CASE NO: AC-2022-LON-001500

IN THE HIGH COURT OF JUSTICE
KING'S BENCH DIVISION
ADMINSTRATIVE COURT
BETWEEN:

THE KING
on the application of
THE ALL-PARTY PARLIAMENTARY GROUP ON FAIR BUSINESS BANKING
Claimant

-and-

THE FINANCIAL CONDUCT AUTHORITY

Defendant

REPLY TO DETAILED GROUNDS OF DEFENCE

I. INTRODUCTION AND SUMMARY

1. This is the APPG's Reply to the FCA's Detailed Grounds of Defence ('**DGD'**).

2. The APPG joins issue generally with the DGD, but here seeks briefly to show why the FCA is wrong to contend that the APPG's challenge is an abuse of process, wrong to contend that the Decision was rational and procedurally fair and wrong to contend that it is highly likely that the outcome would not have been substantially different if the conduct complained of had not occurred (and why in any event it would be appropriate to require the Decision to be retaken lawfully).

3. Defined terms used in the Amended Statement of Facts and Grounds ('**ASFG**') are adopted here. Permission to bring this claim, on both grounds advanced in the ASFG,

was given in the judgment of Mr Justice Fordham dated 29 June 2023 ('**the Permission Judgment**').

II. DUTY OF CANDOUR

4. The disclosure of documents by the FCA in this case, pursuant to the duty of candour in public law proceedings, has been piecemeal, incomplete and in significant part merely responsive to pressure from the APPG. Around 2,300 pages have been disclosed since the Permission Judgment. Among other things, these reveal more about how the FCA, having the advantage of sight of the Review in draft, and conscious that its publication would be likely to provoke representations in favour of action by the FCA to assist Excluded Customers, decided to publish the Decision as a *fait accompli* on the same day the Review was published, thereby ensuring in practice that the Decision could be taken before representations based on consideration of the Review could be made.

5. As at the date of this Reply, the APPG continues to press the FCA for candid disclosure, and the APPG reserves the right to seek to introduce further evidence or submissions in the light of whatever this pressure produces.

III. ABUSE OF PROCESS?

6. In its Summary Grounds of Defence (at paras. 5 and 32 to 39), the FCA took the "*preliminary objection*" that the claim is an "*[i]mpermissible challenge to decisions taken in 2012 and 2013*". The objection was that "*[i]n reality, this claim is a challenge to the decisions taken in 2012 and 2013 when the FSA agreed to establish the IRHP Redress Scheme*" (para. 32), it being far too late to make such a challenge.

7. This objection appears to be rehearsed again at para. 6 of the DGD, where, under the heading of "*Abuse of process*", it is said that the claim "*depends on repeated allegations that the FSA/FCA acted unlawfully in 2012/2013 in entering into the agreements which established the IRHP Redress Scheme*" and that "*the Decision does not provide proper grounds for impugning decisions that ought to have been challenged many years ago, if they were to be challenged at all*".

8. This is not permissible. The Court considered and rejected the abuse of process argument in the Permission Judgment (at para. 17):

> "*In my judgment, the delay and collateral challenge (or abuse of process) points are bad ones. The question of taking action was specifically considered, as is reflected in the Response (§4.1). There was a decision on that (§4.2), as a public authority. That, says [the FCA], was a choice. So was convening the Independent Review. It was a decision taken in light of the changed circumstances of the Report and its reasoning. It was, properly, addressed notwithstanding the Terms of Reference (§4.1). This claim is one whose viability depends on whether the [APPG] can satisfy the Court that the December 2021 decision of the [FCA] – in light of its reasons and in the context of the Report – was itself an unlawful decision. If such a claim – with its target decision – lacks viability, permission would stand to be refused on grounds of non-arguability. But if the claim is arguable, I cannot see how there can be any justification in shutting it out on delay, collateral challenge or abuse of process grounds.*"

9. The question of whether the APPG's claim is an abuse of process has accordingly been determined in the APPG's favour. It cannot be considered further.

10. Alternatively, if, which is denied, it remains open to the FCA to contend that the Court should reject the claim as an abuse of process, the contention is a bad one for the reasons given by the Court in the Permission Judgment, namely that the claim is properly characterised as a timely challenge to the Decision, which was a fresh decision taken in 2021, not as an untimely challenge to decisions taken in 2012 or 2013.

11. The APPG is in these circumstances entitled to contend that the adoption of the Sophistication Test was unlawful. But its case does not depend, as the FCA suggests in support of its "*abuse of process*" objection, on establishing such unlawfulness. The APPG's case is simply that, in the light of the Review's conclusion that the FCA had been *wrong* (whether within the boundaries of legality or not) to exclude the Excluded Customers from the Scheme by the application of the Sophistication Test, and in the light of the reasons given in the Review for that conclusion, the FCA acted irrationally and thus unlawfully in coming to the Decision, i.e. in deciding not to take action to seek to procure belated redress for the Excluded Customers.

IV. FACTUAL BACKGROUND

(i) The Sophistication Test

12. Paras. 19 to 22 of the DGD set out the FCA's justification for the Sophistication Test, which is largely a repetition of the matters set out at paras. 4.4 to 4.14 of the Board Paper and paras. 3.21 to 3.28 and 4.3 of the Response to the Review. It is notable that:

    12.1. The FCA has not disclosed contemporaneous documentary evidence in relation to the rationale behind the Sophistication Test (in so far as there was one) or the internal process by which it was devised. It appears that the FCA did not make or retain records evidencing the decision-making in relation to the Sophistication Test. The significance of this is addressed further below.

    12.2. Notwithstanding the lack of documentary evidence, the FCA does not offer any first-hand evidence from individuals such as Martin Wheatley, who were at the time within the FCA and were involved in the decision-making in relation to the Sophistication Test. These persons would be able to speak to the rationale for the Sophistication Test and the process by which it was arrived at.

    12.3. The FCA has not served evidence from any of the Redress Banks or HM Treasury in relation to the role they played in formulating and agreeing the Sophistication Test, or any documentary evidence relating to the communications between the FCA and the Redress Banks or HM Treasury[1]. Instead, the FCA makes a bare denial that it acted at their behest (and has, to date, refused to give disclosure in relation to its relationship with the Redress Banks and HM Treasury): see para. 35 of the DGD. In the light of the findings of the Review that the arbitrary notional threshold was introduced by HM Treasury (see para. 56.2 of the ASFG), the lack of any explanation or evidence from the FCA to support its bare denial that it acted at the behest of HM Treasury gives rise to an inference that the Sophistication Test was agreed, at least in part, on the instructions of HM Treasury.

[1] This is despite the FCA apparently being in control of such documents, as shown by e.g. para. 59 of Chapter 4, page 165 of the Review, which describes and cites an email from Barclays Bank plc to the FSA dated 5 November 2012 in relation to the Initial Sophistication Test.

12.4. The FCA made the points it now makes about the Sophistication Test in its representations to Mr Swift: see e.g. paras. 1.3 to 1.7, 2.4 to 2.7, 3.17 to 3.29 of the FCA's first set of representations. These arguments were all considered by Mr Swift and his team in reaching the conclusions set out in the Review.

13. As a result of the FCA's failure to produce any contemporaneous documentary or witness evidence in relation to how and why the Sophistication Test was agreed, the Court is asked by the FCA in these proceedings to find that the decision to agree to the Sophistication Test was rational, reasoned, evidence-based and objectively justified on the basis of the FCA's own assertions and beliefs rather than on the basis of any evidence that compels that conclusion.

(ii) Response to the Review

14. The FCA seeks to downplay the Decision to reject the Review's findings in relation to the Sophistication Test by stating that it "*accepted nearly all of Mr Swift's recommendations*": DGD at para. 29. However, the appropriateness and suitability of the eligibility criteria for the Scheme, and the process by which the criteria were arrived at, were central issues dealt with in the Review. One of the four questions in the Terms of Reference[2] was concerned exclusively with the eligibility criteria and the issue also featured heavily elsewhere in the Review. Further, an internal FCA document described the anticipated conclusion in relation to eligibility as "*the most serious finding*"[3]. The rejection of the Review's findings in relation to the eligibility criteria for the Scheme therefore represents a very significant rejection by the FCA of the work and conclusions of Mr Swift and his team.

15. Further, it is clear from the facts pleaded by the FCA in Section D of the DGD and set out in the witness evidence filed with the DGD that the decision not to take action to procure redress for the Excluded Customers, and not to consult affected persons on the possibility of doing so, was taken within the FCA long before either publication of the Review or the taking of the formal Decision. In particular:

[2] Question 2, page 316 Review.
[3] [MB1/1032-1047].

15.1. A meeting took place between the FCA and Mr Swift on 3 March 2021, following which it was recorded in an internal FCA Board Sub-Committee paper dated 18 March 2021 that:

> "*The Independent Reviewer noted in the meeting on 3 March 2021 that it is for the FCA to consider if it accepts his findings on eligibility that the FCA may wish to remediate itself. It is likely that if the Independent Reviewer does not accept the FCA's representations on eligibility and inconsistent outcomes and there is no further redress from the banks, impacted SMEs will look to the FCA either through the Complaints Scheme or legal action. It is worth highlighting that the level of redress delivered from the 2012 intervention is approximately four times the FCA's annual budget. Another relevant factor would be the FCA's statutory immunity*."[4]

15.2. On 30 March 2021, in its first representations to Mr Swift on receiving a draft of the Review, the FCA stated that it did not agree that the FSA had been wrong to confine the scope of the Scheme as it did[5]. The APPG notes in this regard that the FCA successfully sought to persuade Mr Swift to remove from the Review his finding – which was included in the first draft of the Review – that the FCA had breached its regulatory mandate by distinguishing between "Sophisticated" and "Non-Sophisticated" customers[6].

15.3. On 20 May 2021, the FCA stated in an internal minute that its Executive Committee was "*firmly of the view*" that the decision of the FSA to exclude "*sophisticated customers*" "*had been reasonable*"[7].

15.4. On 9 June 2021, the FCA's Julian Watts suggested to the FCA's David Geale and Pritheeva Rasaratnam that there might be consultation before deciding whether "*to use any of our statutory tools now concerning the excluded customers*", since this "*would be doing (belatedly) what Swift says the FSA ought to have done and is transparent*" and "*also maximises our chances of gathering in and considering all relevant arguments for and against.*" Ms

[4] [MS1/1082].
[5] [MS1/822].
[6] See para. 30(c) of the DGD.
[7] [MS1/1158].

Rasaratnam replied that her initial view was against this idea since it would cause uncertainty:

> "*I think we have a duty to consider all the relevant considerations* [words redacted] *before reaching a final decision, but I don't think that we need a consultation for that purpose. We would be leaving open the option that we may in fact need to reopen the Scheme some months down the line, which will amongst other things create a lot of uncertainty in the market. If we genuinely think we have good reasons not to reopen the Scheme (and can justify that* [words redacted]*), I don't think a consultation is necessary*"[8].

15.5. On 10 June 2021, the IRHP Review Sub-committee noted that the Review "*was likely to trigger calls for redress for those customers that had been excluded*" and that it "*would therefore be important to develop an appropriate strategy for preparing a timely answer to such calls*"[9].

15.6. The IRHP Review Sub-committee agreed on 15 September 2021 that "*the reasons not to seek to compel redress from the banks for sophisticated customers outweighed the reasons in favour*"[10].

V. GROUND 1: IRRATIONALITY

(i) Ground 1(i) – Irrational to reject the findings of the Review concerning the Sophistication Test

16. As already noted (see above at para. 11), it is a fallacy to suggest, as the FCA apparently does at para. 34 of the DGD, that the APPG's claim depends on showing the adoption of the Sophistication Test to have been unlawful. It suffices that the Review showed that the Sophistication Test had wronged many businesses by placing them into the class of Excluded Customers, and that the FCA's response to the Review's finding to that effect was irrational.

17. As to the test for irrationality, the FCA quotes (at DGD, para. 34) Lord Diplock's reference in *Council for the Civil Service Unions v Minister for the Civil Service* [1985]

[8] [DG1/9].
[9] [MS1/1198].
[10] [DG1/56].

A.C. 374 at 410 to an irrational decision as one that is "*so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question could have arrived at it.*" But the Court will know that the bar is not always set so high or described so colourfully: compare Sedley J's observations in *R v Parliamentary Commissioner for Administration, ex p Balchin* [1998] 1 P.L.R. 1, 13E-F:

> "*[the claimant] does not have to demonstrate […] a decision so bizarre that its author must be regarded as temporarily unhinged. What the not very apposite term 'irrationality' generally means in this branch of the law is a decision which does not add up - in which, in other words, there is an error of reasoning which robs the decision of logic.*"

18. Mr Justice Fordham noted in the Permission Judgment (at para. 21):

> "*It is arguable, in my judgment, that the Authority's decision not to accept the finding of the Independent Reviewer on the wrongfulness of the eligibility criterion cannot withstand reasonableness scrutiny, including as to legally adequate reasoning, grappling with the Independent Reviewer's analysis in a decision which 'adds up', free of error of reasoning robbing the decision of logic. These points arise in a particular context of having set up an Independent Review to report on the lessons to be learnt, with the value of the identified independence and expertise. The Independent Reviewer's decision is not said by the Authority to have been unreasonable or unlawful. One question is whether to 'depart' from it on the basis of a merits-disagreement is a course which satisfies contextually-applicable standards of common law reasonableness. Another question concerns the nature of the Independent Reviewer's reasoned conclusions, and then an analysis of the nature and cogency of the reasons of the Authority, applying a reasonableness test and the standard of legal adequacy of reasons.*"

19. The APPG suggests, with respect, that Mr Justice Fordham here properly captured the questions before the Court and the approach that ought to be adopted in answering them.

20. The FCA sets out between paras. 35 and 38 of the DGD four grounds upon which it contends it was rational to reject the findings of Mr Swift that are summarised at paras. 65 to 78 of the ASFG. The APPG replies to each of these below.

21. The <u>first</u> and <u>fourth</u> arguments amount to a restatement of the FCA's justification for agreeing to the Sophistication Test in 2012 / 2013 that, as noted above, is a repeat of

what was said by the FCA in the Board Paper, the FCA's representations to Mr Swift and in its Response to the Review.

22. As noted above, the FCA accepts that it does not have evidence that explains the process by which the criteria in the final iteration of the Sophistication Test were arrived at: DGD, para. 35(c)(i). Indeed, an internal document produced by the FCA's Risk and Compliance Oversight division (the division of the FCA with responsibility for the day-to-day conduct of the FCA's work on the Review), which analysed the evolution of the Sophistication Test with reference to FCA documents, records that "*I have been unable to locate any analysis carried out at the time the agreements were formulated as to why a sophistication test was required, other than that it was believed unsophisticated customers would be unlikely to understand structured collars*"[11] and "*there is no record (assuming the exercise was completed) of any analysis of the decision to apply the sophistication test to Category B & C business. It was this decision that created a sub-set of retail customers that were ineligible to take part in the Review*"[12]. Further, as set out at para. 84A of the ASFG, the FCA has also internally conceded that it is unable to dispute the facts as Mr Swift found them to be. It is therefore wholly unclear on what basis the FCA satisfied itself, in deciding to reject Mr Swift's findings in relation to the Sophistication Test, that its decision to agree to the final iteration of the Sophistication Test was – in the light of the findings of Mr Swift – reasoned, based on evidence and objectively justified, as the FCA accepts its judgements were required to be.

23. The FCA seeks to justify the Decision in broad terms on the basis that the Sophistication Test was a necessary compromise in order to prioritise securing redress for the most vulnerable customers from banks when it was in a relatively weak bargaining position. In fact, the Review found that the Sophistication Test's exclusionary criteria were introduced after only the briefest consideration, with no impact assessment, and no evidence that they did in fact distinguish between customers based on the likelihood that they were mis-sold IRHPs. There is no evidence that a Scheme that included all the customers within the FSA's remit could not have been agreed; and, to the extent that the FSA felt its bargaining position was weak, that was a consequence of its own shortcomings.

[11] [MS1/1591].
[12] [MS1/1592].

24. In relation to the adoption of the Companies Act Test, the FCA makes generalised statements regarding the use of numerical thresholds as a proxy for sophistication: e.g. "*the use of thresholds based on financials, the number of employees and the size of transactions as a proxy for financial sophistication is a widely accepted facet of financial regulation*" (para. 35(c)(ii) of the DGD). However, this entirely fails to engage with the specific criticisms made of the FCA's decision-making in relation to the Sophistication Test by both Mr Swift in his Review and the APPG in the ASFG. For example, the FCA has not sought to provide any justification (whether rational or otherwise) for:

24.1. the adoption of criteria derived from ss.382 and 477 of the Companies Act 2006, which are concerned with identifying small companies to be granted exemptions from certain obligations such as filing audited accounts, and which do not involve any assessment of financial sophistication;

24.2. the shift from the initial iteration of the Sophistication Test, the purpose of which was to qualify certain customers for automatic redress (whilst all remaining IRHP sales including the Excluded Transactions would be subject to a review process), to the version included in the Initial Agreement which utilised the Sophistication Test as a means of excluding certain customers from the Scheme altogether;

24.3. the amendment to the Companies Act Test to apply the numerical limits with reference to the customer's company group rather than the individual customer (a decision that calls for particular explanation given the conclusion drawn in the internal document produced by the FCA's Risk and Compliance Oversight division that "*It's clear the FCA was reluctant to include a group test initially and set out in FAQs provided to the skilled persons that membership of a group did not denote sophistication*"[13]); and/or

24.4. the introduction of the Notional Test, in response to HM Treasury's view (it having been "*lobbied hard by the CEOs of the banks*") that "*total redress costs*

[13] [MS1/1593].

needed to be reduced", to exclude any customer with a group aggregate notional value of IRPHs over £10 million: see para. 56.2 of the ASFG.

25. As to the suggestion made at paras. 20(f) and 38(a) of the DGD that the Excluded Customers remained able to pursue mis-selling allegations and claims for redress against the Redress Banks through complaint routes outside of the Review and by litigation*:*

25.1. the FCA itself acknowledges a number of hurdles for customers wishing to bring civil claims in respect of IRHP mis-selling. These include: (i) the fact that an action for damages pursuant to s.150 (later s.138D) FSMA for breach of the COB and COBS rules was only open to "*private persons*", which excludes companies acting in the course of their business[14]; and (ii) issues of limitation: see para. 18(a) of the DGD;

25.2. the FCA has no reliable data available to it in relation to the number of Excluded Customers who were able to obtain relief via alternative means to the Scheme and is therefore not now (and was not at the time of making the Decision) in a position to make an evidence-based judgement that the Excluded Customers had any effective alternative available to them apart from the Scheme; and

25.3. the Review, having analysed the various difficulties faced by customers who sought to litigate as an alternative to (or because they were not permitted to participate in) the Scheme, concluded that "*where parties chose to bring an action in their own right, they faced considerable hurdles in achieving a successful outcome. Irrespective or which cause of action they pursued, the prospects of customers who elected to pursue redress via the courts were relatively poor*": Review, para. 104. Whilst this may not have been known to the FCA at the time of agreeing the Sophistication Test, it was known at the time of making the Decision. (Indeed, although it is obvious that pursuing private legal action is a daunting and often impossible task for many businesspeople, the APPG relies on evidence to this effect based on the illustrative practical

[14] Pursuant to reg. 3(1) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001.

experience of an Excluded Customer adversely affected by IRHP mis-selling and the Sophistication Test: see the statement of Michael Lloyd.)

26. The second argument raised by the FCA in defence of Ground 1(i) is that the APPG is wrong to contend that the Excluded Customers were *prima facie* entitled to the same level of protection as other Private Customers and Retail Clients, because the Consumer Protection Objective requires only that the FCA secures an appropriate degree of protection for consumers having regard to*, inter alia*, the differing degrees of experience and expertise they may have: paras. 14 and 36 of the DGD.

27. The FCA appears to suggest that it was entitled to ignore the COB / COBS classifications entirely in responding to IRHP mis-selling. Parliament surely cannot have intended that the generic Consumer Protection Objective should be interpreted as empowering the FCA, at any rate without cogent justification, to disregard its own COB and COBS classifications (which include stringent criteria for transferring customers into less protected categories[15]) and to instead apply ad hoc, arbitrary criteria to determine which consumers were deserving of its regulatory protection. Certainly, the Review did not consider that the FCA was entitled to do so and, having regard to the genesis of the Sophistication Test in the FCA's attempts to generate automatic redress for a subset of customers within the group of customers classed as Private/Retail pursuant to the COB and COBS rules (see para. 66 of the Review), it does not appear that the FCA thought so either.

28. In any event, when the Review concluded that the Sophistication Test had not been based on any such justification with reference to the Consumer Protection Objective of securing an appropriate degree of protection for consumers ("*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*": see the passage quoted at para. 93 of the ASFG), the FCA was not lawfully entitled to brush this conclusion aside in the manner it did in the Decision. The FCA itself accepts that a decision to distinguish between customers to whom regulatory assistance was to be provided, which is what the Sophistication Test was, must be reasoned, based on evidence and objectively justified (DGD, para. 36); and that it

[15] See paras. 31 to 32 and 35 of the ASFG.

cannot dispute the Review's factual findings (see para. 84A of the ASFG), including that there is no evidence that the FSA undertook any analysis to understand the impact of the Sophistication Test.

29. It is notable in this regard that the internal document prepared by the FCA's Risk and Compliance Oversight division that is referred to above, which Mr Steward states (at para. 65 of his statement) was prepared prior to the first draft of the Review and addressed areas which the FCA considered would feature in the Review based on the Terms of Reference, stated that[16]:

    29.1. "*I do not believe there should have been a sophistication test at all and all sales to retail / private customers should have been considered*";

    29.2. "*The decision to restrict the review to non-sophisticated customers produced a sub-cohort of consumers within the retail/private definition. This had not been done previously, and does not appear to have been done since. This decision is questionable, considering it was recognised that it was retail/private clients that warranted the greatest protection*";

    29.3. "*It was recognised that there were mis-selling concerns with the products and I would argue that 'sophisticated' customers were still at risk of mis-sale, despite being better equipped to understand the product or mount challenge (considering these were still private/retail consumers)*"; and

    29.4. "*The view that all retail / private customers should have been included in the review is supported by the fact that the FCA brought in rules in 2019 restricting the sale of CFDs (and CFD type options) to retail customers. This would suggest the products themselves – mis-sale issues aside – were potentially not appropriate for retail customers and so all sales should have been considered, not just a sub-cohort*."

30. The <u>third</u> objection raised by the FCA is that no individuals had an entitlement to be treated in any particular way by the FSA, or to be within the scope of the Scheme. But the APPG's claim does not depend upon showing that particular persons had particular rights against the FSA. What persons affected by the mis-selling of IRHPs have is a

[16] [MS1/1592-1593].

right to decision-making by the FCA that, as Mr Justice Fordham put it, meets "*contextually-applicable standards of common law reasonableness*"[17], which in the APPG's submission the Decision does not.

(ii) Ground 1(ii) - Irrational to decide to do nothing further

31. The FCA contends at para. 40 of the DGD that if the Sophistication Test was rational, Ground 1(ii) must fail since it is predicated on the findings of the Review. This is a non-sequitur. Whether it was rational (in the sense described above) to take the Decision – that is, the decision to do nothing – in spite of what the Review had revealed about the deficiencies in the Sophistication Test does not depend upon whether it is correct to regard those deficiencies as constituting a public law error.

32. The essence of the FCA's position in relation to Ground 1(ii) is that it (acting through the Board) gave genuine consideration to whether to take further action in light of the findings of the Review and in doing so "*carefully weighed all of the material considerations and decided, as it was entitled to do, that it would not be appropriate to seek to exercise its statutory powers and to compel redress*": DGD, para. 41.

33. In fact, as explained above, it is clear from the documents disclosed by the FCA with the DGD that, by the time the decision came before the Board, there was already a settled intention within the FCA, confirmed by the sub-group of the FCA's Executive Committee and the Board Sub-Committee, to reject the findings of Mr Swift in relation to the eligibility criteria for the Scheme. As a result:

    33.1. the FCA accepts that the Board did not give any consideration to what it would have done if it had accepted Mr Swift's criticisms concerning the Sophistication Test, and, in particular, if it had decided that the measures taken in 2012 and 2013 had not provided an appropriate degree of protection for consumers (DGD, para. 49). This is despite the fact that the FCA accepts that, in principle, its powers under ss.384 and 55L FMSA "*might be available*" to it now: DGD, para. 32(a);

[17] Permission Judgment at para. 21: see para. 18 above.

33.2. the factors that were included in the Board Paper for consideration were weighted heavily against any further action, giving undue weight to the potential views of the Redress Banks and any challenges they might seek to bring to the Decision, though no steps had been taken by the FCA to ascertain their position;

33.3. the interests of the Excluded Customers were given little or no weight, being referred to only in passing in three short paragraphs within the 28-page Board Paper: see paras. 4.46-4.48 of the Board Paper. No consideration was given to the Excluded Customers' legitimate expectations, or to any likely challenge by them to the Decision (despite the FCA being aware of the likelihood that the Review would lead to public pressure for them to take action: paras. 30(d) and 45(b) of the DGD);

33.4. the FCA took no steps to assess the impact of the Sophistication Test upon the Excluded Customers before making the Decision;

33.5. the FCA irrationally and artificially sought to rely upon the purpose for which it had commissioned the Review (to learn lessons for the future) as a reason not to take any action in light of the Review's findings about what had gone wrong in relation to the Sophistication Test; and

33.6. the FCA is therefore wrong to contend that the Board approached the question of whether to take further action on an open-minded basis, considering all of the relevant factors. By irrationally rejecting the findings of the Review, the FCA created a decision-making environment in which it was pre-disposed to take no further action in relation to the Excluded Customers. This was a problem of the FCA's own making.

VI. GROUND 2: PROCEDURAL FAIRNESS

34. The FCA's objection to Ground 2, the Ground that complains of the FCA's failure to consult before reaching the Decision, is primarily based on the contention that there was no duty on the FCA to consult prior to making the Decision. The reasoning of the FCA in support of this contention (see DGD, para. 45) is flawed:

34.1. The APPG does not, and is not required to, contend that the FSMA required the FCA to consult as to its response to the Review: the FSMA, unsurprisingly, does not cater for the situation where the FCA finds itself with the task of considering its response to independent findings that it has in the past acted wrongly towards a large number of persons.

34.2. But the APPG *does* contend that consultation was required at common law, as part of the common law duty of fairness. What the common law demands by way of fairness is dependent on a close examination of the facts. It is, as Lord Mustill put it in *R v Secretary of State for the Home Department, ex p Doody* [1994] 1 A.C. 531, 560 in an often-cited passage (e.g., recently by the Judicial Committee of the Privy Council in *Public Service Commission v Richards* [2022] UKPC 1 at para. 30), "*an essentially intuitive judgment*." The FCA is therefore wrong to state, as it does, at para. 45(a) of the DGD that the APPG has not identified any basis for suggesting that an obligation to consult arose under common law.

34.3. The duty arose in this case from the fact that the FSA/FCA, whose very object is to protect consumers appropriately, had misconducted itself towards consumers in connection with the serious and often ruinous injustice of IRHP mis-selling by failing (in large part at the behest of the perpetrators of the injustice, who stood to gain from regulatory inaction) to act fairly and effectively to remedy that injustice; had commissioned expert independent advice about this that had laid out in clear terms what it had done wrong; now knew that it faced a decision as to what (if any) steps to take to seek to remedy its misconduct; knew that it was obliged in taking that decision to consider fairly all relevant arguments; and knew that consultation would "*maximise[..] [its] chances of gathering in and considering all relevant arguments for and against*" (see para. 15.4 above).

34.4. The FCA seeks at para. 45(a) of the DGD to minimise the significance of the Decision by referring to it as having simply "*maintained the status quo*". But the Decision had the effect of allowing the banks to hold on to the undeserved benefit of the Sophistication Test without giving Excluded Customers any

opportunity to persuade the FCA that it should take action. To the extent that the Decision maintained the status quo, it was a status quo that was arbitrary and unfair to the Excluded Customers and was of the FSA/FCA's own making.

34.5. At para. 45(b) of the DGD, the FCA draws a distinction between, on the one hand, consultation in relation to future redress schemes (in relation to which it accepts that the Review recommended it should consult stakeholders) and, on the other hand, the Decision (in relation to which it contends that the recommendation of the Review does not apply). This distinction is not one drawn in the Review, and it is artificial because, in taking the Decision, the FCA was in substance deciding whether to procure future redress.

34.6. The representations referred to at para. 45(c) of the DGD that were received by the FCA and/or Mr Swift and his team prior to the relevant stakeholders having sight of the Review could not properly have informed the FCA's decision in relation to what action should be taken consequent upon the Review. As Mr Swift found (at para. 37 of the Review) in relation to the FCA's failure to consult in relation to the nature, terms and scope of the Scheme,

> "*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 therefore potentially influence the decision-making process.*"

34.7. Further, the Review found that the steps taken to consult and receive representations prior to and during the Scheme were inadequate, such that the representations that were received by the FCA in that context could not properly have informed the Decision. For example, the Review found (at para. 39) that:

> "*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*".

34.8. The FCA's assertion at para. 45(c) of the DGD that "*a consultation would not have assisted its decision-making*" betrays the closed-minded approach taken by the FCA to making the Decision.

35. Given that the stated aim of the FCA in agreeing the Sophistication Test was to procure redress for the most vulnerable customers, it is striking that the FCA has itself apparently conducted absolutely no follow-up or impact assessment to ascertain whether this objective was achieved, or what further action might now be required in order to achieve that objective. The FCA asserts that its view since agreeing to the Scheme is that the "*Scheme, supplemented by other remedies that may be available to individual customers, provided all consumers with an appropriate degree of protection in respect of the mis-selling of IRHPs by the Redress Banks*": DGD at para. 23. However, it is unclear how the FCA could have rationally or fairly have arrived at this conclusion in circumstances where it has taken no proper steps to ascertain what the impact of the Sophistication Test was for Excluded Customers; and, on its own estimation, between 11% and 33% of IRHPs mis-sold to Excluded Customers between 2001 and 2011 could have been mis-sold: DGD at para. 32(g). A consultation process would have allowed banks and Excluded Customers to provide the FCA with information about the impact of the Sophistication Test upon the Excluded Customers. The APPG puts evidence before the Court (see the statement of Michael Lloyd), illustrating how the Sophistication Test led to great injustice, with the ruinous consequences of IRHP mis-selling (both financial and in terms of mental anguish) being left to lie with its victims. Such evidence would have emerged from a meaningful consultation as to how to respond to the Review and might have led the FCA to take a different view as to how to do so.

36. Moreover, it is clear from the DGD at paras. 30(d) and 45(b), and from the evidence of David Geale (paras. 10 and 53), that the FCA was aware that the public or sections thereof were likely to take the view that the FCA should take steps to procure redress for the Excluded Customers in light of the Review. Not only did the FCA fail to carry out any kind of consultation to provide an opportunity for those views to be aired prior to making the Decision, it intentionally took the Decision behind closed doors, prior to the publication of the Review and without reference to any stakeholders. The reasonable inference is that this was done in order to present the Decision as a *fait accompli* and thereby to minimise the opportunity for public pressure to be exerted on the FCA to arrive at a different decision. The FCA was aware that there were identifiable people or groups who would want to be heard in relation to the Decision and took a deliberate

step to cut them out of the process. The APPG respectfully repeats Mr Justice Fordham's characterisation, at para. 23 of the Permission Judgment, of what the FCA did and its consequences:

> "*The [FCA] plainly took a deliberate procedural decision to secure a temporal alignment between the publication of the Report, the publication of the Response, and the publication of the decision on whether to take any further action. The Authority did that, moreover, specifically thinking about the prospect that there would be voices calling for it to take action, and specifically for 'presentational' and other reasons. The implications of that procedural design of the sequence of events eliminated the prospect of voices – informed, empowered and able to reference the detailed reasoning of the published Report – having the opportunity to persuade the decision-maker prior to the outcome, and before minds were made up.*"

37. It is notable in this regard that the Review itself found (at para. 41) that, although the FCA was in regular communication with external stakeholders during the operation of the Scheme:

> "*The decisive shortcoming in respect of these* [communications] *was that key decisions made by the FSA/FCA were generally presented to those interlocutors as a fait accompli, rather than affording stakeholders an opportunity to shape the decision-making process.*"

38. In the Response, the FCA accepted the recommendation made in the Review that the FCA should improve consultation with all stakeholders. In doing so, the FCA "*recognise*[d] *the important potential advantages of wide and meaningful consultation that the Review highlights*" and committed to "*look for opportunities to consult where we can*": Response, para. 3.63.

39. Notwithstanding this, the FCA chose to adopt, in its response to the Review, the very conduct that the Review had rightly criticised it for.

VII. APPLICATION OF S.31(2A) SENIOR COURTS ACT 1981

40. In granting the APPG permission, Mr Justice Fordham found in relation to s.31(3D) of the Senior Courts Act 1981 that "*the 'highly likely' test for refusing permission for judicial review, invoked by the Authority, is not satisfied*": Permission Judgment, para. 14.

41. Notwithstanding this, in Section G of the DGD the FCA invites the Court to consider whether, if the conduct complained of had not occurred, it is highly likely that the outcome for the APPG would not have been substantially different and to refuse the APPG relief on that basis. In doing so, the FCA places reliance on the considerations set out at paras. 4.14 to 4.39 of the Board Paper and asserts that, in the light of those considerations, it is highly unlikely that the FCA could require the Redress Banks to provide further redress: DGD, para. 49. However:

41.1. The FCA accepts that it has statutory powers that "*might be*" available to it for the purpose of procuring redress for the Excluded Customers: see para. 33.1 above;

41.2. Paras. 4.14 to 4.39 of the Board Paper, which informed the Decision, set out the grounds upon which the FCA considered that "*[i]t seems likely that the banks have a legitimate expectation that the FCA will not require them now to provide redress to sophisticated customers*" (see para. 4.15 of the Board Paper). The APPG's case is that the FCA acted irrationally in placing such heavy reliance upon its perception as to the likely legitimate expectations of the Redress Banks, for the reasons set out at paras. 102 to 104C of the ASFG; and

41.3. The FCA appears to be heavily influenced in advancing and maintaining this argument – even in the face of its rejection at the permission stage – by a perceived need to do justice for the Redress Banks; the very same banks that have been found to have engaged in extensive and serious wrongdoing by mis-selling complex financial instruments to unsophisticated customers for commercial gain. The APPG is concerned by the extent to which the FCA continues to place the interests of those it is charged with regulating over those of the consumers in whose interests the FCA is compelled to act by the statutory Consumer Protection Objective.

42. As to the FCA's reliance upon the agreements that were concluded between the FCA and the Redress Banks:

42.1. It is notable that the FCA itself is not willing to put its argument any higher than being one of probability. It contends at para. 50 of the DGD that "*the agreements **probably** prohibit the FCA from exercising its regulatory powers*" to require further redress, that "*it is **probably** an implied term of the agreements that the FCA will not take any such action*", that if the FCA were to now to exercise its regulatory powers it would "***probably** act in breach of clause 5*" and that "*Clause 6 **probably** preserved the FSA's right to exercise its regulatory powers only in so far as was consistent with the IRHP Redress Scheme agreed with the Banks*" (emphases added). However, even assuming that the FCA is correct in this regard (which, as explained below, it is not) the *probability* of the agreements with the Redress Banks precluding a different outcome is insufficient to engage s.31(2A), which requires a respondent to meet the threshold of "*highly likely*".

42.2. The FCA cannot escape the effect of clause 6 of the agreements, which expressly and in the widest terms preserved in full the FCA's powers to take disciplinary and regulatory action in respect of <u>any</u> matter or business involving the Redress Banks:

> "*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*."

42.3. The contrived construction of clause 6 that is contended for at para. 50(h) of the DGD would require clause 6 to be read as follows (deletions and additional text shown in bold):

> "*Nothing in this Agreement prevents or **~~in any way~~** limits the FSA from taking disciplinary action or any other regulatory action in respect of any matter or business involving the Firm, **provided that such regulatory action does not require the Firm to do any more as regards redress for those to whom it sold IRHPs than it has agreed to do in the Undertaking***".

42.4. If the FSA and the Redress Banks had intended clause 6 to mean this, they would have drafted it in these terms. To suggest that one can spell such a meaning out of clause 6 is to misunderstand the process of contractual construction, under

which the primary indication of what the parties are reasonably to be taken to have meant is to be found in the language they actually used: *Arnold v Britton* [2015] UKSC 36, [2015] A.C. 1619.

42.5. The effect of the construction of clause 6 contended for by the FCA is that the FCA would have contracted out of being able to exercise its regulatory powers further in respect of IRHP mis-selling in the event that it later emerged that the Undertaking the Redress Banks gave under the agreements, namely to apply the Sophistication Test, was actually productive of injustice. The FCA has failed to disclose contemporaneous materials relevant to the facts and circumstances known or assumed by the FCA and the Redress Banks at the time that the agreements were executed. However, the APPG contends that a reasonable person with knowledge of the background facts would not understand that to have been the intention of the agreements.

43. On the premise that the Decision was unlawful for the reasons given by the APPG, it cannot be said to be highly likely that the Decision would have been the same in any event. The FCA lists factors arguably capable of supporting a lawful refusal to provide any redress to Excluded Customers in the face of the damning conclusions of the Review. But to argue that a more favourable outcome for Excluded Customers would therefore have been highly unlikely is to go too far. (It is, moreover, troubling to see the FCA thus coming very close to prejudging the outcome of a new decision-making process, should the Court agree with the APPG that the Decision was unlawful and must be retaken.)

44. Even if the Court does conclude that an identical decision would have been highly likely, it may disregard the consequent requirement not to grant relief "*if it considers that it is appropriate to do so for reasons of exceptional public interest*" (s.31(2B)). It is respectfully submitted that there are such reasons here. This case does not concern a one-off decision by a single official, affecting a single person or a small group of persons, which there is no practical purpose in requiring to be reconsidered. It concerns (on the premise for this part of the argument) an unlawful decision by the regulator of an essential sector of the economy, which decision has had huge financial and personal implications for the many Excluded Customers.

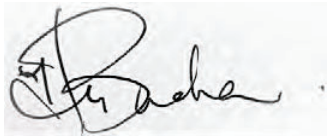
45. The introduction of the statutory "*highly likely*" threshold, replacing the common law question as to whether the decision would *inevitably* have been the same if taken lawfully (see, e.g., *Public Service Commission v Richards* at para. 39), was self-evidently driven by considerations of proportionality: the new threshold reflects Parliament's judgement that it is generally disproportionate to require a decision to be retaken merely because the outcome *might* have been different, if one can see that it is highly unlikely that it would have been different. Such considerations of proportionality hardly arise in the present, exceptional case, the APPG respectfully submits, where there is a strong public interest in requiring the FCA to act lawfully, and to be seen to act lawfully, *even if* the Court thinks it highly likely that the outcome would not have been different if this had been done in the first place.

THOMAS ROE KC

ANNA LINTNER

STATEMENT OF TRUTH

The Claimant believes that the facts stated in this Reply are true. I am duly authorised by the Claimant to sign this statement of truth. I understand that proceedings for contempt of court may be brought against anyone who makes, or causes to be made, a false statement in a document verified by a statement of truth without an honest belief in its truth.

Signed: 

Heather Buchanan, Position: Director of Policy and Strategy, All-Party Parliamentary Group on Fair Business Banking

Date: 13 December 2023