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Kevin Hollinrake MP
House of Commons
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28 January 2019

Our Ref: SA190117A

Dear Kevin,

RE: Clydesdale Bank Tailored Business Loans

Thank you for your letter of 16 January 2019 in response to mine of 19 November 2018 regarding Clydesdale and Yorkshire Bank Group's (Clydesdale) interest rate hedging products (IRHP) and tailored business loans (TBL).

IRHP and the FCA's review

Clydesdale has conducted a review of its IRHP sales between 2001 and 2012. The terms of this review were agreed with the FSA, and included the involvement of a skilled person. Those IRHP customers identified as non-sophisticated in the review were addressed according to the particular IRHP product they held. While sophisticated customers were not addressed as part of the review, they were able to make a complaint to the firm. The skilled person provided the FSA with regular reports on the outcomes of the review, including on the adequacy of Clydesdale's handling of IRHP complaints.

You note that we committed to undertake a review of the IRHP scheme after legal proceedings related to the scheme were complete, and ask when we will publish our conclusions (**Q3**).

In our response to the TSC's Report on Conduct and Competition in SME Lending, we stated that we would make a decision on the nature and extent of the review of the supervisory intervention on Interest Rate Hedging Products, as well as oversight arrangements, once legal proceedings had concluded. On 28 September 2018, the Court of Appeal issued its judgment in *R(Holmcroft Properties Ltd) v KPMG LLP* [2018] EWCA Civ 2093. The relevant parties had 28 days in which to appeal this decision, which expired on 26 October 2018. While an initial appeal was submitted and dismissed, no further appeal was made and these legal proceedings have now concluded. Since this time we have been preparing to start the Independent Lessons Learned Review. This work has included defining the governance arrangements, considering the scope of the review and potential candidates to be appointed as the Independent Reviewer.

TBL and the FCA's powers

We regard TBLs as distinct from IRHP. Our view is that TBLs are commercial loan contracts, not contracts for differences or other investments for the purposes of Article 85 of the regulated activity order. Unlike IRHPs, therefore, they are not regulated products.

Clydesdale conducted a proactive review of the different cohorts of TBLs. This was a voluntary review because those TBLs had some product features similar to IRHP.

You ask us to confirm 'out of the 1,500 or so cases' how many were compensated and to what extent (**Q1**).

Our understanding is that of the complex TBLs held by non-sophisticated customers included in Clydesdale's review, all but one has now received an outcome. Some have referred their cases to the Financial Ombudsman Service ('the Ombudsman Service'). The firm's review is thus at an advanced stage and it is for that reason we have referred to them previously as a "diminishing cohort".

We consider the exact number of cases compensated and the amount of compensation to be confidential information under s348 FSMA, which it would be more appropriate for the firm to disclose at the appropriate time.

You reiterate your view that both complex and fixed rate TBLs are in fact investments. You regard fixed rate TBLs as being similar to vanilla swaps in their channel of sale and impact on the customer, and different only in being structured as one contract rather than two.

As noted, our view is that neither kind of TBL are investment contracts and as such sit outside our regulatory remit, for the reasons set out in detail in our letters to Andrew Tyrie of 26 June 2014 and to you of 19 November 2018.

I note you consider that we could have addressed TBLs under the Financial Promotions Order, and that our Approved Person's rules at the time gave us a route to investigate David Thorburn, as the former CEO who oversaw the bank's TBL sales. Our view, consistent with our opinion of TBLs as commercial loans and not investments, is that there is no "financial promotion" for which the restriction under s21 FSMA might apply. In brief:

- there must be a communication which is an invitation or inducement to "engage in investment activity" for the restriction in s21 FSMA to apply;

- s21(8) FSMA defines "engage in investment activity", the overall effect of which is that a financial promotion must relate in some way to a "controlled investment"

- the list of "controlled investments" are defined in Part 2 of Schedule 1 to the Financial Promotion Order (that is, the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2005/1529));

As commercial loans, TBLs do not fall within that list. Also, they were sold before the controlled activity of 'providing relevant consumer credit' (paragraph 10BA and related controlled investment at paragraph 26D, Schedule 1 FPO) came into force. But in any case, they would not be a "financial promotion" because a relevant exemption would apply (namely, Article 46A(2) of the Financial Promotion Order).

As I explained in my letter to you of 19 November, because TBLs are not regulated, our powers to take action against individuals (or firms) in such circumstances are very limited, even where mistreatment of customers has been identified and accepted. Under the more recently introduced Senior Managers and Certification regime, we have greater powers to hold senior management of banks to account for the way they treat their SME customers and we will do that.

Clydesdale's treatment of fixed rate TBL customers and complainants

You express the view that Clydesdale's review of complex TBLs should also have included fixed rate TBLs, which you consider to also have similar product features to IRHP. More broadly, you consider Clydesdale has not acted fairly concerning fixed rate TBLs because:

- only complaints about them made between 2001-2014 were reopened and reviewed;
- the firm did not assess the root causes of those complaints, or contact and invite other customers potentially affected by those causes to complain;
- those who did complain subsequently were rejected as out of time where they complained after March 2015.

You also say that the NAB Customer Support Group has recently been in contact with the Ombudsman Service, who has expressed concerns about the TBL product, based on complaints coming before it, and intends to refer the matter back to the FCA for further consideration.

Further, you ask how we intend to address these various issues and concerns (**Q2**, **Q5**).

In our view, fixed rate TBLs were unlike complex TBLs and did not have similar product features to vanilla swaps or other IRHP. The FSA agreed with Clydesdale that it would, therefore, not need to take the same proactive approach toward fixed rate TBL as for complex TBLs and IRHPs. We remain of the view that dealing with any customer concerns about fixed rate TBLs through a fair complaint handling process by the firm is a reasonable and proportionate approach.

We understand that the firm has time barred a small proportion of complaints, and that the Ombudsman Service has reviewed some of these. The Ombudsman Service has confirmed that, as the FCA rules provide for a time-bar, businesses are entitled to seek to rely on it. The Ombudsman Service will consider whether the time bar applies in the context of individual cases when it is raised by the business. But this consideration would be about applying the rules, not a judgement about the business's decision to rely on the time-bar.

More broadly, our understanding is that the firm's review is at an advanced stage and that a significant proportion of the complaints concerning fixed rate TBLs (or other TBL cases not in the proactive review) that have been referred to the Ombudsman Service have been closed.

We are aware that the Ombudsman Service is currently considering some fixed rate TBL complaints referred to it, including in light of recent representations by the 'NAB Customer Support Group'. The Ombudsman Service will make its own independent decisions on these cases, in light of what it considers fair and reasonable in the circumstances. When it has reached its decisions, we will consider whether any further intervention by us, for example concerning the firm's handling of these types of complaint, is needed. We are, and will continue, to engage with the Ombudsman Service on the issues they are seeing and will take appropriate action if new information is received.

TBLs and s166 review

You ask why the 'mis-sale of TBLs and subsequent mistreatment of customers' has never been the subject of a s166 review? (**Q4**).

As set out previously, the review by Clydesdale of complex TBLs has been overseen by an independent third party, with the role they played being very similar to the Skilled Person appointed in relation to the IRHP review. Given the issues with TBLs falling outside of the regulatory perimeter, it was considered appropriate for the appointment to be made by the firm on a voluntary basis. The complaints received outside of the formal review are subject to the firm's normal oversight arrangements and where applicable the Ombudsman Service.

Alternative routes to remedy

You note the expense involved in pursuing legal action as an alternative to making a complaint, and suggest that Clydesdale should commit to acting in the manner of a 'Model Litigant', as government departments are now required to do, and ask our view (**Q6**).

We understand the significant expense involved in bringing legal proceedings. As you know, we are expanding the remit of the Ombudsman Service to include SMEs with a turnover of less than £6.5m which either employ fewer than 50 persons or have a balance sheet of less than £5m. This will alleviate the difficulties many SME's face in this regard by providing them with access to fast, fair and cheap dispute resolution mechanisms. In relation to the Model Litigant Code which you note has been introduced in Australia, this would be primarily a matter for the UK courts, and government, to consider.

We welcome the banking industry's voluntary ombudsman scheme, including its assessment of historic cases. However, it is right that the scheme should not seek to re-open complaints already settled under a previous independent redress scheme.

I would also note that since TBLs have not been covered in the same way as IRHP, there is a case for including remaining disputes in the review of past cases proposed by Simon Walker.

Conclusion

We will continue to work with Clydesdale and other stakeholders, including the Ombudsman Service, to bring their TBL (and IRHP) reviews to a conclusion. They are important reviews and remain a priority for the FCA. They have and will result in considerable redress being received by a large number of customers.

I hope this response is helpful. We can discuss these matters at our forthcoming meeting, including any potential next steps, such as your suggestion of a roundtable (**Q8**).

Yours Sincerely

Andrew

Andrew Bailey
Chief Executive