

Kevin Hollinrake MP  
Chair, APPG on Fair Business Banking  
House of Commons  
London  
SW1A 0AA

31 January 2022

Our Ref: C220128A

Dear Kevin

### **INTEREST RATE HEDGING PRODUCTS (IRHP)**

Thank you for your letter of 14 January 2022 addressed to Nikhil Rathi. You raise a number of points and "*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*". I am the Accountable Executive for the IRHP independent review and am responding on behalf of the FCA. I have copied this letter to the Co-Chairs of the APPG on Fair Business Banking and to the Clerk of the Treasury Select Committee.

As you note, in our response to the IRHP independent lessons learned review (the Swift Report), we explained that we do not agree that the FSA was wrong in limiting the scope of the Scheme to less sophisticated customers and that, in any event, it was not appropriate or proportionate for the FCA to take any further action. Accordingly, the FCA decided that it would not seek to use its powers to require any further redress to be paid to IRHP customers.

We have carefully considered the points raised in your letter. In short, we do not consider that the letter raises any material points that were not considered by the FCA when making its decision. The FCA does not, therefore, intend to reconsider its decision. Please note that the FCA's Board has seen your letter and approved this approach.

#### *The Scheme and the Review*

As you know, the IRHP redress scheme (the Scheme), agreed in 2012 and 2013, was a voluntary scheme entered into by (ultimately) 9 banks. As a result of this significant intervention by the FSA, around 14,000 offers of redress were accepted by thousands of customers, amounting to £2.2 billion.

The review carried out by John Swift QC was extremely thorough. It found that the Scheme delivered fair outcomes overall for those customers within its scope, that most of those

customers obtained redress that was in all likelihood 'better' from their perspective than any outcome they could have achieved outside the Scheme, and that the FSA/FCA's intervention was thus of significant direct benefit. However, the review also contained important findings that there were significant weaknesses in the processes adopted and it made important recommendations to the FCA for the future. We accepted nearly all of those recommendations, set out our detailed commitments in response to them and will report regularly on our progress.

Importantly, the terms of reference of the review made clear that it was "not intended to be a route by which the redress scheme can be re-opened", and the Swift Report did not suggest this should be the case.

Nevertheless, on 30 September 2021 the FCA Board gave careful consideration to the findings of the Swift Report (which it saw in near final form) and the question of whether the FCA should seek to use its powers now to require any further redress to be paid to IRHP customers. The FCA Board decided that the FCA should not do so. The reasons are set out in section 4 of the FCA's published response to the Swift Report, repeated at point 7 below.

We note that it is nearly ten years since the FSA made its key decisions about the nature and scope of the scheme and 9 years since the eligibility criteria were finalised. Those decisions were widely discussed, with some stakeholders expressing reservations about them at the time, and the eligibility criteria expressly challenged (unsuccessfully) in judicial review proceedings.

#### *The reasons for our decision*

The majority of the points in your letter set out why the APPG consider that the FCA was wrong to confine the scope of the Scheme to 'non-sophisticated' customers. We recognise that the Swift Report concluded that this was this case. However, as set out in our response to the Swift Report, and for the reasons given there, we believe that the decision to treat sophisticated and non-sophisticated customers differently was justified. The Board was aware of the near final review findings and recommendations at the time it made its decision. As set out above, we do not consider that your letter raises any material points that were not considered by the FCA when making its decision. However, we have set out below our key points in response to your letter, focusing on the reasons why we consider the scope of the Scheme was justified.

1. 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. Many small and medium enterprises (SMEs) were struggling in difficult economic conditions. However, the FSA had a limited knowledge base at the time in respect of IRHPs. A full investigation into the facts and circumstances of each bank's sale of IRHPs was likely to take longer than many of the potentially affected SMEs were likely to survive without intervention by the FSA. Instead, the FSA acted with pace to secure a voluntary agreement with the banks to pay redress in accordance with the terms of the Scheme. As the Swift Report notes, in taking the 'bird in the hand' approach of the agreed voluntary scheme (p305, para 23), the FSA gained an advantage for the customers included within it.
2. The FSA's approach sought to direct redress as quickly as possible to those businesses which were in the most vulnerable circumstances because they were the least able to assess the products the banks sold them and faced more acute financial difficulties. If the FSA had

insisted that a voluntary scheme should include all Private Customers/Retail Clients, there was a significant risk that a scheme including all Private Customers/Retail Clients would not have been agreed, which would have meant that the 'bird in the hand' would have been lost and thousands of vulnerable SMEs would not have received redress in the time frame in which they did, or at all (ultimately, around 14,000 offers were accepted).

3. The dividing lines, from that perspective, between who should and should not have been included in the Scheme were difficult for the FSA to draw and complex, as we have acknowledged. However, we do not consider that the distinction between sophisticated customers and those within the terms of the Scheme was drawn arbitrarily or inconsistently as you suggest. Whilst we recognise that the FSA's regulatory remit and conduct of business rules extended to both the "sophisticated" and "unsophisticated" customers, that does not lead to a conclusion that the FSA was (or the FCA is) bound to regard all customers in the same way or as requiring the same degree of protection. Under FSMA, the FSA was obliged to assess what it considered to be an 'appropriate' degree of protection, taking into account several factors including the differing degrees of experience and expertise that different consumers may have had. The FSA's decision was in accordance with this approach and it was not unreasonable for it to agree a voluntary scheme for only the unsophisticated SMEs within the Private Customer/Retail Client class, given the 'bird in the hand' benefits identified by Mr Swift.
4. Instead, it was reasonable and appropriate for the FSA to judge, as it did, that some customers were more sophisticated and would have likely understood the key features of IRHPs, or able to access relevant expertise and skills to help them understand and appreciate those aspects; and that any redress scheme for IRHP should prioritise, and if appropriate be limited to, less sophisticated customers, so as to secure more timely redress for them, especially given the urgent or dire financial circumstances many of them faced. In our view, the sophistication criteria helped establish a workable and timely scheme that enabled the banks readily to identify customers who should be within the scope of the Scheme and to enable redress, where appropriate, to be provided more quickly to them. Customers whose sales were assessed as sophisticated were able to ask the bank and its skilled person to reconsider that assessment and could provide submissions or evidence to support that reconsideration; and the statuses of some cases were changed as a result.
5. Those excluded from the Scheme were no worse off than if the FSA had not acted at all, and no rights or obligations owed to them were bargained away or lost. They remained able to pursue their grievances and seek redress through existing complaint-handling channels which each bank was obliged to provide to customers including, where applicable, under the Financial Ombudsman Service's jurisdiction. The existing complaint-handling channels were appropriate for those customers who considered they were wrongly classified. They were also entitled to pursue litigation and a number of customers did so. So it is not the case that those who were outside the Scheme were left without recourse or remedy.
6. However, we do deeply regret that small business customers suffered risk, financial loss, and anxiety. Some were small trading businesses which were the lifetime's work of their owners or of generations of family members. Others were businesses carrying out more complex financial or property transactions, sometimes as part of a larger network of companies. As the APPG will recognise, it was the weaknesses in the banks' product design, product governance, incentives, and sales controls which led to poor selling practices for

these complex derivatives; and which ultimately led to customers' losses, which were worsened (or caused) by the economic effects of the global financial crisis. We accepted in our response to the Swift Report that going forward we should regulate more proactively to prevent harm to consumers as well as taking remedial action after harm has occurred.

7. As noted, at the end of September 2021 the FCA Board carefully considered, in light of the Review's near final draft findings and taking in to account all material matters, whether it was appropriate and proportionate to take any further action, but concluded that we should not take any such action and that, accordingly, the FCA should not seek to use its powers to require any further redress to be paid to IRHP customers. We set out the reasons for this decision in paragraphs 4.3 and 4.4 of our public response to Mr Swift's report, which we repeat here for your ease of reference:

*"4.3 First, and most important, as we have explained (3.21-3.28), we do not agree that the FSA went wrong in limiting the scope of the Scheme to less sophisticated customers within the Private Customer/Retail Client class. Notwithstanding the shortcomings in processes and governance which we have acknowledged, we consider that this was a reasonable approach, given the FSA's regulatory aim of providing swift and certain redress to those who were in the most vulnerable circumstances among that varied customer base. We consider that the FSA thereby provided appropriate protection to all the various customers involved, including the more sophisticated, who remained able to pursue mis-selling allegations and claims for redress against the banks through complaint routes outside of the Scheme and by litigation.*

*4.4 Secondly, and in any event, we consider that it would not be appropriate or proportionate for us to take further action now. The Scheme was entered into by the FSA and the banks by voluntary agreement in good faith at the time and the regulator set out the entirety of the steps it required the banks to take (beyond operating their normal complaints channels and responding to court claims) to ensure they paid redress to mis-sold IRHP customers. We have never suggested we would seek to extend the Scheme, or take further steps, to include or assist the excluded customers. Doing so now would also make it harder for us to agree other voluntary remediations with firms in future, which would hamper our ability to resolve issues swiftly and require more formal action more often, with the delays and resource burdens that would bring."*

## **Conclusion**

You ask us now to reconsider that decision not to take further action.

However, having carefully considered the points in your letter, we have concluded that your letter does not raise any material points that were not considered by the FCA when making its decision not to exercise its powers to require further redress to be paid to IHRP customers. The FCA does not, therefore, intend to reconsider that decision.

I appreciate that this will be a disappointment to the APPG and those it represents but trust that our reply above helps explain our reasons. I can assure you that, as the successor body to the

FSA, we are ensuring that we continue to learn the lessons from this especially large and complex voluntary redress scheme.

Please note that we are publishing this response today.

Yours sincerely

**Mark Steward**  
**Executive Director**

cc: Co-chairs, APPG on Fair Business Banking  
(William Wragg, Kate Osborne and Bim Afolami)

Clerk of the Treasury Select Committee