KEVIN HOLLINRAKE MP
HOUSE OF COMMONS
LONDON SW1A 0AA

Nikhil Rathi
Chief Executive
Financial Conduct Authority
12 Endeavour Square
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14 January 2022

Dear Nikhil

I am the Co-Chair of the All-Party Parliamentary Group on Fair Business Banking (the "**APPG**"), and this letter is written in my capacity as such. As you will be aware, the APPG was originally founded in 2012 to highlight the widespread mis-selling of interest rate hedging products ("**IRHPs**") to businesses, and a key part of the APPG's work involved advocating on behalf of affected individuals and businesses for the FCA (then the FSA) to investigate. We have therefore read with keen interest:

(a) John Swift QC's independent review of the FCA's supervisory intervention into IRHP mis-selling to businesses, and the establishment of the voluntary redress scheme the FCA negotiated with first-tier banks (the "**Scheme**") (which was published on 14 December 2021) (the "**Review**"); and

(b) the FCA's response to the Review, published on the same day (the "**Response**").

As you will know, those businesses who were sold IRHPs and were classified as "*retail clients*" or "*private customers*" by their bank were in the regulatory purview of the FSA at the time the products were sold, and at the time the Scheme was established. Over 10,000 sales of IRHPs to approximately 5,000 "*retail clients*" or "*private customers*" were excluded from the Scheme by the FSA, on the basis of a "*sophistication*" test, which sought to categorise and exclude victims of IRHP mis-selling based on inflexible criteria without reference to individual circumstance or factual events, and unsupported by any impact assessment. The Review has concluded – in clear terms – that the FSA was wrong to exclude these sales from the Scheme, which amounted to approximately 35% of the total sales of IRHPs that were subject to greater regulatory protection from the FSA.

The APPG is therefore concerned to note that that, notwithstanding the conclusions of the Review, by the Response the FCA has stated that it "*does not consider that the FSA was wrong to limit the scope of the redress scheme to less sophisticated customers and has concluded that it would not be appropriate or proportionate to take further action. Accordingly, the FCA will not seek to use its powers to require any further redress to be paid to IRHP customers.*"[1] The FCA has justified its position on the basis that it was entitled to differentiate between the customers who were designated as "*retail clients*" or "*private customers*". The FCA asserts that, because there were differing degrees of experience and expertise within this category of banking customers, it was appropriate to prioritise the less sophisticated customers over those who were more sophisticated and who would more likely have understood their

[1] https://www.fca.org.uk/news/press-releases/fca-publishes-swift-review-supervisory-intervention-interest-rate-hedging-products

IRHPs. However, all such customers were entitled to enhanced and equal regulatory protection under the Financial Services and Markets Act 2000 ('**FSMA**') and, as the Review concludes, the FCA's position "*does not sit well with the regulatory framework*"[2].

The APPG is concerned that the Response fails to address the conclusions reached in the Review in several material respects, and that its decision not to seek to use its powers to require any further redress to be paid to the excluded IRHP customers is flawed, for at least the following reasons:

(a) There was no need for the FSA to adopt blunt eligibility criteria which risked arbitrarily excluding some victims of mis-selling from the redress scheme. The FSA's original intention of adopting a "*sophistication*" test was to provide redress for certain "*less sophisticated*" customers of the most complex IRHPs automatically, i.e. without enquiry into the circumstances of the sale. In all other instances, it was intended that an individual assessment would determine whether an IRHP was mis-sold in each case. The FCA asserts that it departed from an individual assessment approach in order to obtain redress in a timely manner. However, in fact, two different types of individual assessment did occur in any event: (i) the FSA permitted banks to exclude customers based on a subjective assessment of customers' sophistication and ability to understand IRHPs; and (ii) a factual enquiry was undertaken in relation to the sale of less-complex IRHPs for all customers who were deemed unsophisticated. As such, case-by-case assessments were in fact undertaken even for those "*prioritised*", "*unsophisticated*" eligible customers, whereas customers who were deemed sophisticated under the test were not given the opportunity to disprove that designation, notwithstanding that the FSA's regulatory remit extended equally to both "*sophisticated*" and "*unsophisticated*" customers.

(b) The Review found that, even if it were appropriate for the FSA to distinguish between customers based on their level of sophistication, there was no basis for concluding that the blunt criteria to determine sophistication that the FSA adopted were appropriate. The criteria were based on the parameters set out in the Companies Act 2006 and had no connection to the remit of the FSA or the FSMA, which itself sets out criteria for distinguishing between customers who needed a higher degree of regulatory protection. Additional exclusions and criteria to determine sophistication were also overlaid at the banks' request. The criteria were applied to all IRHPs, regardless of the complexity of the product. In this light, the APPG is concerned that it is untenable for the FCA to assert that it is satisfied that by using these criteria, it did in fact prioritise customers based on their ability to understand their IRHPs (and that such a prioritisation exercise was acceptable at all).

(c) The FCA's continued focus on the sophistication of customers assumes that the only issue with IRHP misselling concerns the customers' ability to understand the product. It overlooks that there were a number of areas of concern, including that the banks were not selling products that were suitable for the particular customer's circumstances and that the banks' sales incentives for IRHPs were creating undeclared conflicts of interest. Where the banks have breached these obligations in respect of the customers excluded from the redress scheme, their conduct has not been subject to serious scrutiny; they have essentially been given a free pass.

(d) The language of "*prioritisation*" is apt to misdescribe. It gives the impression that the Scheme merely put smaller customers first in the queue, ahead of larger customers. In reality, the FSA obtained redress for some customers who came within the eligibility criteria, but effectively bargained away the regulatory protections afforded to other customers entirely, excluding them from any effective remedy and handing the banks impunity in respect of those cases.

(e) The consequences of FCA's conduct were, in many cases, extreme. The inability of those customers to seek redress through the Scheme left many with no remedy at all. Livelihoods were lost, businesses built up over

[2] P319, https://www.fca.org.uk/publication/corporate/independent-review-of-interest-rate-hedging-products-final-report.pdf

many years were destroyed, and lives were ruined. The APPG is in contact with many victims of IRHP mis-selling who were excluded from the Scheme by virtue of being deemed "*sophisticated*": the pain and suffering they have endured continues to this day, and the possibility of obtaining redress following the publication of the Review could have positive, life-changing effects.

(f) Access to justice for bank customers like those who were excluded from the Scheme remains a live issue. The APPG has worked extensively with all stakeholders, including the FCA, to establish the BBRS and, as you know, the FCA is currently undertaking a consultation (CP21/13 and CP21/36) in relation to the establishment of a new consumer duty, owed by FCA regulated firms to "*retail clients*". These are welcome developments on the issue of future access to justice. However, the relevant protections and access to justice for those customers excluded from the Scheme existed at the time it was established; the issue appears to be that they were denied protection and access to justice purely because of failures by the FSA, as identified by the Review.

Whatever pressures affected the FSA's decision making – rightly or wrongly – in 2012, it is now aware that (i) the eligibility criteria cannot be assumed to have correctly achieve its objective of distinguishing between customers based on their degree of sophistication; and (ii) permitting an individual assessment of customers' cases was not a material barrier to timely redress.

With these points in mind, on behalf of the APPG I therefore ask the FCA to reconsider its decision by the Response not to investigate the treatment of the customers excluded from the redress scheme, and not to seek to use its powers to require any further redress to be paid to such IRHP customers.

Should the FCA decline to do so, the APPG is keeping under consideration the filing of a judicial review application, and in this regard has instructed solicitors at Hausfeld & Co LLP and Leading Counsel to advise.

Having regard to the time periods applicable to Judicial Review proceedings, we request that we receive the FCA's reply as soon as possible, and in any event by 28 January 2022. Please note that we will be placing this letter, and any reply, in the public domain.

Yours sincerely

Kevin Hollinrake MP
Co-chair, APPG on Fair Business Banking