCA Records, *Board Paper*, 26 February 2015, p. 1, para. 1.1; FCA Records, Board Paper, 24 March 2015, 599393.

<sup>1718</sup> House of Commons Treasury Committee, "Conduct and Competition in SME lending", (Eleventh Report of Session 2014-2015), 10 March 2015, accessible at [https://www.parliament.uk/globalassets/documents/commons-committees/treasury/Conduct\\_and\\_Competition\\_in\\_SME\\_lending.pdf](https://www.parliament.uk/globalassets/documents/commons-committees/treasury/Conduct_and_Competition_in_SME_lending.pdf)

	and provide a proposal to Non-Executive Directors regarding the nature of any such review. <sup>1719</sup>
June 2015	The FCA confirms publicly that it intends to perform a lessons learned exercise with independent oversight. Consideration of the nature and extent of the review are deferred pending the outcome of legal proceedings. <sup>1720</sup>
1 September 2015	The FCA's Risk and Controls Committee considers the potential issue around break gains further. It agrees that: (i) this matter does not fall within the scope of the Scheme; (ii) all compliance assessments have now been completed; and (iii) the incidence appears likely to be small (one of the first-tier banks reported to the FCA that around two per cent of its total IRHP sales were potentially impacted). <sup>1721</sup>
October 2015	A " <i>Steering Update</i> " states that even if Parliament extended the FCA's remit to cover TBL, the FCA could not take action retrospectively. <sup>1722</sup>
February 2016	The High Court hands down its judgment in <u>R (Holmcroft)</u> . <sup>1723</sup>
April 2016	With only 15 customers waiting for a basic redress offer and 350 waiting for their consequential loss claim to be assessed the FCA remarks in a report to the Board that the " <i>review is coming to a close</i> ".
April 2016	The FCA begins receiving final reports from the Skilled Persons. <sup>1724</sup>
30 September 2016	The FCA confirms that all compliance, sophistication, and initial basic redress outcomes have been assessed and communicated to customers. <sup>1725</sup>

<sup>1719</sup> FCA Records, *Internal Document*, 23 March 2015, 574059; FCA Records, *Board Paper*, 24 March 2015, 599393.

<sup>1720</sup> House of Commons Treasury Committee, "*Financial Conduct Authority Response to the Eleventh Report of the Treasury Committee, 2014-15 Conduct and Competition in SME Lending*", June 2015, accessible at <https://www.parliament.uk/globalassets/documents/commons-committees/treasury/responses/financial-conduct-authority-response-to-conduct-and-competition-in-sme.pdf>, p. 4.

<sup>1721</sup> FCA Records, *Memorandum – Potential Misquoting of Break Costs/Gains*, 1 September 2015, 641385.

<sup>1722</sup> FCA Records, *Memorandum – IRHP review – Steering Update 14 October 2015*, 14 October 2015, 676735.

<sup>1723</sup> [2016] EWHC 323 (Admin).

<sup>1724</sup> FCA Records, *Internal Document*, 19 March 2018, 1188115.

<sup>1725</sup> The Financial Conduct Authority, "*Progress of sales through stages of the review as at 30 September 2016*" – All banks, accessible at <https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf> (ARTICLE 026).

October 2016	Scheme closes as a risk in the FCA's Risk Register.
September 2017	Oversight of the Scheme passes from the CEDW Team to Retail Banking. <sup>1726</sup>
16 October 2018	The FCA confirms that SMEs with an annual turnover of £6.5 million and fewer than 50 employees or a balance sheet below £5 million will be able to refer unresolved complaints to the FOS, with the award limit increasing from £150,000 to £350,000. <sup>1727</sup> These measures come into effect on 1 April 2019.
28 September 2018	The Court of Appeal hands down its judgment in <u>R (Holmcroft)</u> . <sup>1728</sup>
2019	The non-Executive Directors of the FCA commission an independent 'lessons learned review' into the FSA's (and subsequently the FCA's) design, implementation and oversight of the Scheme. John Swift QC appointed as the Independent Reviewer in June 2019.

---

<sup>1726</sup> FCA Records, *Internal Document*, 4 August 2017, 1036434.

<sup>1727</sup> The Financial Conduct Authority, "*FCA confirms greater access for SMEs to the Financial Ombudsman Service*", 16 October 2019, accessible at <https://www.fca.org.uk/news/press-releases/fca-confirms-greater-access-smes-financial-ombudsman-service>.

<sup>1728</sup> R. (on the application of Holmcroft Properties Ltd) v KPMG LLP [2018] EWCA Civ 2093.



## Appendix 2 - Protocol

## **PROTOCOL**

### **For the conduct of the lessons learned review commissioned by the Non-Executive Directors of the Financial Conduct Authority (FCA) of the redress scheme for Interest Rate Hedging Products**

#### **A. Introduction**

1. John Swift QC (hereafter "you") have been appointed by the FCA, to carry out an independent review of the redress scheme for Interest Rate Hedging Products (IRHPs).
2. The scope of the review is set out in the Terms of Reference published by the FCA on 20 June 2019.
3. This Protocol sets out the procedures under which the review is to be carried out, reflecting the requirement for this review to be, and to be seen to be, independent.

#### **B. Administrative Matters**

4. You will be given specific individual contacts at the FCA, including the Accountable Executive ('AE') to whom the Sub-Committee of the Board has delegated responsibility for oversight of this review.
5. The AE will be supported in his/her role by a Project Review Board which will provide advice to the AE when he/she requests it but which will not have any delegated decision-making powers. Any interactions you have (or may have) with the Project Review Board will be at the discretion of, and through, the AE.
6. To facilitate you in conducting the review, particularly in relation to requesting and obtaining relevant documents and information, a dedicated email inbox for communications relating to the review has been set up. You should send communications relating to the review to this inbox as this will ensure that they are logged and actioned efficiently.

#### **C. Documents, other information and meeting**

##### **Documents: requests and production**

7. You will send all requests for the production of relevant documents (to include, for the purposes of this Protocol, documents, information and communications in hard copy and in electronic form) to the email address referred to in paragraph 6 above. Such requests will set out the documents or class of documents requested for production.
8. Provided that the documents requested for production are within the FCA's power, custody or possession, they will be provided to you either in hard

copy or in electronic form (via a secure IT route) as soon as possible. No such documents will be withheld from you.

9. Where documents are not within the FCA's power, custody or possession you should follow the procedure above and the FCA will contact the organisation holding the documents and request the documents on your behalf.

#### **General information requests and general explanations**

10. In the event that you require other information and/or explanations relating to the FCA's activities, and falling within the scope of the Terms of Reference, you will send a request to the email address referred to in paragraph 6 above.
11. The FCA will respond as soon as possible to any such request.
12. In the event that you require other information and/or explanations relating to the activities of another organisation, falling within the scope of the Terms of Reference, you should follow the procedure above and the FCA will contact the relevant organisation to request its assistance and to obtain the relevant information and/or explanations for you.

#### **Meetings with individuals**

13. In the event that you wish to meet with any individual currently or formerly employed by the FCA, you will notify the FCA of the individuals whom you wish to meet (using the email address referred to in paragraph 6 above, attaching a letter from you to the individual for the FCA to pass on to the individual).
14. The FCA will endeavour to secure the attendance at a meeting of any identified individuals who are current or former employees of the FCA. It should be noted, however, that attendance by an individual at a meeting with you is not required under statutory powers.
15. Any meetings with individuals not within paragraphs 13 and 14 will be arranged by your team (the Independent Reviewer's team).
16. Meetings will be arranged at a mutually convenient time for yourself and the individual. You will provide to the FCA, no less than six working days in advance of the meeting (i) a broad outline of the topics you wish to cover during the meeting and (ii) a list of the principal documents you may wish to reference during the meeting (together the "meeting information"). The FCA will pass the meeting information to each individual no less than five working days in advance of the meeting between that individual and yourself. Meetings will be recorded by your professional services team and transcript provided to the individual<sup>1</sup>. The information obtained by reason

---

<sup>1</sup> For the avoidance of doubt, the transcripts will not be made available to the FCA. The transcripts, however, will be retained by the FCA after the review has been completed in a secure electronic area, in accordance with the FCA's Records Management Policies and Standards

of the interviews may be relied upon by you in preparing your report.

17. To the extent possible you will endeavour to hold any meetings at a mutually convenient location for yourself and the individual with whom you are meeting. If you require it, the FCA will make available for any meeting a suitable room at its premises at 12 Endeavour Square, Stratford.

#### **Third party assistance**

18. You may contact third parties directly for assistance in relation to the review and the FCA will, to the extent that it is able to do so, facilitate such assistance (for the avoidance of doubt this is not in relation to your professional services team).

#### **Escalation**

19. The FCA is committed to providing you with assistance to facilitate your conduct of the review. However, in the event that you consider that the FCA is not providing you with the co-operation or information that you reasonably require to fulfil your responsibilities, please escalate matters promptly to the Chairman of the FCA.

### **D. Legal privilege and confidentiality**

#### **Privilege**

20. It may be necessary for the FCA to provide you with information that is subject to the FCA's legal privilege. The FCA will not withhold documents from you on the grounds of legal privilege but, for the avoidance of doubt, the provision of such material to you does not constitute a more general waiver of legal privilege.
21. You may refer to privileged documents in your report but the Board Sub-Committee will decide whether to redact parts of the material provided to persons as part of the representations process referred to in paragraphs 25 and 26 below or of the final report before its publication on the basis that this is necessary to protect and preserve privilege. If the Board Sub-Committee decides to redact parts of the final report on that basis, it will include in the published report an explanation of the reason for the redactions.

#### **Confidentiality**

22. It may be necessary for the FCA to provide you with information that is deemed to be confidential within the meaning of section 348 of the Financial Services and Markets Act 2000 ("FSMA").
23. You may refer to such confidential information in your report. If required it will be the responsibility of the FCA, for the purposes of such references, to obtain the consent of the person from whom the information was obtained by the FCA and, if different, the consent of the person to whom it relates. If

such consent is not obtained, you may nevertheless refer to such confidential information in your final report and the Board Sub-Committee will then decide whether to redact parts of the final report before its publication on the basis of the restrictions in section 348 of FSMA. If the Board Sub-Committee decides to redact parts of the report on that basis, they will include in the published report an explanation of the reasons for the redactions.

### **Naming personnel**

24. Your final report will not name or identify the position of any personnel (whether current or former FCA or former FSA employees) who were below the level of Director at the time of their actions.

### **E. Representations Process**

25. Insofar as you intend in your report to criticise individuals, groups of individuals whose members are identifiable or organisations, including the FCA (both in its own right and/or as the successor of the FSA for actions pre-April 2013), you will (i) identify those individuals, groups or organisations (ii) provide them with a reasonable opportunity to make representations in relation to your proposed criticism and (iii) consider any representations made before finalising your report.
26. The contacts referred to in paragraph 4 above will (i) assist you, if so requested, in deciding which individuals, groups or organisations should be given the opportunity to make representations and (ii) provide you with such administrative assistance as you may reasonably require for the purposes of conducting the representations process.

### **F. Governance and reporting**

27. You will keep the AE informed in relation to the logistical progress of the review, including its costs, but not in relation to matters of substance.
28. You should raise directly with the AE any matter which you consider to be so urgent or important that it needs to be disclosed to him/her.
29. You will share a draft of your report with the AE for information only. The AE may at his/her discretion share, and discuss, the draft with the Project Review Board, Board Sub-Committee and subject matter experts.
30. To the extent that you consider it necessary for the FCA to address issues relating to factual accuracy, or confidential information pursuant to section 348 of FSMA or legal privilege, you may share the relevant sections of your draft report with the contacts referred to in paragraph 4 above. These contacts will, with your specific and express permission, be entitled to share these sections with appropriate individuals at the FCA for the purposes of assisting you and finalising the draft report.

**G. Publication**

31. The FCA will arrange for the publication of your final report on behalf of the Board Sub-Committee.

## **Appendix 3 – Terms of Reference**

## Terms of Reference

### **Lessons Learned Review commissioned by the Non-Executive Directors of the Financial Conduct Authority into the supervisory intervention on Interest Rate Hedging Products (IRHPs)**

1. The Board of the Financial Conduct Authority (FCA) is commissioning an independent lessons learned review (the Review) into the supervisory intervention on Interest Rate Hedging Products. The Review will cover both the actions of the Financial Services Authority (FSA) and FCA.
2. Subject to legal considerations, the Board intends to publish the report of the Review in full.
3. The Review will cover the period from 01 March 2012 to 31 December 2018. This enable the Independent Reviewer to look at the both the implementation and operation of the pilot and the subsequently the full Redress Scheme.
4. The Review will examine the quality and effectiveness of the supervisory intervention including judgements relating to securing redress for SMEs. The Review will provide an assessment of the FSA/FCA's actions relating to the redress exercise and set out the lessons (if any) that should be learned from the Review. The Review is not intended to be a route by which the redress scheme or individual cases can be re-opened; nor is it intended to assess the appropriateness and reasonableness of individual offers.
5. The Review will address the following questions:
  - 1) Whether the FSA's approach to the intervention, including the potential benefits over alternative options and parameters for the scheme, was a reasonable response to the FSA's concern about the mis-selling of IRHPs, including:
    - (a) The extent of the FSA's jurisdiction over sales of IRHPs
    - (b) The work undertaken to collate and analyse information and assess the extent of IRHP sales
    - (c) The use of a pilot scheme and development of the full scheme, including implementation of any learnings
    - (d) The voluntary nature of the scheme and whether, in light of scope of the FSA's jurisdiction, it was an appropriate way to address concerns about the sale of IRHPs
    - (e) The appropriateness of the communication of the substance and operation of the scheme, including the issuing of guidance, to persons potentially affected by it
    - (f) The transparency of the scheme, including the confidentiality of the agreements with the firms
    - (g) The work to identify and maintain relationships with key internal and external



stakeholders and the extent, nature and frequency of any communications

- 2) Whether the criteria for eligibility to benefit from the scheme were appropriate, including:
  - (a) The scope of the scheme in light of the FSA's jurisdiction, including the definitions of SMEs who might benefit from it, the products covered and whether it was right to exclude commercial loans with mark-to-market break costs
  - (b) The different approach to remediation based on the complexity of the products
- 3) Whether overall, the scheme delivered fair and consistent outcomes for SMEs within the scope of the scheme in a proportionate and transparent way, including:
  - (a) The approach to technical issues, such as but not limited to break cost, contingent liability, application of the sophistication criteria and alternative products as redress (swaps for swaps)
  - (b) The approach to consequential losses including the appropriateness of guidance given by the FSA, both formal and informal
  - (c) The treatment of SMEs in financial difficulty or insolvency
  - (d) Whether the involvement of the skilled persons appointed under s166 FSMA provided adequate assurance that the banks acted fairly in discharging their obligations under the IRHP agreements to achieve consistent outcomes
  - (e) The extent and effectiveness of the FSA's and later the FCA's oversight of the scheme, including the level of reliance on skilled persons and approach to ensuring consistency across firms and skilled persons
  - (f) Whether the agreements provided adequate mechanisms to allow SMEs within the scope of the scheme to challenge proposed redress offers
  - (g) The impact of SMEs ability to refer their case to the Financial Ombudsman Service before their case has been resolved via the redress scheme
  - (h) The approach to monitoring firms' progress and the work of the skilled persons, including the production of management information
- 4) Whether the redress exercise was delivered in an effective and timely way, including whether the effectiveness of the FSA's and later the FCA's oversight of the timeliness of redress, and communications about timescale.
6. The Review will be led by an Independent Reviewer, John Swift QC, who will prepare the report. The Independent Reviewer may make recommendations to the FCA as they see fit.
7. The FCA will provide the necessary supporting resources to enable the Review to be carried out.
8. The Review will be completed within a period of 15 months beginning on the date upon which the Independent Reviewer is appointed by the FCA.

9. If the Independent Reviewer considers that it will not be possible to complete the Review within the period of 15 months mentioned in paragraph 8, they must inform the FCA of:
  - (a) The reasons for the delay in the conclusion of the Review, and
  - (b) A revised target date for the conclusion of the Review.
  
10. Subject to legal considerations, on completion of the Review the FCA will publish the final report as soon as is practically possible.

**Appendix 4 – Draft Initial Agreement shared with banks on 25 June 2012**

**DRAFT – WITHOUT PREJUDICE**

**STRICTLY CONFIDENTIAL**

**AGREEMENT RELATING TO PAST SALES OF INTEREST RATE HEDGING  
PRODUCTS**

**("the Agreement")**

**Parties:** (1) **THE FINANCIAL SERVICES AUTHORITY**  
("the FSA"), of 25 The North Colonnade, Canary Wharf,  
London, E14 5HS

(2) [ ] ("the Firm"), of [ ]

together "the Parties".

**Date:**

**Recitals:**

- (A) The FSA has found evidence of poor practices in the Firm's sale of interest rate hedging products (as defined in Clause 15 below) to retail clients or private customers (as defined in the FSA's Glossary of Definitions for the purposes of the Conduct of Business sourcebook) on or after 1 December 2001 (the "**Relevant Business**"), and is concerned that such practices, combined with product complexity, customer sophistication and sales incentives may lead to poor outcomes for customers.
- (B) The Parties have conducted confidential settlement discussions in relation to the Relevant Business on a without prejudice basis.

- (C) The relevant FSA decision makers and [ *insert name of CEO* ] have approved the terms of this settlement between the Parties to this Agreement on behalf of the FSA and the Firm respectively.

### **Written Undertaking**

1. The Firm will provide a written undertaking (“**Undertaking**”) to the FSA at the same time as executing this Agreement.
2. The Undertaking shall be in the form set out in Annex A.

### **Publication**

3. The FSA may publish any statements relating to the subject matter of the Undertaking at any time on or after 29 June 2012 (“**Intended Publication Date**”).
4. The Firm agrees that:
  - (a) it will not publish a public statement relating to the subject matter of the Undertaking before 29 June 2012; and
  - (b) if the Firm wishes to publish a public statement relating to the subject matter of the Undertaking on or after 29 June 2012, it will give the FSA at least 48 hours notice of the fact that the statement is to be issued (except in an urgent situation, in which case as much time as is reasonably possible will be provided), and at the same time, provide a copy of the draft statement to the FSA for the purposes of agreeing the form or content of the statement.

5. The Parties agree that all future statements or actions (including any responses to questions) relating to or connected with the subject matter of the Undertaking will be consistent with the content of this Agreement and the Undertaking generally.

#### **Future Action**

6. Nothing in this Agreement prevents or in any other way limits the FSA from taking disciplinary action or taking any other regulatory action in respect of any matter or business involving the Firm.

#### **Without Prejudice**

7. The Parties confirm that the negotiations and related correspondence prior to this Agreement are confidential and have been conducted and/or written on a without prejudice basis.

#### **No Precedent**

8. This is a unique solution to a specific set of FSA concerns. It is agreed between the Parties that nothing in this Agreement or the discussions to date, including all related correspondence, is to be regarded as establishing a precedent for the FSA's approach in the event of similar matters or issues arising in respect of other aspects of the Firm's business.

#### **Rights of persons other than the Parties**

9. A person who is not a Party to this Agreement has no right under the Contracts (Rights of Third Parties) Act 1999 or otherwise to enforce any term of this Agreement.

#### **Governing Law**

10. This Agreement is governed by and shall be construed in accordance with the law of England and Wales. The courts of England shall have exclusive jurisdiction to settle

any claim, dispute or matter of difference which may arise out of, or in connection with this Agreement.

### **Confidentiality**

11. The terms of this Agreement are confidential between the Parties and their legal advisers and shall not be disclosed to any third party except as envisaged in this Agreement, to the extent required by law or to ensure, enable or enforce compliance with this Agreement.

### **Entire Agreement**

12. This Agreement constitutes the entire agreement between the Parties, and supersedes any previous agreement between the Parties and any of them relating to the subject matter of this Agreement. The Agreement may be varied or modified only by the written agreement of the Parties.

### **Counterparts**

13. This Agreement may be executed in any number of counterparts, each of which, when executed, shall be an original, and all the counterparts together shall constitute one and the same instrument.

### **Definitions and Interpretation**

14. Except where otherwise provided in this Agreement, terms used in this Agreement have the meaning given to them in FSMA and the FSA's Glossary of Definitions.
15. In this Agreement, a reference to –
  - a) 'interest rate hedging product' means a derivative (as defined in the FSA's Glossary of Definitions), which is separate to a lending arrangement and is for the purpose of securing a profit or avoiding a loss by reference to interest rate fluctuations;

- b) a document is a reference to that document as modified or replaced from time to time;
- c) a person includes a reference to a corporation, association or partnership;
- d) a person includes a reference to that person's legal representatives, successors and permitted assigns;
- e) the singular includes the plural and vice versa.

**Signed by:** ..... **Dated**.....

[name]

For and on behalf of the Firm

**Signed by:** ..... **Dated**.....

[name]

For and on behalf of the FSA



**ANNEX A – DRAFT WRITTEN UNDERTAKING**

DRAFT

## **Appendix 5 – Initial Agreement**

**STRICTLY CONFIDENTIAL**

**AGREEMENT RELATING TO PAST SALES OF INTEREST RATE  
HEDGING PRODUCTS**

("the Agreement")

**Parties:** (1) **THE FINANCIAL SERVICES AUTHORITY**  
("the FSA"), of 25 The North Colonnade, Canary Wharf,  
London, E14 5HS

(2) *[NAME OF FIRM]*, of *[insert address]* ("the Firm")

together "the Parties".

**Date:** June 2012

**Recitals:**

- (A) The FSA has found evidence of poor practices in the Firm's sale of interest rate hedging products (as defined in Clause 15 below) to retail clients or private customers (as defined in the FSA's Glossary of Definitions for the purposes of the Conduct of Business sourcebook) on or after 1 December 2001 (the "**Relevant Business**"), and is concerned that such practices, combined with product complexity, customer sophistication and sales incentives may lead to poor outcomes for customers.
- (B) The Parties have conducted confidential settlement discussions in relation to the Relevant Business on a without prejudice basis.
- (C) The relevant FSA decision makers and *[insert name of CEO]* have approved the terms of this settlement between the Parties to this Agreement on behalf of the FSA and the Firm respectively.

## Written Undertaking

1. The Firm will provide a written undertaking (“**Undertaking**”) to the FSA at the same time as executing this Agreement.
2. The Undertaking shall be in the form set out in Annex A.

## Publication

3. The Firm agrees that the FSA may publish statements substantially in the form set out in Annex B relating to the subject matter of the Undertaking at any time on or after 29 June 2012 (“**Intended Publication Date**”), and that the FSA may publish any other statements relating to the subject matter of the Undertaking.
4. The Firm agrees that:
  - (a) it will not publish any public statement relating to the subject matter of the Undertaking before the Intended Publication Date;
  - (b) it will not publish any public statement relating to the subject matter of the Undertaking on the Intended Publication Date unless the statement has first been agreed by the FSA; and
  - (c) if, after the Intended Publication Date, the Firm wishes to publish a public statement relating to the subject matter of the Undertaking, it will give the FSA at least 48 hours notice of the fact that the statement is to be issued (except in an urgent situation or as required by law, in which case as much time as is reasonably possible will be provided), and at the same time, provide a copy of the draft statement to the FSA for the purposes of agreeing the form or content of the statement.
5. The Parties agree that all future statements or actions (including any responses to questions) relating to or connected with the subject matter of the Undertaking will be consistent with the content of this Agreement and the Undertaking generally.

### **Future Action**

6. Nothing in this Agreement prevents or in any other way limits the FSA from taking disciplinary action or taking any other regulatory action in respect of any matter or business involving the Firm.

### **Without Prejudice**

7. The Parties confirm that the negotiations and related correspondence prior to this Agreement are confidential and have been conducted and/or written on a without prejudice basis.

### **No Precedent**

8. This is a unique solution to a specific set of FSA concerns. It is agreed between the Parties that nothing in this Agreement or the discussions to date, including all related correspondence, is to be regarded as establishing a precedent for the FSA's approach in the event of similar matters or issues arising in respect of other aspects of the Firm's business.

### **Rights of persons other than the Parties**

9. A person who is not a Party to this Agreement has no right under the Contracts (Rights of Third Parties) Act 1999 or otherwise to enforce any term of this Agreement.

### **Governing Law**

10. This Agreement is governed by and shall be construed in accordance with the law of England and Wales. The courts of England shall have exclusive jurisdiction to settle any claim, dispute or matter of difference which may arise out of, or in connection with this Agreement.

## **Confidentiality**

11. The terms of this Agreement are confidential between the Parties and their legal advisers and shall not be disclosed to any third party except as envisaged in this Agreement, to the extent required by law or to ensure, enable or enforce compliance with this Agreement. Further, the Firm may disclose the terms of this Agreement to its auditors. The Firm shall obtain the prior written consent of the FSA before disclosing the terms of this Agreement to any other third party.

## **Entire Agreement**

12. This Agreement constitutes the entire agreement between the Parties, and supersedes any previous agreement between the Parties and any of them relating to the subject matter of this Agreement. The Agreement may be varied or modified only by the written agreement of the Parties.

## **Counterparts**

13. This Agreement may be executed in any number of counterparts, each of which, when executed, shall be an original, and all the counterparts together shall constitute one and the same instrument.

## **Definitions and Interpretation**

14. Except where otherwise provided in this Agreement, terms used in this Agreement have the meaning given to them in FSMA and the FSA's Glossary of Definitions.
15. In this Agreement, a reference to:
  - (a) 'interest rate hedging product' means a derivative (as defined in the FSA's Glossary of Definitions), which is separate to a lending arrangement and is for the purpose of managing interest rate fluctuations;

- (b) a document is a reference to that document as modified or replaced from time to time;
- (c) a person includes a reference to a corporation, association or partnership;
- (d) a person includes a reference to that person's legal representatives, successors and permitted assigns;
- (e) the singular includes the plural and vice versa.

Signed by: ..... Dated.....

*[insert name of CEO]*

Duly authorised to sign for and on behalf of *[insert name of Firm]*

Signed by: ..... Dated.....

For and on behalf of the FSA

## ANNEX A – DRAFT WRITTEN UNDERTAKING

[On Firm's letterhead]

Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London  
E14 5HS

For the attention of: *[insert name of Supervisor(s)]*

Dear Sirs

### **WRITTEN UNDERTAKING IN RELATION TO INTEREST RATE HEDGING PRODUCTS**

The defined terms used in this undertaking are set out in the attached Appendix.

We, *[insert name of Firm]* undertake to the FSA that, as soon as reasonably practicable after our receipt of a written notice from the FSA under section 166(1) of the Financial Services and Markets Act 2000 ("Section 166 Notice") in relation to the matters contained in this undertaking, we will:

- (a) carry out a review in accordance with the terms set out in the Appendix. This will include:
  - (i) providing proactive redress to all Customers who do not meet the Sophisticated Customer Criteria to whom we sold Structured Collars (as defined in the Appendix) on or after 1 December 2001. Redress (whether in the form of cash payments or variation of contracts) will be determined and, if relevant, provided on the basis of what is fair and reasonable in the circumstances.
  - (ii) if, during the period of the Skilled Person's appointment, we receive a Complaint from a Customer (who does not meet the Sophisticated Customer Criteria) in relation to the sale of a Cap made on or after 1 December 2001, reviewing the circumstances of the sale and determining and, if relevant, providing redress in the way described in paragraph (iii) below. If a Complaint



is received from a Customer after the period of the Skilled Person's appointment, that Complaint will be dealt with in accordance with our usual complaints handling process and, if applicable, DISP.

- (iii) carrying out a past business review of sales of all other Interest Rate Hedging Products to Customers made on or after 1 December 2001. This will include:
- identifying Customers who do not meet the Sophisticated Customer Criteria;
  - writing to those Customers to ask if they want their sale reviewed;
  - carrying out file reviews for all Customers who indicate that they would like their sale reviewed to assess compliance with the Regulatory Requirements;
  - contacting Customers for information to supplement that which is held in our records;
  - carrying out an appropriate review exercise which will include taking into account all of the evidence and the individual circumstances of the customer;
  - if a breach of the Regulatory Requirements has occurred, determining and, if relevant, providing appropriate redress on the basis of what is fair and reasonable in the circumstances.
- (b) comply with the terms of the s.166 Notice and appoint a Skilled Person to report on our conduct of the review set out in paragraph (a).
- (c) with effect from the date of this undertaking, we will cease all marketing of Structured Collars to retail clients.

I, *[insert name of CEO]* confirm that I will have responsibility for oversight of *[insert name of Firm]*'s conduct of this review and will take reasonable steps to ensure that it operates in accordance with the terms set out in the Appendix. This will include ensuring that *[insert name of Firm]* treats its complainants fairly. I will ensure that *[insert name of Firm]* prioritises any Customers who are in financial difficulty and, except in exceptional circumstances, such as, for example, where this is necessary to preserve value in the Customer's business, will not foreclose on or adversely vary existing lending facilities

(without giving prior notice to the Customer and obtaining their prior consent) until *[insert name of Firm]* has issued a final redress determination and, if relevant, provided redress to that Customer.

**Signed by:** .....

*[insert name of CEO]*

Duly authorised to sign for and on behalf of  
*[insert name of Firm]*

## APPENDIX

### TERMS OF PROACTIVE REDRESS EXERCISE AND PAST BUSINESS REVIEW

#### 1. Definitions and Interpretation

- 1.1. Except where otherwise provided in this Appendix, terms used in this Appendix have the meaning ascribed to them in the FSA's Glossary of Definitions.
- 1.2. 'Cap' means an Interest Rate Hedging Product which enables a customer to restrict his exposure to interest rate increases to a maximum upper limit, with no lower limit.
- 1.3. 'Complaint' means any oral or written expression of dissatisfaction, whether justified or not, from, or on behalf of, a Customer about the provision of, or failure to provide, a financial service which alleges that the Customer has suffered (or may suffer) financial loss, material distress or material inconvenience.
- 1.4. 'Customer' means:
  - 1.4.1. in respect of sales made by the Firm on or before 31 October 2007, a person categorised by the Firm, at the time the sale was concluded, as a private customer for the purposes of COB 2 and COB 5 as defined by the version of the FSA's Handbook of rules and guidance then in force; or
  - 1.4.2. in respect of sales made by the Firm on or after 1 November 2007, a person categorised by the Firm, at the time the sale was concluded, as a retail client in accordance with COBS 3.4.1R.
- 1.5. 'Firm' means *[insert name of Firm]*.
- 1.6. 'Interest Rate Hedging Product' means a derivative (as defined in the FSA's Glossary of Definitions) which is separate to a lending arrangement and is for the purpose of managing interest rate fluctuations.
- 1.7. 'Redress determination' shall be construed in accordance with paragraph 3.
- 1.8. 'Regulatory Requirements' means the principles, rules and guidance contained in the FSA's Handbook.
- 1.9. The 'Sales Standards' are:
  - 1.9.1. In good time before conclusion of the contract, the Firm has provided the Customer with appropriate, comprehensible and fair, clear and not misleading information on the features, benefits and risks associated with the Interest Rate Hedging Product.

- 1.9.2. In good time before conclusion of the contract, the Firm has provided the Customer with an appropriate, comprehensible and fair, clear and not misleading disclosure of any potential break costs.
- 1.9.3. The Interest Rate Hedging Product does not exceed the term or value of any lending arrangements without a legitimate reason, and if it does, the potential consequences have been disclosed to the Customer in a comprehensible and fair, clear and not misleading way.
- 1.9.4. The Firm has had due regard to the information needs of the Customer and provided comprehensible, and fair, clear and not misleading information about the features, benefits and risks of relevant alternative Interest Rate Hedging Products.
- 1.9.5. In relation to an advised sale:
  - 1.9.5.1. The Firm has obtained sufficient personal and financial information about the Customer, including the Customer's investment objectives, level of education, profession or former profession and relevant past experience of Interest Rate Hedging Products.
  - 1.9.5.2. The Firm has taken reasonable steps to ensure that the personal recommendation is suitable for the Customer.
- 1.9.6. In relation to a non-advised sale, no advice has been given to the Customer during the sales process.
- 1.9.7. In relation to a non-advised sale on or before 31 October 2007, the Firm has taken reasonable steps to ensure that the Customer understands the nature of the risks involved and provided the Customer with the relevant risk warning notice.
- 1.9.8. In relation to a non-advised sale on or after 1 November 2007, the Firm has assessed whether entering into the Interest Rate Hedging Product is appropriate for the Customer by determining whether the Customer has the necessary knowledge and experience to understand the risks involved. The Firm has obtained information regarding the client's level of education, profession or former profession, and relevant past experience of Interest Rate Hedging Products.
- 1.10. 'Skilled Person' means the independent third party, approved by the FSA, who will report to the FSA under section 166 of the Financial Services and Markets Act 2000 on the Firm's conduct of the review.
- 1.11. 'Sophisticated Customer Criteria' means:
  - 1.11.1. In the financial year during which the sale was concluded, a Customer who met at least two of the following:

1.11.1.1. a turnover of more than £6.5 million; or

1.11.1.2. a balance sheet total of more than £3.26 million; or

1.11.1.3. more than 50 employees;

or

1.11.2. The Firm is able to demonstrate that, at the time of the sale, the Customer had the necessary experience and knowledge to understand the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved.

1.12. 'Structured Collar' means an Interest Rate Hedging Product which enables a customer to limit interest rate fluctuations to within a specified range, but involves arrangements where, if the reference interest rate falls below the bottom of the range, the interest rate payable by the customer may increase above the bottom of the range.

## **2. Scope of review**

2.1. The Firm will carry out:

2.1.1. a proactive redress exercise in relation to its and its associates' sales of Structured Collars to Customers who did not meet the Sophisticated Customer Criteria made on or after 1 December 2001 ("Category A Business");

2.1.2. a past business review of its and its associates' sales of Interest Rate Hedging Products to Customers who did not meet the Sophisticated Customer Criteria which are not Structured Collars or Caps made on or after 1 December 2001 ("Category B Business"); and

2.1.3. if, after the date of this undertaking and during the period of the Skilled Person's appointment, it receives a Complaint from a Customer who did not meet the Sophisticated Customer Criteria in relation to the sale of a Cap made on or after 1 December 2001 ("Category C Business"), a review of that sale in accordance with the process for the Category B Business set out in paragraphs 3.10 to 3.16;

under which it will determine what redress should be provided and actions should be taken in respect of defined categories of customers.

## **3. Review process**

### Category A Business

3.1. The Firm will provide appropriate redress to all Customers of the Category A Business, other than those Customers determined to meet the Sophisticated Customer Criteria in accordance with the process set out in paragraph 3.2 below.

- 3.2. The Firm will identify any Customers of the Category A Business who, in its opinion, meets the Sophisticated Customer Criteria and notify the Skilled Person of these Customers. The Skilled Person will carry out an assessment of whether, in its opinion, each of those Customers meets the Sophisticated Customer Criteria. If, in the Skilled Person's opinion, a Customer did not meet the Sophisticated Customer Criteria, the Firm will accept that opinion and provide appropriate redress to that Customer. If, in the Skilled Person's opinion, a Customer did meet the Sophisticated Customer Criteria, the Firm will write to that Customer clearly explaining that:
  - 3.2.1. the Customer is deemed to meet the Sophisticated Customer Criteria, together with the basis for reaching that conclusion;
  - 3.2.2. this means the Customer is not eligible for any automatic redress under the Firm's proactive redress exercise; and
  - 3.2.3. the Customer may make a Complaint to the Firm which the Firm will consider under its usual complaints handling procedures and, if applicable, DISP.
- 3.3. The Firm will determine the appropriate redress for each Customer who does not meet the Sophisticated Customer Criteria ("Relevant Category A Customer") on the basis of what is fair and reasonable in the circumstances, taking into consideration the following presumptions:
  - 3.3.1. Where the Firm can demonstrate that a requirement to have interest rate protection was a legitimate condition of the lending arrangement or the Firm can demonstrate that the Customer had an express wish for interest rate protection, fair and reasonable redress will be replacing the Structured Collar with simple interest rate protection (e.g. a fixed rate loan) at the rate prevailing at the time of the sale and refunding any charges paid by the Customer in relation to the Structured Collar which would not have been payable had the Customer entered into a simple interest rate protection product.
  - 3.3.2. If the term of the Structured Collar exceeded the term or value of any relevant lending arrangements without a legitimate reason, fair and reasonable redress will include the difference between the amount the Customer paid and the amount the Customer would have paid if the Structured Collar had not exceeded the term or value of the lending arrangement.
  - 3.3.3. For all other Customers, depending upon their individual circumstances, fair and reasonable redress may include, but is not limited to, offering the Customer the option of exiting the Structured Collar at no cost, or at a proportion of the cost, and/or a refund of part or all of the charges paid by the Customer to date.
- 3.4. Before any redress is provided to Relevant Category A Customers, the Skilled Person will review the Firm's assessments of the appropriateness of redress and the fair and reasonable nature of the Firm's redress proposals. If the Skilled Person does not agree with any of the Firm's assessments, the Skilled Person will provide the Firm with reasons for that

disagreement and an explanation of why, in the Skilled Person's opinion, an alternative approach is needed. The Firm will then put forward an alternative redress proposal for the Skilled Person to review. The Firm will not issue a provisional redress determination to a Relevant Category A Customer until the Skilled Person has agreed with the fair and reasonable nature of the Firm's redress proposal.

- 3.5. The Firm will issue a provisional redress determination to each Relevant Category A Customer on the basis of the proposals agreed with the Skilled Person in paragraph 3.4. The provisional redress determination will specify why the redress is appropriate and refer to the fact that the redress proposal has been reviewed by an independent third party. If the Relevant Category A Customer accepts the provisional redress determination, the Firm will issue a final redress determination and provide redress in a prompt manner to the Customer in accordance with that redress determination. The Firm and the Customer may agree an alternative redress solution.
- 3.6. The final redress determination, or, if relevant, the letter sent to the Relevant Category A Customer following agreement of an alternative redress solution and review by the Skilled Person, will be treated as the Firm's final response for the purposes of DISP 1.6.2R and will inform the Customer that he may be eligible to complain to the Financial Ombudsman Service if he is dissatisfied with the Firm's redress determination, and must do so within six months.

#### Category B Business

- 3.7. The Firm and the Skilled Person will design the methodology for the past business review; this will include agreeing the information to be obtained from the Customer and will take into account the matters sets out in paragraphs 3.8 to 3.16 and paragraph 4. The proposed methodology will be reviewed by the FSA to ensure that it meets the key requirements set out in this Appendix. Once the methodology has been approved by the FSA, the Firm will carry out the review in accordance with that methodology.
- 3.8. The Firm will carry out a past business review in respect of the Category B Business on the following terms:
  - 3.8.1. the Firm will identify any Customers of the Category B Business who, in its opinion, meets the Sophisticated Customer Criteria and notify the Skilled Person of these Customers. The Skilled Person will carry out an assessment of whether, in its opinion, each of those Customers meets the Sophisticated Customer Criteria. If, in the Skilled Person's opinion, a Customer did meet the Sophisticated Customer Criteria, the Firm will write to that Customer clearly explaining that:
    - 3.8.1.1. the Customer is deemed to have meet the Sophisticated Customer Criteria, together with the basis for reaching that conclusion;
    - 3.8.1.2. this means the Customer is not eligible to request a review by the Firm under its past business review; and

- 3.8.1.3. the Customer may make a Complaint to the Firm which the Firm will consider under its usual complaints handling procedures and, if applicable, DISP.
- 3.8.2. the Firm will write to all Customers of the Category B Business who, in the Skilled Person's opinion, do not meet the Sophisticated Customer Criteria ("Relevant Category B Customer") clearly explaining in general terms any potential failings and inviting them to respond to the Firm if they would like the Firm to review its sale of the relevant Interest Rate Hedging Product. The letter will refer to the fact that the Customer may be entitled to compensation and the Customer will be asked to complete a simple standard form which will allow them to indicate that they would like their sale reviewed.
- 3.9. If a Customer does not respond to the letter sent by the Firm in paragraph 3.8.2, the Firm will send a further letter to that Customer containing the information set out in paragraph 3.8.2.
- 3.10. The Firm will review all sales of Interest Rate Hedging Products to Relevant Category B Customers who return the form to indicate that they would like their sale reviewed. This review will assess the compliance of the sale of the relevant Interest Rate Hedging Product with the Regulatory Requirements, taking into account, in particular, the Sales Standards. As part of this review, the Firm will take reasonable steps to contact each Relevant Category B Customer who responds indicating that they would like their sale reviewed in order to discuss the sale orally. The Firm will ensure that the reviews are not conducted by a person who was involved in the sale of the relevant Interest Rate Hedging Product.
- 3.11. The Firm will carry out an assessment of whether it is appropriate to provide redress to each Relevant Category B Customer who responds to indicate that they would like their sale reviewed. If the Firm concludes that it would be appropriate to provide redress to a Relevant Category B Customer, it will determine what redress would be fair and reasonable in the circumstances. Fair and reasonable redress may include, but is not limited to, offering the Customer the option of exiting the relevant Interest Rate Hedging Product at no cost, or at a proportion of the cost, and a refund of part or all of the charges paid by the Customer to date. It may also include offering the customer an alternative product (e.g. a fixed rate loan).
- 3.12. Before any redress is provided to Relevant Category B Customers, the Skilled Person will review each of the Firm's assessments of the appropriateness of redress and the fair and reasonable nature of the Firm's redress proposals, if relevant. If the Skilled Person does not agree with any of the Firm's assessments, the Skilled Person will provide the Firm with reasons for that disagreement and an explanation of why, in the Skilled Person's opinion, an alternative approach is needed. The Firm will then put forward an alternative redress proposal for the Skilled Person to review. The Firm will not issue a redress determination to a Relevant Category B Customer until the Skilled Person has agreed with the



appropriateness of the redress and the fair and reasonable nature of the Firm's redress proposal.

- 3.13. The Firm will issue a provisional redress determination to each Relevant Category B Customer on the basis of the proposals agreed with the Skilled Person in paragraph 3.12. The provisional redress determination will explain the basis for the conclusion on redress being due (or not) and (where relevant) how the redress has been determined. The provisional redress determination will refer to the fact that the redress proposal has been reviewed by an independent third party.
- 3.14. In all cases the Firm will issue a final redress determination to each Relevant Category B Customer.
- 3.15. If a Customer accepts the Firm's redress determination, the Firm will provide any redress due in a prompt manner to each Relevant Category B Customer in accordance with its redress determinations. The Firm and the Customer may agree an alternative redress solution.
- 3.16. The final redress determination, or, if relevant, the letter sent to the Relevant Category B Customer following agreement of an alternative redress solution and review by the Skilled Person, will be treated as the Firm's final response for the purposes of DISP 1.6.2R and will inform the Customer that he may be eligible to complain to the Financial Ombudsman Service if he is dissatisfied with the Firm's redress determination, and must do so within six months.

#### Category C Business

- 3.17. If, during the period of the Skilled Person's appointment, the Firm receives a Complaint from a Customer in relation to the sale of a Cap, the Firm will determine whether that Customer meets the Sophisticated Customer Criteria. The Skilled Person will carry out an assessment of whether, in its opinion, each Customer meets the Sophisticated Customer Criteria. If, in the Skilled Person's opinion, the Customer does not meet the Sophisticated Customer Criteria, the Firm follow the process set out in paragraphs 3.10 to 3.16. If, in the Skilled Person's opinion, the Customer does meet the Sophisticated Customer Criteria, the Complaint will be dealt with in accordance with the Firm's usual complaints handling procedures and, if applicable, DISP.
- 3.18. If a Complaint is received from a Customer in relation to the sale of a Cap after the period of the Skilled Person's appointment, that Complaint will be dealt with in accordance with the Firm's usual complaints handling procedures and, if applicable, DISP.

#### **4. General**

- 4.1. The Firm will agree with the FSA, in advance, the content of all customer communications and other key documents used in connection with the review undertaken pursuant to this Appendix.

- 4.2. The Firm will not make any communication to a Customer which seeks to influence for the benefit of the Firm the outcome of the processes undertaken pursuant to this Appendix.
- 4.3. The Firm will put clear and appropriate information on its website to explain how Customers of the Category A Business who do meet the Sophisticated Customer Criteria and Customers who entered into a Cap can make a Complaint to the Firm. This will include information about the timescale within which Customers who entered into a Cap would need to complain in order for the Firm to review their Complaint using the process set out in paragraphs 3.11 and 3.16 and explain that any Complaints received after this time will be dealt with by the Firm in accordance with its usual complaints handling procedures without the involvement of an independent third party.
- 4.4. The Skilled Person will provide a report to the FSA in accordance with the terms of the Section 166 Notice.
- 4.5. The Firm will provide regular updates to the FSA on the conduct of the review exercise.

## **Appendix 6 – Supplemental Agreement**

**STRICTLY CONFIDENTIAL**

**STRICTLY CONFIDENTIAL**

**SUPPLEMENTAL AGREEMENT RELATING TO PAST SALES OF  
INTEREST RATE HEDGING PRODUCTS**

**("the Supplemental Agreement")**

**Parties:** (1) **THE FINANCIAL SERVICES AUTHORITY**  
("the FSA"), of 25 The North Colonnade, Canary Wharf,  
London, E14 5HS

(2) *[NAME OF FIRM]*, of *[insert address]* ("the Firm")

together "the Parties".

**Date:** **January 2013**

**Recitals:**

- (A) The FSA and the Firm entered into an agreement on [ ] June 2012 in relation to sales of interest rate hedging products (the "Agreement"). On that date, the Firm also provided an Undertaking to the FSA.
- (B) In the Undertaking, the Firm undertook to (a) provide proactive redress to all Customers who did not meet the Sophisticated Customer Criteria to whom the Firm sold Structured Collars on or after 1 December 2001; (b) carry out a past business review of sales of all other Interest Rate Hedging Products (except Caps) to Customers made on or after 1 December 2001 (including appropriate redress); and, (c) if, during the period of the Skilled Person's appointment, the Firm receives a Complaint from a Customer (who does not meet the Sophisticated Customer Criteria) in relation to the sale of a Cap made on or after 1 December 2001, reviewing the circumstances of the sale and determining and, if relevant, providing redress (together, the "proactive redress and past business review exercise").

**STRICTLY CONFIDENTIAL**

- (C) The Firm has tested its methodology for carrying out the proactive redress exercise and past business review by assessing a number of sales files and these have been reviewed by the Skilled Person (the “pilot exercise”).
- (D) The FSA has also considered the cases assessed by the Firm and Skilled Person during the pilot exercise and each of the Parties considers it desirable that certain changes be made to the Undertaking.

**Amendment of the Undertaking**

- 1. The FSA and the Firm agree that the Undertaking be amended in accordance with the provisions set out in the Schedule.

**Application of the Agreement and Undertaking**

- 2. References in the Agreement to the “Undertaking” shall be construed as references to the Undertaking as amended by this Supplementary Agreement.
- 3. The provisions of clauses 3 to 15 of the Agreement shall apply to this Supplementary Agreement as they apply to the Agreement.

**Signature**

**Signed by:** ..... **Dated**.....

*[insert name of CEO]*

Duly authorised to sign for and on behalf of *[insert name of Firm]*

**Signed by:** ..... **Dated**.....

For and on behalf of the FSA

**SCHEDULE**  
**AMENDMENTS TO THE UNDERTAKING**

**Definitions and Interpretation**

1. For clause 1.11 substitute—
  - 1.1.1. “‘Sophisticated Customer Criteria’ shall be construed in accordance with following.
  - 1.1.2. A Customer who did not belong to a Companies Act group at the time of the sale meets the Sophisticated Customer Criteria if any of the tests set out in clauses 1.11.2.1, 1.11.2.2 or 1.11.4 are met.
    - 1.1.2.1. A Customer who did not belong to a Companies Act group at the time of the sale meets the Sophisticated Customer Criteria if, in the financial year during which the sale was concluded, the Customer met—
      - 1.1.2.1.1. the section 382 thresholds set out in clauses 1.11.5.1 (turnover), 1.11.5.2 (balance sheet) and 1.11.5.3 (employees); or
      - 1.1.2.1.2. the section 382 thresholds set out in clauses 1.11.5.1 (turnover) and 1.11.5.2 (balance sheet); or
      - 1.1.2.1.3. the section 382 thresholds set out in clauses 1.11.5.1 (turnover) and 1.11.5.3 (employees).
    - 1.1.2.2. Where there is insufficient information to determine whether a Customer (who did not belong to a Companies Act group at the time of the sale) met the section 382 thresholds pursuant to clause 1.11.2.1 in the financial year during which the sale was concluded, or where the Customer met —
      - 1.1.2.2.1. none of the section 382 thresholds (in the financial year during which the sale was concluded); or
      - 1.1.2.2.2. only one of the section 382 thresholds (in the financial year during which the sale was concluded); or
      - 1.1.2.2.3. only the section 382 thresholds set out in clauses 1.11.5.2 (balance sheet) and 1.11.5.3 (employees) (in the financial year during which the sale was concluded),then the Customer shall only meet the Sophisticated Customer Criteria if either—
      - (a) the Customer:

## STRICTLY CONFIDENTIAL

- (i) was a member of a BIPRU group; and
    - (ii) the aggregate notional value of all the Interest Rate Hedging Products in existence immediately after the particular sale being assessed was entered into and which had been entered into by members of the BIPRU group was greater than £10 million; or
  - (b) the Customer:
    - (i) was not a member of a BIPRU group; and
    - (ii) the aggregate notional value of all the Interest Rate Hedging Products in existence immediately after the particular sale being assessed was entered into and which had been entered into by the Customer was greater than £10 million.
- 1.1.3. A Customer who belonged to a Companies Act group at the time of the sale meets the Sophisticated Customer Criteria if any of the tests set out in clauses 1.11.3.1, 1.11.3.2 or 1.11.4 are met.
- 1.1.3.1. A Customer who belonged to a Companies Act group at the time of the sale meets the Sophisticated Customer Criteria if, in the financial year during which the sale was concluded, the Customer's Companies Act group met—
- 1.1.3.1.1. the section 383 thresholds set out in clauses 1.11.6.1 (turnover), 1.11.6.2 (balance sheet) and 1.11.6.3 (employees); or
  - 1.1.3.1.2. the section 383 thresholds set out in clauses 1.11.6.1 (turnover) and 1.11.6.2 (balance sheet); or
  - 1.1.3.1.3. the section 383 thresholds set out in clauses 1.11.6.1 (turnover) and 1.11.6.3 (employees).
- 1.1.3.2. Where there is insufficient information to determine whether a Companies Act group (to which the Customer belonged at the time of the sale) met the section 383 thresholds pursuant to clause 1.11.3.1 in the financial year during which the sale was concluded, or where the Customer's Companies Act group met:
- 1.1.3.2.1. none of the section 383 thresholds (in the financial year during which the sale was concluded); or
  - 1.1.3.2.2. only one of the section 383 thresholds (in the financial year during which the sale was concluded); or

**STRICTLY CONFIDENTIAL**

1.1.3.2.3. only the section 383 thresholds set out in clauses 1.11.5.2 (balance sheet) and 1.11.5.3 (employees) (in the financial year during which the sale was concluded),

then the Customer shall only meet the Sophisticated Customer Criteria if either—

(a) the Customer:

- (i) was a member of a BIPRU group; and
- (ii) the aggregate notional value of all the Interest Rate Hedging Products in existence immediately after the particular sale being assessed was entered into and which had been entered into by members of the BIPRU group was greater than £10 million; or

(b) the Customer:

- (i) was not a member of a BIPRU group; and
- (ii) the aggregate notional value of all the Interest Rate Hedging Products in existence immediately after the particular sale being assessed was entered into and which had been entered into by the Customer's Companies Act group was greater than £10 million.

1.1.4. A Customer meets the Sophisticated Customer Criteria if the Firm is able to demonstrate that, at the time of the sale, the Customer had the necessary experience and knowledge to understand the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved.

1.1.5. In this clause 1.11, the 'section 382 thresholds' are—

- 1.1.5.1. a turnover of more than £6.5 million;
- 1.1.5.2. a balance sheet total of more than £3.26 million;
- 1.1.5.3. more than 50 employees,

calculated in accordance with relevant provisions of the Companies Act 2006 (as amended).

1.1.6. In this clause 1.11, the 'section 383 thresholds' are—

- 1.1.6.1. a turnover of more than £6.5 million net (or £7.8 million gross);
- 1.1.6.2. a balance sheet total of more than £3.26 million net (or £3.9 million gross);



## **STRICTLY CONFIDENTIAL**

1.1.6.3. more than 50 employees,

calculated in accordance with relevant provisions of the Companies Act 2006 (as amended).

1.1.7. In this clause 1.11, 'Companies Act group' shall be construed in accordance with the definition of 'group' in section 474(1) of the Companies Act 2006, and the related definitions of 'undertaking', 'parent undertaking' and 'subsidiary undertaking' in sections 1161 and 1162 of, and Schedule 7 to, the Companies Act 2006.

1.1.8. In this clause 1.11, 'BIPRU group' means one of the following:

1.1.8.1. two or more persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; or

1.1.8.2. two or more persons between whom there is no relationship of control as set out in (1) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would be likely to encounter funding or repayment difficulties,

and for these purposes, 'control' means control as defined in Article 1 of the Seventh Council Directive 83/349/EEC (the Seventh Company Law Directive) or a similar relationship between any person and an undertaking."

**Appendix 7 - Letter from Clive Adamson to the banks dated 17 January 2013**

## Financial Services Authority

**Clive Adamson**  
Director of Supervision, Conduct Business Unit  
Direct line: 020 7066 0362  
Email: [clive.adamson@fsa.gov.uk](mailto:clive.adamson@fsa.gov.uk)



17 January 2013

Rich Ricci  
Chief Executive of Corporate and Investment Banking  
Barclays Bank PLC  
5 The North Colonnade  
London  
E14 4BB

*Dear Rich*

### **INTEREST RATE SWAPS REVIEW – BARCLAYS BANK PLC ('BARCLAYS')**

In June 2012 we reached an agreement with Barclays to carry out a review of its sales of interest rate hedging products ('IRHPs') to retail/private customers (the 'Agreement'). We acknowledge that a considerable amount of work has been conducted by you and your team to prepare Barclays to carry out this exercise. This has included appointing Skilled Persons to provide oversight of the review, designing an appropriate methodology, carrying out a Pilot Exercise, recruiting internal/external support and engaging with multiple stakeholders in preparation for the Main Review.

The Pilot Exercise has proved extremely helpful and has reinforced our position that this review must be customer centric, with a clear focus on the customer's understanding of the risks prevailing at the time of the sale. It has validated the need to consider each customer's individual circumstances. It has also demonstrated the value of the Skilled Persons' close engagement in the review.

The Pilot Exercise has provided further evidence that, across the population of consumers within the scope of the review, significant numbers have, or are likely to have, been mis-sold IRHPs. It has also identified that additional clarity around our expectations about the conduct of the review is needed – principally in relation to determining whether the original sale complied with regulatory requirements and on determining redress. Anomalies in the operation of the sophistication test were also identified.

We have now considered these issues and I am writing to inform you of our decisions and what this means for the conduct of the Main Review. We are confident that we have reached a position that will ensure fair outcomes, including fair and reasonable redress for customers, where appropriate.

The enclosed annexes set out our position. Our expectation is that you will conduct the review on this basis and will make the necessary changes to your methodology to this end. Of course, you may wish to provide more favourable outcomes for consumers generally or in specific cases.

Your supervisory team and our IRS project team will be available to answer any questions you may have on this material. The Sophisticated Customer Criteria set out in the Annex is different to that set out in the original Undertaking and so that Undertaking will need to be amended. We will discuss the mechanics of this with you when you have considered the material in this letter. In addition we are setting up a meeting with you to provide you with firm-specific feedback on the Pilot Exercise. Our expectation is that you will take this into consideration, making any changes necessary to your methodology.

### Next Steps

Our intention is to publish a report on the Pilot Exercise on 31 January 2013. This will set out, at a high level, the results of the Pilot Exercise and look forward to the Main Review. We intend to say which banks have agreed with us the terms under which they can proceed with the Main Review. We will share this report with you for factual comment before publication.

For the purposes of our report, an agreement in principle means that, taking into consideration the Pilot Exercise, Barclays has demonstrated an overall preparedness for carrying out the Main Review and has agreed to:

- Amend its methodology, in line with the position set out in the annexes (these amendments can be made after 31 January 2013).
- Address matters raised in the feedback about the Pilot Exercise. We expect the bank and Skilled Person to attest that these concerns have been addressed as soon as reasonably possible after agreement in principle is reached.

We would like you to confirm by close of business 23 January 2013 that you will make the necessary changes to your methodology to enable Barclays to conduct the Main Review to deliver the customer outcomes that the approach in the annexes and the firm-specific feedback requires.

We are writing in similar terms to each of the banks who signed an Undertaking with the FSA in June. We are setting up a meeting with all the Skilled Persons of the four banks to inform them about the material in the annexes and the implications for the conduct of the Main Review. We will be also writing to the other banks who have undertaken to conduct a review of IRS sales. We hope this will deliver the consistency that all parties are looking for.

We remain of the view that, as a result of failures in the sales of these products, many consumers should receive redress from the firms that sold them. This redress exercise provides an opportunity for the banks to right 'past wrongs' and rebuild consumer confidence in the banking industry. I appreciate that the timetable here is challenging, but it is important to maintain momentum on this exercise, and with your confirmation, we can progress to the Main Review.

*Tommy*

*Clive*

## Annex 1 – Sophisticated Customer Criteria

1. The current sophistication test has two elements; an objective test and a subjective test. No amendments are suggested in relation to the subjective element of the test.
2. The current objective sophistication test is as follows:
  - (i) In the financial year during which the sale was concluded, the customer had at least two of the following:
    - a) a turnover of more than £6.5 million; or
    - b) a balance sheet total of more than £3.26 million; or
    - c) more than 50 employees.
3. The current subjective sophistication test is as follows:

*“The Firm is able to demonstrate that, at the time of the sale, the Customer had the necessary experience and knowledge to understand the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved.”*
4. We have identified the following potential weaknesses with the current Sophisticated Customer Criteria:
  - (i) Customers meeting the Sophisticated Customer Criteria, by virtue of having large fixed assets and employing seasonal workers, who should be included within the review, because neither of those factors alone reliably denotes financial sophistication. This typically results in farms, care homes and schools who have high value fixed assets (e.g. land, buildings, machinery etc.) and may employ a large number of seasonal workers being excluded from the review.
  - (ii) Firms have insufficient details about their customers to determine whether the Sophisticated Customer Criteria has been met without seeking further information from the Customer.
  - (iii) Customers failing to meet the Sophisticated Customer Criteria, even though they are part of a large/complex group, which indicates a high level of financial sophistication, and should be regarded as sophisticated.
5. In our view, the Sophisticated Customer Criteria should be amended as follows:
  - (i) **Test 1 – Additional Value Overlay:** In the financial year during which the sale was concluded, a Customer who met at least two of the following:
    - a) a turnover of more than £6.5 million; or
    - b) a balance sheet total of more than £3.26 million; or
    - c) more than 50 employees,

will be deemed to have met the Sophisticated Customer Criteria, save that, where the Customer is deemed to meet the Sophisticated Customer Criteria on the basis

of the thresholds in paragraphs (b) and (c) alone (and not paragraph (a)), the Customer will be deemed to meet the Sophisticated Customer Criteria only where the notional value of the relevant Interest Rate Hedging Product(s) (which is calculated by aggregating the notional values of all 'live' trades at the time of the trade subject to the review) was more than £7.5 million at the time of the trade;

Or

- (ii) **Test 2 – Alternative Test (which can be applied on a case by case basis):** Banks can choose to apply this test on a case by case basis, but we only expect them to use this test where there is insufficient information to determine whether the thresholds in paragraphs 5(i)(a) – (c) are not met. A Customer with an Interest Rate Hedging Product(s) with a notional value (which is calculated by aggregating the notional values of all trades at the time of the trade subject to the review) of the more than £7.5 million at the time of the trade will be deemed to have met the Sophisticated Customer Criteria, save that if the Customer can demonstrate that it would not have met at least two of the thresholds set out in paragraphs 5(i)(a)-(c) in the financial year during which the sale was concluded, the Customer will be deemed not to have met the Sophisticated Customer Criteria;

Or

- (iii) **Test 3 – Group Tests:** A Customer will be deemed to meet the Sophisticated Customer Criteria where the Customer is not a subsidiary or a parent of a group which would have qualified as a small group pursuant to section 383 of the Companies Act 2006 (as amended) in the financial year during which the sale was concluded. When determining whether a group would not have qualified as a small group, the following thresholds apply:

- a) an aggregate turnover of not more than £6.5 million net (or £7.8 million gross); or
- b) an aggregate balance sheet total of not more than £3.26 million net (or £3.9 million gross); or
- c) not more than 50 employees,

as calculated in accordance with section 383 (and other relevant provisions) of the Companies Act 2006. When applying this test the Firm and Skilled Person will be required to ensure the consolidated group accounts are calculated appropriately (according to the definitions in the Companies Act 2006) and to ensure that the customer truly is functioning as part of a group;

Or

- (iv) **Subjective Test:** The Firm is able to demonstrate that, at the time of the sale, the Customer had the necessary experience and knowledge to understand the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved.

## Annex 2 – Principles of Sales Reviews

6. As a result of the pilot exercise a number of banks have sought clarification on what is required in order to meet regulatory requirements on each of the Sales Standards. Banks have raised concerns about the high-level nature of our current requirements which leaves application of the review process open to interpretation – as an example, what level of disclosure of break costs would be adequate to meet our regulatory requirements?
7. Banks also raised the concern that whilst these high level standards remain “open to interpretation” there is a risk of inconsistency in application between the banks.
8. We have considered these concerns as part of our pilot review and believe a case by case assessment of all relevant evidence is necessary.
9. In our view, the assessment of a sale requires an objective assessment of the facts to determine whether, in that customer’s circumstances, the firm has complied with the Regulatory Requirements (taking into account the Sales Standards), and in particular, whether the Customer understood the features and risks of the product. In any case assessment banks must ensure that there is full consideration of the Customer's individual circumstances and all applicable rules in our Handbook are applied correctly. Therefore, general guidance will not assist banks when carrying out this review, because a case by case assessment is necessary.
10. This case by case assessment should involve (but is not limited to) a holistic consideration of the following:
  - the size and nature of the Customer;
  - the Customer’s knowledge and understanding of these types of products generally and the specific product purchased;
  - the Customer’s interaction during the sales process;
  - the complexity of the product; and
  - the information provided during the sales process, particularly the quality and nature of the information provided, when and how it was provided and how long the Customer had to digest and understand it.
11. We expect the level and nature of disclosure required to achieve a compliant sale must meet our requirement of being clear, fair and not misleading. Therefore, a consideration of the all the circumstances of the case must be carried out to determine whether the sale complied with the Regulatory Requirements<sup>1</sup> (taking into account the Sales Standards). This means that the level of disclosure required to e.g. satisfy the various disclosure requirements will vary from case to case.

---

<sup>1</sup> Providing clear information is essential for delivering fair outcomes for consumers. Firms must ensure that all of their communications satisfy FSA 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).

FSA Treating Customers Fairly (TCF) Outcome 3 ('Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale') emphasises this requirement.

## Annex 3 – Redress

12. As a result of the pilot exercise, we have listened to what both the firms and the small business groups have been telling us is needed; a clear, consistent and transparent set of principles for how to conduct the redress exercise. As a result, we have developed a set of principles as to what fair and reasonable redress entails. The principles set out below are the ‘baseline’ for the redress exercise; firms and Skilled Persons may deem it fair and reasonable to go beyond the minimum standards in individual cases.

### Principles of redress

13. The core principle of this redress exercise is to pay fair and reasonable redress to Customers where due. In our view, fair and reasonable redress requires that the Customer be put back into the position they would have been in had the breach of the Regulatory Requirements not occurred.

### Process for determining whether redress is payable

14. To determine whether redress is payable, a firm and Skilled Person should make a series of decisions as laid out below unless the sale relates to a Category A product (i.e. automatic redress).
15. For Category A Customers, firms have agreed to provide fair and reasonable redress to all non-sophisticated Customers.
16. For Category B and C Customers, firms have agreed to assess the compliance of sales of IRHPs with the relevant Regulatory Requirements<sup>2</sup>, taking into account, in particular, the Sales Standards. In determining what is fair and reasonable redress, the firms will need to consider the following:
  - a. Was the sale of the IRHP in breach of the Regulatory Requirements (taking into account, in particular the Sales Standards)? If so there has been a non-compliant sale.
  - b. For non-compliant sales, has the Customer suffered loss (either past loss, or expected future loss due to being ‘out of the money’)?
  - c. If so, did the breach of the Regulatory Requirements cause the loss?
  - d. If so, the Customer is due fair and reasonable redress.

### Non-compliant sale but no redress

17. This outcome is only relevant to Category B and C products<sup>3</sup>.

---

<sup>2</sup> The Principles, rules and guidance contained in the FSA’s Handbook.

<sup>3</sup> In certain circumstances, this may also apply to Category A Customers if they are currently ‘in-the-money’. See section on ‘Customers in-the-money’ below.



18. If there has been a non-compliant sale, but either no loss has been suffered by the Customer, or it is reasonable to conclude that had the breach of the Regulatory Requirements not occurred then the Customer would have followed the same course of action as they did, then no redress is likely to be the fair and reasonable outcome.
19. These are classed as ‘non-compliant sales with no redress’.

### **Observations on fair and reasonable redress**

20. Where redress is due to a Customer, there are a number of factors that need to be considered when determining what is fair and reasonable.
21. We assume that the same set of principles apply to each product category.
22. The starting point is that there are two broad types of redress to be considered.
  - (i) ‘Full tear-up’ – i.e. the exit from the IRHP at no charge to the Customer, and a refund of all historic cashflows deriving from the IRHP including, where appropriate, any break costs previously paid (plus interest).
  - (ii) ‘Alternative product’ – i.e. the conclusion that an appropriate (non-advised) or suitable (advised) alternative IRHP would have been selected by the Customer at the time. In this case redress is a refund of the difference in cashflows between the actual product purchased and the alternative product selected including, where appropriate, the difference between break costs paid and break costs that would have been payable under the alternative product (plus interest).

### **Full tear-up**

23. In the event of a non-compliant sale, where the IRHP was not a legitimate condition of the lending arrangement, and where, were it not for the breach of the Regulatory Requirements, the evidence suggests that the Customer would not have purchased an IRHP, fair and reasonable redress is likely to be a full tear-up.
24. Firms and Skilled Persons can consider whether there was an express wish for interest rate protection when considering whether the Customer would have purchased an IRHP at the original point of sale.
25. In the event of a full tear-up where, were it not for the tearing up of the IRHP, the Customer would have continued in a hedging product going forward, the firm should ensure that the Customer is aware of their new risk profile.
26. Redress payable to the Customer will be the exit from the IRHP at no charge, and a refund of all historic cashflows deriving from the IRHP (plus interest) including, where appropriate, any break costs previously paid.

## Alternative product

27. In the event of a non-compliant sale, where, were it not for the breach of the Regulatory Requirements, a reasonable conclusion is that the Customer would have purchased alternative interest rate protection (whether due to it being a legitimate condition or not), fair and reasonable redress is an alternative product that provides such protection.
28. Firms and Skilled Persons can consider whether there was an express wish for interest rate protection when considering whether the Customer would have purchased alternative interest rate protection.

## *Selection of an alternative product*

29. The appropriate alternative product will be the product the Customer would, on the balance of probabilities, have taken at the time.
30. Three key principles underpin the process for determining an alternative product.
  - (i) There is full consideration of the Customer's individual circumstances and all applicable rules in our Handbook are applied correctly;
  - (ii) A Customer acting with full knowledge would have purchased a simple product (i.e. a cap, vanilla swap / fixed rate loan or vanilla collar) without any extendable or callable elements. Which of these products a Customer would have been likely to purchase will be a Customer-specific assessment;
  - (iii) Taking individual circumstances into account, it is extremely unlikely that a Customer acting with full knowledge of break costs would have purchased a product with break costs that, under pessimistic but plausible interest rate scenarios, exceed 7.5% of the notional value of the IRHP. In practice, this means that no alternative product should exceed the *maximum term* (defined below) as calculated from the date of the original sale.
31. The firm and the Skilled Person should use the evidence available to them, including contemporaneous evidence, the profile of the lending arrangement and Customer testimony, to determine the appropriate alternative product. The firm and the Skilled Person should assume a Customer acting with full knowledge; and the exercise should be carried out in a holistic manner with a full consideration of the facts.
32. It is not reasonable to use a vanilla swap / fixed rate loan or a vanilla collar as a 'default' option, as the alternative product must be determined on the basis of the evidence available; and determined considering the acumen / knowledge of the Customer.
33. Taking individual circumstances into account, it is extremely unlikely that a Customer acting with full knowledge, who had been presented with the full implications of the potential downside risks (i.e. substantial break costs in a pessimistic but plausible interest rate environment), would have purchased either a cap, a vanilla swap / fixed rate loan or a vanilla collar with a longer tenor than the *maximum term* (defined below). This is because the potential downside risks (i.e. break costs) are above 7.5% under pessimistic but plausible interest rate scenarios.

34. The firm and the Skilled Person must take into account all the relevant individual circumstances when deciding what term the Customer would have opted for were it not for the breach of the Regulatory Requirements. For example, the evidence available may demonstrate that, were it not for the breach of the Regulatory Requirements, the Customer would have opted for a term shorter than the maximum.
35. If a Customer, in the original sale, said they did not want a cap on the basis that they did not wish to pay a premium, then the assessment of the sale should consider whether any breach of the Regulatory Requirements contributed to that decision; for example, a lack of sufficient disclosure in relation to the downside risks of non-cap products. In such circumstances, a choice by the Customer of a collar or a swap cannot be relied on as evidence of the alternative product the Customer would have chosen.
36. Redress for the Customer will be the refunding of any charges paid by the Customer in relation to the IRHP which would not have been payable had the Customer entered into a simple interest rate protection product (plus interest). If the trade is still live, the Customer may be likely to continue with the alternative product for the remainder of the term, though the firm and the Skilled Person should consider the current circumstances of the Customer.

#### *Pricing of alternative products*

37. The pricing of an alternative product must be fair and reasonable in the circumstances.
38. In the event that the alternative product is a cap or vanilla collar, the cap rate should be defined according to a holistic consideration of the circumstances of the Customer at the time. It is not sufficient to say that the cap rate of the alternative product should always be the same as the previous cap rate, if a collar was originally sold, or the most common market level of the time. Caps were/are available at different levels, and a holistic assessment should decide the appropriate level for the cap according to the Customer's individual circumstances at the time of the original sale.

#### **Over-hedging**

39. Over-hedging as a concept encompasses a number of issues, including, but not limited to, exceeding the term or value of any lending arrangements, preceding the drawdown of the facility, an index mis-match and a profile mis-match (i.e. the repayment profile of the lending arrangement does not match the profile of the IRHP).
40. There are a limited number of factors which constitute a 'legitimate reason' for over-hedging. This includes, but is not limited to, a broader debt profile that the Customer actively wishes to hedge and/or 'technical' over-hedging due to operational factors; for example, an IRHP may be 'booked' the day after the drawdown of the loan, and thus end a day later. The firm and the Skilled Person should decide whether the 'technical' over-hedging is fair and reasonable in the circumstances of the individual Customer.

41. A Customer choosing a longer term or higher notional (and a resulting over-hedge) solely because this is ‘cheaper’ than a shorter term, or lower notional, IRHP is not a legitimate reason for over-hedging unless it can be clearly demonstrated that the Customer fully understood the implications of doing so, including the potential for significantly larger break costs.
42. Where over-hedging is present without a legitimate reason, and a full tear-up is not required, redress is an adjustment of the IRHP and a refund of the cashflows paid in excess of what would have been paid in the absence of an over-hedge, in addition to, if relevant, the selection of an alternative product.

### **Interest**

43. Interest should be payable on any redress due to Customers in line with that applied by the FOS – i.e. 8% a year simple, or in line with an identifiable cost that the Customer incurred as a result of having to borrow money in the meantime.

### **Consequential loss**

44. In the context of the Review, it may be fair and reasonable for the firms to approach the issue of “consequential loss” by applying the general legal principles relevant to cases involving breaches of the FSA’s rules.
45. This means that a Customer claiming redress in respect of consequential loss will need to show (on the balance of probabilities), amongst other things, that the loss was caused by the breach (both a factual test and a legal test) and that the loss is not too “remote” (or outside the scope of the duty owed by the firm).
46. Although the general legal principles may be fair and reasonable in many cases, the test for redress under the Review is what is fair and reasonable in the circumstances of the case and is therefore not limited to claims that a court would accept. Each claim for consequential loss will need to be assessed on its own merits.

### **Offsetting**

47. When calculating redress amounts, the principle is that the overall position of the Customer should be the position they would have been in had the breaches of the regulatory requirements not taken place. This means that firms and Skilled Persons can take into account periods of time when the Customer benefited from the particular IRHP or payments were suspended as a result of this review.
48. Where cash payments are due to the Customer it is not acceptable for these amounts to be used for any purpose, including ‘offsetting’ against other debts, without the agreement of the Customer.

### **Third-party advice for the Customer**

49. In certain circumstances, where the Customer has sought third-party advice in respect of the redress proposal, the firm and Skilled Person should consider whether it is fair and reasonable to pay for the cost of that advice.

### **Customer ‘in-the-money’**

50. During the review, the firm and the Skilled Person may find non-compliant sales to Customers who are now ‘in-the-money’. In these circumstances, the firm should contact the Customer and provide detail of the risks associated with their IRHP to ensure that the Customer makes a fully informed decision as to whether to continue with their product. This is of particular importance in relation to Category A sales.

### **Definitions**

#### *Legitimate condition of a lending arrangement*

51. In order to determine whether or not the sale of an interest rate hedging product (IRHP) is a legitimate condition of lending (LCOL), firms and Skilled Persons should consider all the facts of the case. Although we set out below factors that may be considered when making this decision, we emphasise that these factors are not exhaustive and that satisfying one (or more) does not automatically mean there is a LCOL. We stress that it is important for firms and Skilled Persons to reach rounded judgements having given proper consideration to all the facts and circumstances of each case.
52. Firms and Skilled Persons should consider whether there is evidence that the firm’s credit policies required the Customer to have the IRHP. For example, subject to other factors, the sale of the IRHP may be a LCOL where the Customer’s loan/facility met a specified criterion (e.g. credit rating, risk rating, LTV etc) for which the firm’s credit policy required interest rate protection.
53. There should also be consideration of evidence that indicates that the sale of the IRHP complied with the firm’s documented lending process. For example, the firm’s documented lending process may have stipulated that interest rate protection must be agreed with the credit function. Where that decision to make the IRHP a condition of the loan has been agreed with the credit function, then, subject to other factors, this may be a LCOL.
54. Subject to other factors, firms and Skilled Person should consider whether there is evidence that the hedging complied with the requirements of the credit function, such as the notional value of the hedge and duration.
55. Firms and Skilled Persons should consider whether there is evidence that the Customer’s circumstances made it reasonable for firm to impose the requirement to hedge. For example, subject to other factors, for there to be a LCOL the file must evidence that at the point of sale it was reasonable for the Customer to be hedged in light of the risk of interest payments.

56. Similarly, there should be consideration of any evidence that suggests that sales incentives/inducements inappropriately influenced the decision to make the IRHP a condition of the loan. For example, it is not a LCOL where there is evidence that sales staff put in place the IRHP solely for commercial (and/or personal) benefit without due regard for the needs of the Customer.
57. Firms and Skilled Persons should also consider whether there is evidence that the communication of the IRHP as a condition of lending was in good time, fair, clear and not misleading. For example, for there to be a LCOL, the Customer must have been informed in a timely manner of the condition in the loan/facility before accepting it.
58. Firms and Skilled Persons should also note that where they are satisfied that the condition of lending is legitimate, there must be a further assessment to ensure that the sale of the particular IRHP complied with the regulatory requirements.

#### *Express wish for interest rate protection*

59. An 'express wish' is an unsolicited request from a Customer seeking to obtain interest rate protection on a lending arrangement. A Customer must not be regarded as having an express wish for interest rate protection unless there is clear and credible supportive evidence on file.
60. Firms and Skilled Persons should consider whether the discussion and the decision to have the interest rate hedging product (IRHP) were Customer-led. For example, if there is evidence on file to verify that the Customer initiated the request for interest rate protection or the Customer proactively requested an IRHP, then subject to other factors, this may constitute an express wish.
61. Firms and Skilled Persons should also consider whether or not there is evidence that the firm influenced the Customer to purchase the IRHP. Evidence of pressure, direction or misleading information from the firm would indicate that the Customer did not have an express wish for interest rate protection. Firms and Skilled Persons should note that where the firm presents to the Customer a range of products and the Customer chooses a particular IRHP, this by itself is not sufficient to indicate an express wish.
62. It is important for firms and Skilled Persons to reach rounded judgements having given proper consideration to all the facts and circumstances of each case.

#### *Maximum term*

63. Taking individual circumstances into account, it is extremely unlikely that a Customer acting with full knowledge would have purchased a product with break costs that, under pessimistic but plausible interest rate scenarios, exceed 7.5% of the notional value of the IRHP. In practice, this means that no alternative product should exceed the *maximum term*.
64. This is because the potential downside risks (i.e. break costs) are above 7.5% under pessimistic but plausible interest rate scenarios, and because there are likely to be changes in the circumstances of the Customer over the term that could, for example, lead to a reduction in the capital amount owed.

65. The details of how to calculate the maximum term will be discussed at a working level with each firm. Broadly, this is done by shocking the interest curve by a pessimistic but plausible amount (2 standard deviations). The maximum term will therefore change according to the interest rate environment at the time of sale. For example, as at 31 January 2007, the maximum term of a non-amortising vanilla swap would be 4.7 years, an amortising vanilla collar (cap +150bp) would be 9.2 years and a cap +150bp would be 20.7 years.

**Appendix 8 – Letter from Clive Adamson to the banks dated 29 January 2013**



**Clive Adamson**  
**Director of Supervision, Conduct Business Unit**  
Direct line: 020 7066 0362  
Email: [clive.adamson@fsa.gov.uk](mailto:clive.adamson@fsa.gov.uk)

[*Firm name*]

29 January 2013

### **INTEREST RATE HEDGING PRODUCTS (IRHPs) REVIEW – [*Firm name*]**

Thank you for meeting with us today and for the meeting with your team on 18 January 2013 and subsequent dialogue at working level. In addition to meeting with you, we have met with [*other banks' names*], HMT and other stakeholders. We have listened carefully to the concerns raised by you and others, including consumer stakeholders, about the review as originally outlined in June 2012. We have considered, in particular, the issues surfaced through the pilot and our recent discussions and have taken them into consideration in reaching our final position set out below.

We are confident that our position will provide fair outcomes for consumers sold IRHPs by [*firm name*] and, where appropriate, fair and reasonable redress. We are also confident that our position is fair to the banks who sold these products.

Set out in more detail in the Annexes is our final position but in summary:

1. **Sophisticated Customer Criteria** : We recognise the concerns raised about the previously proposed Sophisticated Customer Criteria and, in particular, the concern that certain types of retail customers could be incorrectly categorised as non-sophisticated (e.g. subsidiaries of large groups, SPVs etc) or sophisticated (e.g. farmers and Bed & Breakfasts). We have re-drafted the Sophisticated Customer Criteria to address these concerns.
2. **Sales standards** : Our position on the sales review is unchanged, but we should clarify that the test is whether, taking into account all the circumstances, the customer could reasonably have understood the features and risk in the product.
3. **Redress** : We have not changed our position on redress – it is a sound basis for the determination of fair and reasonable redress, where appropriate, although we have clarified some aspects. However, it is important point that the redress criteria we are setting out here and in particular the test on alternative products of 7.5% break costs, is only for the purposes of this redress exercise. We are not changing our rules in this area or setting out new guidance. Therefore we believe firms can continue to offer longer term products to customers provided that the customer is able to understand the risks and benefits of the product and makes an informed choice.

4. Consequential loss : We have changed our position on consequential loss. We accept that a straightforward approach that will allow for consequential loss to be determined as part of the review provides the right balance.
5. Financial Service Ombudsman (“FOS”) : In our announcement in June 2012 we said we would approach the FOS to ask if it would consider offering a specific Scheme for dealing with the outcome of the review and related matters. We have decided not to proceed with a FOS Scheme for customers dissatisfied with the determination of their case. We accept that a FOS Scheme will lengthen the review process. However, this means it is extremely important that the Skilled Persons are effective in their role, providing independent oversight and ensuring that the banks follow the FSA’s position and provide fair outcomes for consumers.
6. Moratorium on payments : The British Banking Association (‘BBA’) announced in November 2012 that banks will consider whether to apply a moratorium on payments of IRHPS on a case by case basis. We have some concerns arising from information supplied by the consumer groups that not all banks are adequately applying such a moratorium. We understand the BBA is arranging a forum where banks can share best practices on this matter, but we are also going to increase the scope of the first Skilled Persons’ Requirement Notice to require the first Skilled Person to assess the effectiveness of the banks’ procedures for considering a moratorium on payments in individual cases.
7. Offsetting : We also accept that you can offset amounts payable as redress, but only against loans that have been taken out for the sole purpose of paying break costs.

The Skilled Persons’ Requirement Notice will need to be amended in light of our position on the moratorium on payments. A revised section 166 Requirement Notice will be issued in due course.

This is our final position. Our expectation is that you will conduct the review on this basis and will make the necessary changes to your methodology to this end. Of course, you may wish to provide more favourable outcomes for consumers generally or in specific cases.

## Next Steps

We ask you to confirm in writing by **12pm on Wednesday 30 January 2013** whether you agree in principle to proceed to the main review. We will expect [*firm name*] to:

- Amend its methodology, in line with the position set out in the annexes to the letter dated 17 January 2013 (where applicable, as amended by the annexes enclosed). These amendments can be made after 31 January 2013.
- Address matters raised in the feedback about the Pilot Exercise, which requires re-reviewing the pilot cases in accordance with the revised methodology.

As soon as reasonably possible, we expect an approved person within [*firm name*] and lead partner for the Skilled Person to attest that the methodology has been amended and any feedback in relation to pilot cases considered, before the pilot customers receive a provisional redress determination.

We are writing in similar terms to each of the banks who signed an Undertaking with the FSA in June 2012. We are also meeting with the Skilled Persons of all ten banks to inform them of our final position.

As you will note, the original Undertaking will need to be amended to take into account the amended Sophisticated Customer Criteria. Please find enclosed at Annex 4 a draft supplemental agreement.

As you are aware, we intend to publish a report on 31 January 2013, which will set out, at a high level, the results of the pilot exercise and the basis upon which we expect the review to be conducted.

We will also be asking the firms to send FSA branded communications to their customers on behalf of the FSA, which will outline the findings from the pilot exercises and the next steps.

We look forward to receiving your response.

## Annex 1 – Sophisticated Customer Criteria

1. The current Sophisticated Customer Criteria has two elements; an objective test and a subjective test. No amendments are suggested in relation to the subjective test.
2. The current objective sophistication test is as follows:
  - (i) In the financial year during which the sale was concluded, the customer had at least two of the following:
    - a) a turnover of more than £6.5 million; or
    - b) a balance sheet total of more than £3.26 million; or
    - c) more than 50 employees.
3. The current subjective sophistication test is as follows:

*“The Firm is able to demonstrate that, at the time of the sale, the Customer had the necessary experience and knowledge to understand the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved.”*
4. We have identified the following unintended consequences with the current Sophisticated Customer Criteria:
  - (i) Certain customers that we would have expected to fall within the review population were being excluded as sophisticated customers by virtue of having a large balance sheet and a high number of employees (potentially due to having a seasonal work force). These customers included farmers and Bed & Breakfasts.
  - (ii) Firms having insufficient details about their customers to determine whether the Sophisticated Customer Criteria has been met without seeking further information from the customer.
  - (iii) Some customers were being determined as non-sophisticated despite being part of a large/complex group which we would expect to be regarded as sophisticated. This was by virtue of the fact that the Sophisticated Customer Criteria was applied at an entity level, without consideration of the wider group.
  - (iv) Some customers who are SPVs are constituted in a way that falls outside the Companies Act 2006 definition of a “group”, but are part of a group of connected entities and are likely to be sophisticated customers.
5. We have considered the issues and now put forward revised objective Sophisticated Customer Criteria.
6. The flow diagram below outlines how we would expect the amended objective Sophisticated Customer Criteria to work.
7. The first consideration of the amended objective test is whether the customer is part of a “group” as defined in section 474(1) of the Companies Act 2006, and construed in accordance with sections 1161 and 1162 of, and Schedule 7 to, the Companies Act 2006.

8. Where the customer was part of a Companies Act group, you must consider whether the group met two of the three small Companies Act group thresholds (e.g. aggregate turnover of more than £6.5 million net (or £7.8 million gross); aggregate balance sheet total of more than £3.26 million net (or £3.9 million gross); or more than 50 employees) during the financial year of the sale. Where the Companies Act group met all three thresholds or the turnover threshold and either the balance sheet or employee threshold, the customer is deemed to meet the Sophisticated Customer Criteria.
9. Where in the financial year of the sale a Companies Act group met:
- (i) none of the thresholds; or
  - (ii) only one of the thresholds; or
  - (iii) only the balance sheet total and employee number thresholds; or
  - (iv) insufficient information to determine whether or not groups meet the test

it is then necessary to consider whether the customer belonged to a “group of connected clients” as defined in BIPRU 10.3 (a “BIPRU group”).

If the customer belonged to such a BIPRU group and the aggregated notional value<sup>1</sup> of all interest rate hedging products held by the BIPRU group, in existence at the time of the particular sale being assessed, was greater than £10 million, the customer will be deemed to meet the Sophisticated Customer Criteria.

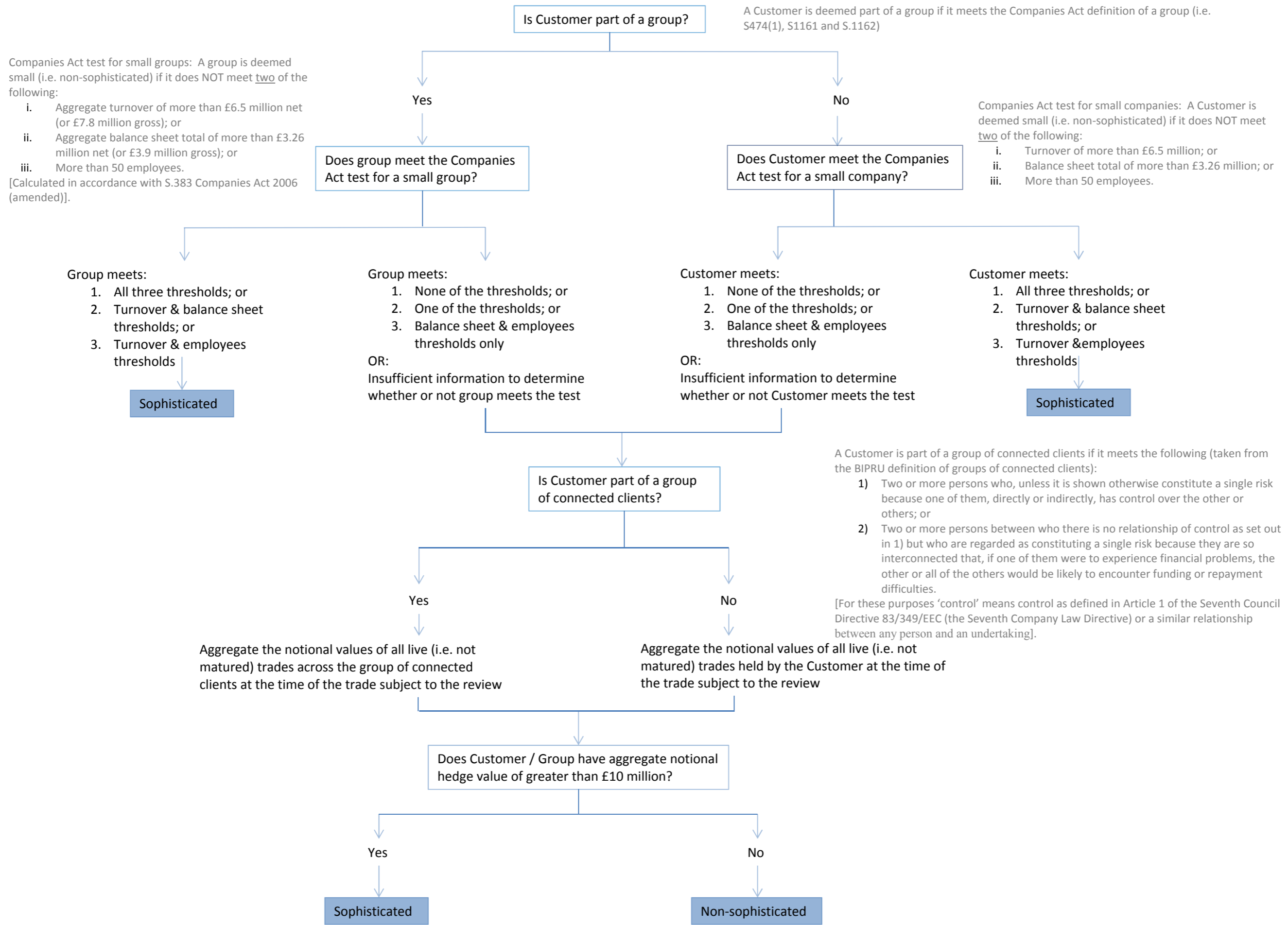
If the customer did not belong to a BIPRU group and the aggregated notional value of all interest rate hedging products held by the Companies Act group, in existence at the time of the particular sale being assessed and held by the customer across that Companies Act group was greater than £10 million, the customer will be deemed to meet the Sophisticated Customer Criteria.

10. Where the customer did not belong to a Companies Act group, you must consider whether the customer met two out of three of the small company thresholds (e.g. turnover of more than £6.5 million; balance sheet total of more than £3.26 million; or more than 50 employees) during the financial year of the sale. Where the customer met all three thresholds or the turnover threshold and either the balance sheet or employee threshold, the customer is deemed to meet the Sophisticated Customer Criteria.
11. Where in the financial year of the sale the customer met:
- (i) none of the thresholds; or
  - (ii) only one of the thresholds; or
  - (iii) only the balance sheet total and employee number thresholds;
  - (iv) insufficient information to determine whether or not groups meet the test

---

<sup>1</sup> The aggregated notional hedge value is calculated using the notional hedge values of all ‘live’ hedges held by customer at that point in time. Therefore, it does not include the notional hedge value of a hedge that is being re-structured. For a collar the notional hedge value is the larger of the floor or cap value.

it is then necessary to consider whether the customer belonged to a “group of connected clients” as defined in BIPRU 10.3. The same methodology and notional value is applied as outlined above in relation to small Companies Act groups



## **Annex 2 – Sales Review Principles**

1. We have listened carefully to the concerns raised in relation to our sales review principles. Particularly, your concerns, that they are too high level and hence open to interpretation and concerns that they appear inconsistent with Court Judgments.
2. In our view, the assessment of a sale requires an objective assessment of the facts to determine whether, in that customer's circumstances, the firm has complied with the Regulatory Requirements (taking into account the Sales Standards), and in particular, whether the Customer was provided with sufficient information to enable the Customer to understand the features and risks of the product.
3. In any case assessment banks must ensure that there is full consideration of the Customer's individual circumstances and all applicable rules in our Handbook are applied correctly. Therefore, general guidance will not assist banks when carrying out this review, because a case by case assessment is necessary.
4. This case by case assessment should involve (but is not limited to) a holistic consideration of the following:
  - the size and nature of the Customer;
  - the Customer's knowledge and understanding of these types of products generally and the specific product purchased;
  - the Customer's interaction during the sales process;
  - the complexity of the product; and
  - the information provided during the sales process, particularly the quality and nature of the information provided, when and how it was provided and how long the Customer had to digest and understand it.
5. The level and nature of disclosure required must meet our requirement of being clear, fair and not misleading. Therefore, a consideration of all the circumstances of the case must be carried out to determine whether the sale complied with the Regulatory Requirements<sup>2</sup> (taking into account the Sales Standards). This means that the level of disclosure required to e.g. satisfy the various disclosure requirements will vary from case to case.

---

<sup>2</sup> Providing clear, fair and not misleading information is essential for delivering fair outcomes for consumers. Firms must ensure that all of their communications satisfied FSA 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').



### **Annex 3 – Redress**

6. Following our review of the pilot exercises carried out by the firms, we set out below our views as to the very minimum that we expect from firms when considering fair and reasonable redress in the proactive redress exercise and past business review envisaged by the Undertaking.

#### **A. Tenets of redress**

7. The core tenet of this proactive redress exercise and past business review is to pay fair and reasonable redress to Customers where appropriate. In our view, fair and reasonable redress requires that the Customer be put back into the position they would have been in if there had not been any breach of the Regulatory Requirements<sup>3</sup>.

#### **B. Determining whether redress is payable**

8. For Category A Customers, firms have agreed to provide fair and reasonable redress to all Customers who do not meet the Sophisticated Customer Criteria.
9. For Category B and C Customers, firms have agreed to assess the compliance of sales of IRHPs with the relevant Regulatory Requirements, taking into account, in particular, the Sales Standards. In determining whether it is appropriate to pay fair and reasonable redress, and if so, what that fair and reasonable redress entails, the firm will need to consider the following:
- a. Whether the sale of the IRHP was in breach of the Regulatory Requirements (taking into account, in particular, the Sales Standards)? If so there has been a non-compliant sale.
  - b. For non-compliant sales, whether the Customer suffered loss (either past loss, or expected future loss due to being ‘out of the money’)?
  - c. If so, whether the breach of the Regulatory Requirements caused the loss?
  - d. And, if so, the Customer is due fair and reasonable redress.

#### **C. Non-compliant sale but no redress**

10. If there has been a non-compliant sale, but either:
- (i) the Customer has suffered no loss; or
  - (ii) it is reasonable to conclude that the Customer would have followed the same course of action, notwithstanding the breach of the Regulatory Requirements (the “counter-factual”),
- then no redress is likely to be the fair and reasonable outcome.

---

<sup>3</sup> The Principles, rules and guidance contained in the FSA’s Handbook.

11. When considering the counter-factual the firm should presume, in the absence of evidence to the contrary, that the Customer would have purchased a simple product (cap, vanilla swap or vanilla collar) without any callable or extendable elements.
12. When considering the counter-factual in cases where the firm has failed to comply with the Regulatory Requirements in relation to the disclosure of break costs the firm should presume, in the absence of relevant evidence to the contrary (see paragraph 13), that the Customer would not have taken an IRHP with a potential break cost greater than 7.5% of the notional value of the IRHP in a pessimistic but plausible scenario.
13. Relevant evidence might include the Customer's demands, needs and intentions at the time of the sale, including any testimony by the Customer about the reasons at the time of sale for purchasing the IRHP, but in this context the firm should also take into account the impact that the failure to comply with the relevant Regulatory Requirements may have had on those demands, needs, intentions and reasons.

#### **D. Full tear-up and alternative product**

14. There are two broad types of redress:
  - (i) 'Full tear-up' – where the counter-factual is that the Customer would not have selected any product. In this case, fair and reasonable redress is the exit from the IRHP at no charge to the Customer, and a refund of all historic payments paid under the IRHP including, where appropriate, any break costs paid.
  - (ii) 'Alternative product' – where the counter-factual is that the Customer would have selected an alternative IRHP. In this case, fair and reasonable redress is a refund of the difference between the payments made under the actual IRHP entered into and the payments that would have been made had the Customer entered into the alternative product. This includes, where appropriate, the difference between break costs paid and break costs that would have been payable under the alternative product.
15. In both cases, interest will be payable as part of fair and reasonable redress (see para. 33)

##### Full tear-up

16. In the event of a non-compliant sale, where the IRHP was not a legitimate condition of the lending arrangement, and where the counter-factual is that the Customer would not have purchased an IRHP, fair and reasonable redress is presumed to be a full tear-up.
17. When considering the counter-factual, the firm can consider whether there was an express wish for interest rate protection (see para. 48).
18. If the firm proposes a full tear-up for the Customer, the firm should ensure that the Customer is aware of the risks of not having such an IRHP.

##### Alternative product

19. In the event of a non-compliant sale, where the counter-factual is that the Customer would have purchased an alternative IRHP (whether due to it being a legitimate condition of lending or not), fair and reasonable redress is presumed to be an alternative product that provides such protection.

20. When considering the counter-factual, the firm can consider whether there was an express wish for interest rate protection (see para. 48).

*Selection of an alternative product*

21. The appropriate alternative product will be the IRHP that the Customer would, in the counter-factual scenario, have taken at the time.
22. Two key principles underpin the process for determining an alternative product.
- (i) The firm should presume, in the absence of evidence to the contrary, that the Customer would have purchased a simple product (cap, vanilla swap or vanilla collar) without any callable or extendable elements.
  - (ii) When considering the counter-factual in cases where the firm has failed to comply with the Regulatory Requirements in relation to the disclosure of break costs the firm should presume, in the absence of relevant evidence to the contrary (see paragraph 13), that the Customer would not have taken an IRHP with a potential break cost greater than 7.5% of the notional value of the IRHP in a pessimistic but plausible scenario. This means that the tenor of the product should not exceed the maximum term (as defined in para. 52)

Relevant evidence might include the Customer's demands, needs and intentions at the time of the sale, including any testimony by the Customer about the reasons at the time of sale for purchasing the IRHP, but in this context the firm should also take into account the impact that the failure to comply with the relevant Regulatory Requirements may have had on those demands, needs, intentions and reasons.

23. It is not reasonable to use a vanilla swap or a vanilla collar as a 'default' option, as the alternative product must be determined on the basis of the evidence available; and determined considering the financial sophistication, knowledge and understanding of the Customer.
24. The firm should take into account the Customer's circumstances at the time of the sale when considering what term the Customer would have opted for were it not for the breach of the Regulatory Requirements. For example, the evidence available may demonstrate that, were it not for the breach of the Regulatory Requirements, the Customer would have opted for a term shorter than the maximum term.
25. If during the original sale, a Customer said they did not want a cap on the basis that they did not wish to pay a premium, then the assessment of the sale should consider whether any breach of the Regulatory Requirements contributed to that decision; for example, a lack of sufficient disclosure in relation to the features and risks of non-cap products.
26. Where the counter-factual is that the Customer would still be in the alternative product, it is likely to be fair and reasonable for the Customer to be placed into that alternative product for the remainder of the counter-factual term, though the firm should also consider the current circumstances of the Customer.

*Pricing of alternative products*

27. The pricing of an alternative product must be fair and reasonable in the circumstances.

28. In the event that the alternative product is a cap or vanilla collar, the strike rate of the cap should be defined according to a holistic consideration of the circumstances of the Customer at the time of the original sale. It is not sufficient for the strike rate of the alternative product to default to the actual strike rate, or the most common market rate at the time of the original sale, if a collar was originally sold.

#### **E. Over-hedging**

29. Over-hedging encompasses a number of issues, including, for example, where the term or value of the IRHP exceeds the term or value of any associated lending arrangements.
30. There are only a limited number of circumstances that might be a 'legitimate reason' for over-hedging. This includes, for example, where the Customer has a number of separate lending arrangements that are associated with the IRHP and/or 'technical' over-hedging due to operational factors such as an IRHP being 'booked' the day after the drawdown of the loan, or ending a day later. The firm should consider whether the 'technical' over-hedging is fair and reasonable in the circumstances of the case.
31. A Customer choosing an IRHP with a longer term or higher notional value than the associated lending arrangement solely because the interest rate was less than it would have been for a shorter term, or lower notional value, is not a legitimate reason for over-hedging unless the firm can demonstrate that the Customer understood the risks of doing so.
32. Where there is no legitimate reason for over-hedging, and a full tear-up is not required, fair and reasonable redress is an adjustment of the IRHP and a refund of the payments made in excess of what would have been made in the counter-factual scenario, in addition to, if relevant, the selection of an alternative product.

#### **F. Interest**

33. Interest should be paid on any redress due to Customers at a rate that is in line with the approach applied by the FOS – i.e. 8% a year simple, or in line with an identifiable cost that the Customer incurred as a result of having to borrow money.

#### **G. Consequential loss**

34. "Consequential loss" should be determined by reference to the general legal principles relevant to claims in tort or for breach of statutory duty (e.g. breaches of the FSA's rules).
35. This will involve a consideration of causation and remoteness (i.e. whether the loss was reasonably foreseeable at the time of the breach of the Regulatory Requirements).

#### **H. Offsetting**

36. When calculating redress amounts, the overall position of the Customer should be the position they would have been in had the breaches of the Regulatory Requirements not taken place. Firms can take into account periods of time when the Customer benefited from the particular IRHP or when payments were suspended. Firms can offset redress against any loans provided purely for the purposes of paying break costs.

37. Where cash payments are due to the Customer these amounts cannot be used for any other purpose, including offsetting against other debts, without the agreement of the Customer.

#### **I. Third-party advice for the Customer**

38. In certain circumstances, where the Customer has sought, or would like to seek, third-party advice in respect of the redress proposal, the firm should consider whether it is fair and reasonable to pay for the cost of that advice.

#### **J. Customers ‘in-the-money’**

39. During the review, the firm may find non-compliant sales where the Customer is now ‘in-the-money’ (i.e. were the IRHP to be ‘broken’ the Customer would be owed money by the firm). In these circumstances, the firm should contact the Customer and provide details of the risks associated with the IRHP to ensure that the Customer makes a fully informed decision as to whether to continue with the IRHP. This is of particular importance in relation to Category A sales.

#### **K. Definitions**

##### Legitimate condition of a lending arrangement

40. In order to determine whether or not the sale of an IRHP is a legitimate condition of lending (LCOL), the firm should consider all the facts of the case. Although we set out below factors that may be considered when making this decision, we emphasise that these factors are not exhaustive and that satisfying one (or more) does not automatically mean there is a LCOL. We stress that it is important for the firm to reach rounded judgements having given proper consideration to all the facts and circumstances of each case.
41. The firm should consider whether there is evidence that the firm’s credit policies required the Customer to have the IRHP. For example, subject to other factors, the sale of the IRHP may be a LCOL where the Customer’s loan/facility met a specified criterion (e.g. credit rating, risk rating, LTV etc) for which the firm’s credit policy required interest rate protection.
42. There should also be consideration of evidence that indicates that the sale of the IRHP complied with the firm’s documented lending process. For example, the firm’s documented lending process may have stipulated that interest rate protection must be agreed with the credit function. Where that decision to make the IRHP a condition of the loan has been agreed with the credit function, then, subject to other factors, this may be a LCOL.
43. Subject to other factors, the firm should consider whether there is evidence that the hedging complied with the requirements of the credit function, such as the notional value of the hedge and duration.
44. The firm should consider whether there is evidence that the Customer’s circumstances made it reasonable for firm to impose the requirement to hedge. For example, subject to other factors, for there to be a LCOL the file must evidence that at the point of sale it was reasonable for the Customer to be hedged in light of the risk of interest payments.

45. Similarly, there should be consideration of any evidence that suggests that sales incentives/inducements inappropriately influenced the decision to make the IRHP a condition of the loan. For example, it is not a LCOL where there is evidence that sales staff put in place the IRHP solely for commercial (and/or personal) benefit without due regard for the needs of the Customer.
46. The firm should also consider whether there is evidence that the communication of the IRHP as a condition of lending was in good time, fair, clear and not misleading. For example, for there to be a LCOL, the Customer must have been informed in a timely manner of the condition in the loan/facility before accepting it.
47. The firm should also note that where they are satisfied that the condition of lending is legitimate, there must be a further assessment to ensure that the sale of the particular IRHP complied with the regulatory requirements.

#### Express wish for interest rate protection

48. An 'express wish' is an unsolicited request from a Customer seeking to obtain interest rate protection on a lending arrangement. A Customer must not be regarded as having an express wish for interest rate protection unless there is clear and credible supportive evidence on file.
49. The firm should consider whether the discussion and the decision to have the interest rate hedging product (IRHP) were Customer-led. For example, if there is evidence on file to verify that the Customer initiated the request for interest rate protection or the Customer proactively requested an IRHP, then subject to other factors, this may constitute an express wish.
50. The firm should also consider whether or not there is evidence that the firm influenced the Customer to purchase the IRHP. Evidence of pressure, direction or misleading information from the firm would indicate that the Customer did not have an express wish for interest rate protection. The firm should note that where the firm presents to the Customer a range of products and the Customer chooses a particular IRHP, this by itself is not sufficient to indicate an express wish.
51. It is important for the firm to reach rounded judgements having given proper consideration to all the facts and circumstances of each case.

#### Maximum term

52. When considering the counter-factual in cases where the firm has failed to comply with the Regulatory Requirements in relation to the disclosure of break costs the firm should presume, in the absence of relevant evidence to the contrary (see paragraph 13), that the Customer would not have taken an IRHP with a potential break cost greater than 7.5% of the notional value of the IRHP in a pessimistic but plausible scenario. This means that the tenor of the product should not exceed the maximum term.
53. The calculation of the maximum term is done by shocking the interest curve by a pessimistic but plausible amount (2 standard deviations).

## **Appendix 9 – Sales Standards**

The **`Sales Standards'** are:

1. In good time before conclusion of the contract, the Firm has provided the Customer with appropriate, comprehensible and fair, clear and not misleading information on the features, benefits and risks associated with the Interest Rate Hedging Product.
2. In good time before conclusion of the contract, the Firm has provided the Customer with an appropriate, comprehensible and fair, clear and not misleading disclosure of any potential break costs.
3. The Interest Rate Hedging Product does not exceed the term or value of any lending arrangements without a legitimate reason, and if it does, the potential consequences have been disclosed to the Customer in a comprehensible and fair, clear and not misleading way.
4. The Firm has had due regard to the information needs of the Customer and provided comprehensible, and fair, clear and not misleading information about the features, benefits and risks of relevant alternative Interest Rate Hedging Products.
5. In relation to an advised sale:
  - a. The Firm has obtained sufficient personal and financial information about the Customer, including the Customer's investment objectives, level of education, profession or former profession and relevant past experience of Interest Rate Hedging Products.
  - b. The Firm has taken reasonable steps to ensure that the personal recommendation is suitable for the Customer.
6. In relation to a non-advised sale, no advice has been given to the Customer during the sales process.
7. In relation to a non-advised sale on or before 31 October 2007, the Firm has taken reasonable steps to ensure that the Customer understands the nature of the risks involved and provided the Customer with the relevant risk warning notice.
8. In relation to a non-advised sale on or after 1 November 2007, the Firm has assessed whether entering into the Interest Rate Hedging Product is appropriate for the Customer by determining whether the Customer has the necessary knowledge and experience to understand the risks involved. The Firm has obtained information regarding the client's level of education, profession or former profession, and relevant past experience of Interest Rate Hedging Products.



## **Appendix 10 – Biographies**

## **Introduction**

This Report was prepared by John Swift QC with the assistance of his Support Team.

### **John Swift QC**

John Swift QC is a non-practising barrister, a tenant of Monckton Chambers and was Head of Monckton Chambers from 1999-2002. He was in full time practice at the Bar until 1993 and from 1999-2014. He is a Bencher of the Inner Temple.

His regulatory experience in the public sector encompasses positions as the first Rail Regulator (1993-1998), on the Cooperation and Competition Panel for NHS funded services (2008-2013), as the first Chairman of the Enforcement Decision Panel of Ofgem (2014-2019), as a member of the Case Work Committee of Ofwat, and as a member of the Determinations Panel of the Pensions Regulator (2017-2020).

John is a graduate of the University of Oxford and the Johns Hopkins School of Advanced International Studies. He is a Fellow of the Chartered Institute of Transport and Logistics.

### **Nikolaus Grubeck**

Nikolaus Grubeck is a barrister at Monckton Chambers. He has particular expertise in complex public law and regulatory matters, competition law, data protection, and cases involving issues of national security, armed conflict and international relations.

Nikolaus is a former judicial assistant to Lord Neuberger of Abbotsbury. Before being called to the bar in 2010, Nikolaus worked for the United Nations in Afghanistan and Sudan. He is a graduate of Oxford University and Harvard Law School.

### **Kristina Lukacova**

Kristina Lukacova is a barrister at Monckton Chambers. She was called to the Bar in 2015.

Kristina has a broad commercial and chancery practice with a focus on company and insolvency matters, civil fraud and commercial arbitration. She is a graduate of the University of Cambridge and the University of Oxford.

## **Ashurst LLP**

The following individuals from Ashurst LLP were key members of the Support Team:

### ***David Capps***

David Capps led John Swift QC's Support Team and is a dispute resolution partner specialising in financial regulatory investigations, enforcement matters, and finance-related disputes. Before joining Ashurst, David was Head of Litigation and Legal Risk at a major investment bank from 2004-2012.

Prior to that role, David was a partner in other major UK and US law firms, where his financial regulatory experience involved dealing with both UK and overseas regulators and law enforcement agencies. His financial regulatory disputes experience dates back to 1989.

David also regularly advises clients on regulatory compliance issues and is a recognised expert in relation to UK financial services regulation.

### ***Anna Varga***

Anna specialises in contentious financial services and commercial litigation. Anna's practice includes advising investment and retail banks in relation to both litigation and contentious regulatory issues, mis-selling and contractual debt disputes. Anna is a founding member of the ESG taskforce within the Strategy Advisory division in London, and a member of Ashurst's global sustainability initiative, advising institutional clients variously on ESG-conduct risk and mitigation in the UK.

Prior to joining Ashurst, Anna worked for six years at the FCA as both an investigator and a barrister. In her position at the FCA, she advised and acted for enforcement case teams on investigative and sanctions powers and for the supervision department in relation to early intervention powers. In addition, she advised authorisation regarding contentious permissions and approval applications.

Anna was not involved with IRHPs in any way while at the FCA.

### ***Rosie Stanger***

Rosie is an associate in the dispute resolution team, with a focus on contentious financial, regulatory and insolvency matters. She has a wide range of experience in advising corporates and financial institutions on commercial disputes, restructuring and internal investigations.

Prior to joining Ashurst, Rosie worked as a commercial underwriter for a specialist insurance company.

### ***Andrew Sims***

Andrew Sims is an associate in the dispute resolution team. Andrew focuses on contentious financial, regulatory, ESG and insolvency matters. He has a broad range of experience in assisting financial institutions and other corporates on commercial matters, as well as with regulatory and internal investigations.

### ***Catherine Lillycrop***

Catherine Lillycrop is an associate in the dispute resolution team, with a focus on contentious financial, corporate crime and ESG matters. Catherine has a broad range of experience in advising financial institutions and corporates on commercial disputes, internal investigations and internal compliance programmes.

### ***Other members of the Ashurst team***

During the course of the Review, the following individuals at Ashurst were also involved as members of the Support team:

- Laura Bell
- Anna Burn
- Beth Griffith-Clarke
- Emily Lemaire
- Julia Petinos
- Melissa Sibley

## **Kenny Kemp, Kemp Communications**

Kenny Kemp is an award-winning journalist, business writer and media adviser. He is the founder of Kemp Communications (UK) Ltd, set up in 2003, which has undertaken advisory work for a range of companies and not-for-profit organisations. He is the author of several international business biographies. He is an Associate of the University of Edinburgh Business School and lives in Edinburgh.