

## Prudential Regulation Authority

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London  
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Dear Mr Hollinrake

Thank you for your letter dated 7<sup>th</sup> October 2022 on behalf of the APPG on Fair Business Banking. This response is provided on behalf of both the FCA and PRA (the Regulators). For ease, we have adopted the definitions used in your letter.

As you note in your letter, the failure of HBOS and the accountability of HBOS senior management for the failure is a matter of acute public interest and a focus for the Regulators. In that light, we understand the closure of the investigations without enforcement action in relation to any additional HBOS individuals gives rise to legitimate questions. To the extent possible, we have sought to answer each of your questions below.

Before answering the detail of those questions, we thought it would be helpful to provide additional context on: (i) the limited powers available to the Regulators in

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relation to the subjects of the Regulators' investigations; and (ii) the legal constraints and legitimate procedural safeguards which apply.

### **Enforcement powers available to the Regulators given the passage of time**

The Green and TSC Reports concluded that the FSA's decision not to investigate additional HBOS senior managers in relation to the failure of HBOS was not reasonable.

In 2016, as recommended by the Green Report<sup>1</sup>, the Regulators conducted further analysis and, following application of the Regulators' respective investigation referral criteria, decided to open joint investigations into certain former HBOS senior managers in the period September 2001 to October 2008 (when HBOS requested Emergency Liquidity Assistance from the Bank of England).

However, as the Green Report acknowledged<sup>2</sup>, given many years had already passed since the failure of HBOS, the Regulators no longer had the full range of enforcement powers at their disposal. Due to time limits imposed under the Financial Services and Markets Act 2000 (FSMA)<sup>3</sup>, the Regulators were unable to consider *disciplinary* proceedings for past misconduct. Indeed, the only option available to the Regulators was to investigate in order to establish whether or not certain former senior managers at HBOS should be subject to a prohibition order which would prevent them from performing certain roles within the financial services industry in the future.

When considering the Decision (noting that there were separate decisions by the PRA and FCA in respect of each individual subject investigated by the Regulators, but for ease we shall refer to 'the Decision' as you have), the distinction between prohibition proceedings and disciplinary proceedings is important. As noted, disciplinary proceedings concern whether a person is guilty of misconduct and should therefore face a penalty or be publicly censured whereas a prohibition order is protective, not punitive, and the central question to be considered is whether the individual is fit and proper to perform specified functions in the future on the basis of their honesty, integrity and reputation; competence and capability; and financial soundness. It involves a wider consideration of all relevant circumstances (including for example recent professional experience, insights, reflections and lessons learned).

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<sup>1</sup> See paragraphs 343 – 345 of the Green Report

<sup>2</sup> See paragraph 329 of the Green Report

<sup>3</sup> Sections 66(4) – 66(5ZA) FSMA. At the time, the limitation period was two years, so would have expired in 2010. Although not retrospective, the limitation period has since been increased to six years.

### **Procedural safeguards in contested enforcement cases**

Before the Regulators can take enforcement action they must conduct a thorough investigation and follow the statutory notice process prescribed by Parliament in Part XXVI of FSMA. That process rightly contains a number of procedural safeguards.

First, the Regulator must decide whether or not to give a “Warning Notice” to the subject of investigation. Any Warning Notice is confidential and must set out the proposed action and the reasons for that proposed action. When a Warning Notice is issued, the Regulators can, in certain circumstances, issue a public ‘Warning Notice statement’ giving some high-level details about the proposed action. However, a Warning Notice statement is not permitted in relation to prohibition cases. FSMA also specifically prohibits the publication of any Warning Notice, rendering it impossible to issue any interim statement or Warning Notice in relation to prohibition cases.<sup>4</sup>

The subject of an issued Warning Notice may, by right, make representations on the matters contained therein. Having heard the subject’s representations on a Warning Notice, the Regulator can then either issue a Decision Notice setting out the enforcement action taken and the reasons for it or decide not to take action. If a Decision Notice is issued, the subject can then either accept the enforcement action taken, which will result in a published Final Notice, or refer the matter to the Upper Tribunal which then leads to a full judicial process, in public, with a public judgment delivered at the conclusion of the proceedings.

Thus, in the interests of natural justice, the statutory notice process appropriately safeguards the individual’s right to privacy until such time as the Regulators have decided to take enforcement action *i.e.*, after the point when a Decision Notice is issued.

### **Decision-making in contested enforcement cases**

Pursuant to section 395 of FSMA, Parliament has imposed on the Regulators specific requirements to design its procedures for taking decisions to issue Warning and Decision Notices in enforcement cases which are contested, in such a way as to ensure objectivity and fairness.

Consistent with section 395 FSMA, the Regulators have each established a separate, and independent decision-making committee – the Regulatory Decisions Committee (RDC) at the FCA and the Enforcement Decision Making Committee (EDMC) at the

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<sup>4</sup> Section 391(1ZA) FSMA

PRA. Both of these committees are part of the respective Regulators' enforcement decision-making frameworks, but are entirely distinct and independent of the Executive.<sup>5</sup> Decision-making in contested Enforcement cases has been transferred in entirety to these committees by the Executive at the Regulators. In making their decisions, the committees have distinct, individual procedures. The RDC follows procedures which are set out in the FCA Handbook (in the Decision Procedure and Penalties Manual at DEPP 3) and the EDMC follows procedures which are set out in *Procedures – The Enforcement Decision Making Committee (April 2018)*, published on the Bank of England website.

The EDMC is chaired by Sir William Blair, a former High Court Judge, and the RDC is chaired by Mr Tim Parkes, a very experienced commercial litigation solicitor. Other than Mr Parkes who is an FCA employee, none of the committee members are employees of the Regulators. Neither the PRA nor the FCA can themselves “appeal” a decision of the EDMC or the RDC since in legal terms, the decisions made by these committees are attributed to be ultimately the decisions of the Regulators.

In line with the need to ensure procedural fairness to the subjects, the EDMC and RDC process is conducted in private.

**Question 1: The date (or dates) when the Decision was made**

The Decision was taken on 25 August 2022.

The EDMC and RDC communicated the Decision to the subjects of the investigations and relevant Executives at the PRA and FCA on 25 August 2022, following extensive consideration of whether enforcement action was appropriate and proportionate.

Having announced the commencement of these investigations, it was incumbent on the Regulators to also announce the outcome of the investigations. Each subject was provided with a copy of the public statement and given 24 hours' notice of the fact it would be published on the Regulators' websites. We therefore made the public statement referred to above on 26 August 2022. Very careful consideration was given to the content of the public statement in order to ensure compliance with the statutory regime under which the Regulators operate.

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<sup>5</sup> In formal terms, the RDC is a committee of the FCA Board and the EDMC is accountable to the Bank of England's Court of Directors.

## Question 2: Reasons for the Decision

Where the EDMC and RDC decide against taking enforcement action, either because they decide not to issue a Warning Notice or they decide not to issue a Decision Notice, their decision-making and details of their considerations remain confidential. The committees do not produce a public judgment detailing their decisions in the way that a Court or Tribunal would.

In contested enforcement cases, where the EDMC and RDC has decided not to issue a Decision Notice, FSMA requires the Regulators to give the relevant subject a confidential written notice of discontinuance. No reasoning is provided to the subject of the investigation. In such cases, the Regulators may not publish any information about the matter to which the discontinued proceedings relate without the consent of the subject and any publication must not be unfair to the subject<sup>6</sup>. The transparency permitted in relation to contested enforcement cases that do not result in a Decision Notice has therefore been determined by the statutory regime which must be observed by the Regulators.

We are not, therefore, able to provide reasons for the Decision. It is important to note, however, the following key points in relation to the Decision:

- First, and as noted above, the Committees were only considering whether a prohibition was appropriate. A prohibition requires more than an individual's conduct being worthy of criticism or censure. It requires a finding that an individual is not fit and proper today i.e. poses a present and future risk to the public today; it is a forward-looking question, not just a backwards-looking assessment.
- Second, where the Committees' judgment required an assessment of the individual's conduct at the relevant time, it was rightly judged by reference to the relevant standards of the time, namely across 2001-2008, without the application of hindsight and on the basis of contemporaneous information.
- Third, due to the FSA's earlier decision not to investigate, a large period of time had passed since the failure of HBOS. This had implications for the availability of contemporaneous documentation. While there was a vast amount of material for the Regulators to consider, including some two million documents, there were some gaps due to the appropriate application of document retention policies.

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<sup>6</sup> S. 391(2) and (6A)(a) FSMA

We also note that since the failure of HBOS, fundamental changes have been made to the regulatory regime. In particular, the introduction of the Senior Managers and Certification Regime in 2016 has embedded greater individual accountability by ensuring authorised firms allocate clear responsibilities to key decision-makers.

**Question 3: The persons who made the Decision**

As set out in our public statement dated 26 August 2022, the Decision was taken by the EDMC (chaired by Sir William Blair) and the RDC (chaired by Tim Parkes).

**Question 4: The factual materials considered by those persons**

As set out in the public statement dated 26 August 2022 referred to above, the Regulators conducted rigorous and forensic investigations into whether prohibition orders were appropriate. In the course of these investigations, the Regulators gathered more than 2 million documents, interviewed former HBOS senior managers, engaged extensively with the parties, and undertook substantial analysis of contemporaneous documentary evidence considering those senior managers' roles and responsibilities at HBOS prior to its failure in 2008.

The independent EDMC and RDC extensively reviewed the matters under consideration and decided not to impose prohibition orders in respect of the subjects of the investigation.

**Question 5: Whether delaying the Decision to consider the findings of Dame Linda Dobbs DBE (the Dobbs Report) was considered, and if so, to what extent**

As you rightly point out, the Dobbs Report will focus on the period following HBOS's acquisition by Lloyds Banking Group (LBG) in January 2009, with some consideration of matters prior to 2009 to the extent they inform what LBG knew or should reasonably have known about the HBOS Reading fraud at the time of its acquisition of HBOS. However, the Dobbs Report is not intended to address what HBOS senior management knew or any failings by HBOS senior management in connection to the fraud. The likelihood of direct relevance to the investigations carried out by the PRA and FCA is therefore low. This is especially so in light of the FCA's prior investigation relating to HBOS Reading leading to the action taken against Bank of Scotland plc in June 2019.

We also note from public announcements by Dame Linda that the work towards the Dobbs Report continues. To await this report and consider its findings before progressing to decision-making at the PRA and FCA would have likely added several years to decisions being made. Given the peripheral overlap with our investigations, it would have been disproportionate to await the publication of the Dobbs Report, and –

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crucially – would have been inappropriate and wholly unfair to the individuals under investigation.

**Question 6: The process for and costs of the investigations that led to the Decision**

The process of the investigation has been outlined above, as has the process of decision-making at the Regulators.

The cost to the Regulators of the HBOS investigations is estimated at £7,238,000. This includes both Regulators' internal and external costs. The internal costs cover the cost of the permanent FCA and PRA staff engaged on this matter and then the separate costs of the independent committees, the EDMC and RDC. The external costs, which equate to £2,711,622, include expenditure on external legal counsel, external forensic accountants and external contractors to assist with the investigation.

We appreciate that is a material figure. However, given the significant public interest in these matters, it was appropriate that the Regulators devoted considerable resources to a thorough examination of the issues and deliberation through the relevant decision-making committees.

We have striven in our response to provide the information requested to the fullest extent possible, subject to the statutory prohibitions outlined above. Accordingly, we consider that the above explanations suffice to stand as a full and final substantive response.

Yours sincerely



**Sam Woods**  
Deputy Governor and CEO



**Nikhil Rathi**  
CEO