Complaints Commissioner

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Mr Mark Taber
By email

27-10-2017

Dear Mr Taber

Complaint against the Financial Conduct Authority
Reference Number: FCA00165

Thank you for your email of 5 May 2017. I have now reviewed the information sent to me by you and the Financial Conduct Authority (FCA), and am able to write to you. Although this letter addresses the specific issues you raised with the FCA and its complaint response, I have also accepted your role as the co-ordinator of a group complaint involving complaints raised with the FCA about regulatory matters involving Lloyds Banking Group (LBG) Enhanced Capital Notes (ECNs). My response is therefore also intended for those who have contacted me and asked to be linked with you via the group complaint in so far as it covers the same ground. In view of the public role you have taken, you have agreed to waive your anonymity.

How the complaints scheme works

Under the complaints scheme, I can review the decisions of the FCA's Complaints Team. If I disagree with their decisions, I can recommend that the FCA should apologise to you, take other action to put things right, or make a payment.

What we have done since receiving your complaint

I have reviewed all the papers you and the regulator have sent to my office. Both you and the FCA have had the opportunity to comment in response to my preliminary decision. I have carefully considered the points made and, where appropriate, make further reference to them below.

Your complaint

In January and February 2016 you complained to the FCA about various regulatory matters related to its, and its predecessor body the Financial Services Authority (FSA)'s, involvement with the creation and proposed early redemption of LBG ECNs. You sought compensation and an apology from the FCA for what you considered to be mistakes, bias and lack of care.

On 11 March 2016 the FCA wrote to you setting out its understanding of your complaints and confirmed that they were accepted for investigation under the Complaints Scheme (the Scheme). You had previously indicated that you did not wish your various complaints to be considered together; however, the letter from the FCA said that although it had summarised your complaints into key elements, all the points you had made would be considered. In fact, you have had four separate responses from the FCA to your individual complaints.

The FCA identified five elements to your complaint as follows:

Element One – email of 29 January 2016

An allegation that the Financial Services Authority (FSA) made a 'mistake', displayed 'bias' and acted beyond its statutory remit by:

a) developing novel and complex capital instruments (ECN) to assist Lloyds Banking Group (LBG) in meeting its commercial objective of withdrawing from the Government Asset Protection Scheme; and
b) ensuring that Lloyds had to offer the ECNs to a large number of retail investors.

Element Two – email of 5 February 2016

An allegation that the Financial Conduct Authority (FCA) made a 'mistake' and exercised a 'lack of care' by omitting to:

a) prevent LBG from redeeming the ECNs prior to the Supreme Court decision;
b) instruct LBG to cover the trustee's costs of appealing to the Supreme Court;
c) request the Prudential Regulation Authority withhold permission for LBG to redeem the ECNs until the issue of the trustee's costs is resolved; and
d) act on the problems redemption of the ECNs would cause the trustee.

Element Three – email of 17 February 2016

An allegation that the FCA made a 'mistake', showed 'bias' and exercised a 'lack of care' by:

a) giving a misleading statement on 17 March 2014 from the then chief executive, Martin Wheatley on the circumstances by which LBG could declare a Capital Disqualification Event (CDE). You allege you only became aware the misleading statement was incorrect during correspondence with Andrew Bailey on 20 February 2015;
b) reaching its initial decision of 13 March 2015 not to intervene to make a declaratory judgement possible; and
c) failing to accept offers of information from you which led to bias being shown against consumers in favour of LBG.

Element Four – email of 18 February 2016

An allegation that the FSA made a 'mistake' and exercised a 'lack of care' by:

a) putting itself in a biased position when it came to approving the ECN prospectus (due to its role in creating ECNs) and meeting its operational objective of providing protection to consumers;
b) approving the ECN prospectus when it was too long and technical for retail investors to comprehend;
c) not spotting a mistake in the drafting of the CDE clause; and
d) approving the prospectus despite material omissions which it should have been aware of at the time.

Element Five – email of 22 February 2016

An allegation that the FCA issued an ECN key facts document to MPs which contains a

number of inaccurate statements and misleading information/omissions about:

a) the mechanisms in place for LBG to compensate investors;
b) the development of ECNs;
c) the FCA's role and ability to intervene;
d) the justification of allowing LBG to recapitalise; and
e) the FCA's response to the CDE clause drafting error.

The FCA regarded this as an allegation of 'unprofessional behaviour' and 'mistakes and lack of care' on the part of the FCA.

On 14 March 2016 you wrote to the FCA reiterating that you did not wish your various complaints to be considered together. You also said that key aspects of your complaints relating to Elements Three and Four had been ignored and provided further details. During the course of the complaint investigation, you continued to provide the FCA with further information and evidence in support of your complaints.

The FCA Complaints Team responded to Element 4 of your complaint on 6 February 2017, to Element 5 on 28 February 2017, to Elements 1 and 2 on 17 March 2017, and to Element 3 on 6 April 2017. Your complaints were not upheld. You are dissatisfied with this response and have asked me to investigate Elements 1, 3 and 4. Element 4 deals with the Prospectus issues, which are the subject of the group complaint. You are not referring Element 2 because the Supreme Court proceedings are concluded. You would, however, like me to consider the issue of delay. You have not referred Element 5.

My position

In investigating your complaint, I have carefully considered the FCA's complaint file and supporting documents, as well as your submissions. I have also considered other relevant material, including the contents of the Exchange Offer Memorandum (EOM) and the Supreme Court Judgment dated 16 June 2016. My approach has been to consider the FCA's rationale for its decision-making and whether that, and the FCA's complaint response, can be considered reasonable in all the circumstances.

In response to my preliminary decision, you have said that my stated approach to the investigation has caused some concern and confusion, that you feel much of the important information and evidence you supplied in support of your complaints has been 'skipped over' and that you are not clear whether it has been considered and, if so, on what grounds it has been dismissed. I am of course sorry to hear that you feel this to be the case and I have made some amendments to the wording above to clarify my approach. I would also like to reassure you that all points made have been considered even if not specifically referred to below. A summary of the points you made to me in respect of each element of your complaint was included in my preliminary decision and I have added some wording below to address the further points you have made.

Elements One and Three

I have considered these elements together because they relate to the period before the Supreme Court decision and leading up to LBG's decision to seek to redeem the ECNs.

In relation to Element One of your complaint the FCA Complaints Team concluded that the FCA had not acted beyond its statutory remit in the way it supervised the design and execution of the ECNs in 2009 nor in the way the ECNs were made available to retail investors. It said that the evidence you had provided about the FSA's involvement with the creation of the ECNs was consistent with its supervisory functions and that the principal responsibility for matters relating to the ECNs rested with LBG. Regarding the decision not to intervene to prevent redemption of the ECNs, the complaint response said that the FCA "*was monitoring the situation closely and had been in discussions with LBG and the Trustee regarding costs and compensation*". The Complaint Team was satisfied that, while recognising this was an unpopular decision, the FCA gave detailed consideration to the options available in line with its own objectives before deciding not to intervene and that this was a reasonable decision for the FCA to make.

In relation to Element Three of your complaint the FCA Complaints Team referred you to an earlier decision I had made on the subject of Martin Wheatley's two emails of 17 March 2014 in which I had noted that the "FCA accepts there may have been some confusion regarding the two statements". In its published response to my decision, the FCA clarified the comments made by Martin Wheatley were not from a public statement, but a response by Martin Wheatley's office to an email exchange with you. The complaint response concluded:

a) *In my opinion, there was scope for the first email to be misinterpreted but I have not upheld this part of your complaint because I believe the second email, which was sent later the same day, was sufficiently clear. It follows from this that I do not upheld your points about the adverse consequences to you of Martin Wheatley's first email.*
b) *I have not upheld this part of your complaint. I appreciate the points you make about why you believe the FCA's decision not to intervene to make a declaratory judgment possible was a mistake. However, from what I have seen I am satisfied the decision was a reasonable one in the circumstances.*
c) *I have not upheld this part of your complaint. I do not agree that the FCA has shown a lack of care by not accepting offers of information from you. From what I have seen, all the information you provided was fully considered by the FCA in deciding how to proceed at each stage of this matter.*

In your submissions to me, you have said that the FCA has not responded to key elements of your complaints about these matters. You say that:

1. In failing to intervene to require LBG to agree to declaratory judgment the FCA put you in a position where the only way an application for declaratory judgment was possible was for you to take actions (including recommending hundreds of retail investors direct the Trustee and soliciting funds from retail investors to cover the costs of Leading Counsel) at very short notice which potentially breached FCA rules... this was a serious mistake, act of bad faith and unprofessional behaviour on the part of the FCA. The FCA's failure to consider or respond to this element of your complaint is unacceptable and a clear attempt to avoid being held accountable for its 11th hour decision to finally intervene and then doing so in such a way that required you to take considerable risks and incur significant time and expense in order that consumers were afforded protection. The FCA's response does not address the following:

    i. Was the FCA's initial decision not to intervene correct in the circumstances?

ii. Was the FCA's decision not to accept your offer to provide opinion from leading counsel correct?

iii. The FCA's eventual decision to intervene when presented with the letter from leading counsel and questions from a government minister who had been presented with the letter… the FCA did change its position and, in substance, took action. The FCA's position in its response that it cannot say what action it took due to the confidentiality provisions of FSMA is flawed and unacceptable.

iv. Was the FCA decision to intervene in such a way which left you in a position where you had to break FCA rules and incur substantial time and cost in order that the matter could be heard by the courts correct and fair on you?

2. The FCA displayed unreasonable delay and bias against consumers in favour of LBG in reaching its decision on whether to formally intervene to require declaratory judgment… the FCA had been aware of the issue since at least February 2014 yet took until March 2015 to communicate its position. This left consumers just days, before the PRA deadline of 18 March 2015, to act when the FCA failed to intervene.

3. The FCA's response in relation to your complaint about the Martin Wheatley emails makes no sense, is inconsistent with the facts and evidence and does not address the fact that the FCA failed to correct any inaccuracy in its statements despite presumably being aware that you and other investors were relying upon them. You also consider that the complaint response leans heavily on a previous decision of mine, about a complaint not made by you, rather than considering and addressing the facts and evidence you presented.

There is a lengthy regulatory background to the creation of the ECNs and the decision by LBG to redeem them, some of which I set out in a decision I published in December 2015: http://frccommissioner.org.uk/wp-content/uploads/FCA00053-FD-publish-25-11-15.pdf

In that decision, I accepted that, although the FSA supervised the design and execution of the ECNs in 2009, principal responsibility for this rested with LBG. I note your comments, made in response to my preliminary decision, that you are confident that the ECNs were conceived and suggested to LBG by UK Financial Investments Ltd and the FSA in order that LBG could avoid entering the Government Asset Protection Scheme (GAPS). That would not, in my view, alter the responsibility held by LBG under the FSA's supervision. I also concluded in my 2015 decision that the FCA's previous decision not to intervene in 2014 "cannot be said to have been unreasonable, the decision having been reached after careful analysis of the factors involved in a way which is consistent with the FCA's regulatory approach". The FCA's complaint response to you said that similar considerations applied in early 2016 and that the FCA considered a variety of options before deciding not to intervene.

However, the Complaints Team also told you that it could not "*share exactly what options were considered due to the restrictions placed on sharing confidential information by s348 of the Financial Services and Markets Act (FSMA). This relates mainly to information the FCA receives but there are other relevant policy considerations as well*".

In response to my preliminary decision, you have said I have missed an opportunity to provide some clarity to complainants, and consumers who are retail investors, on where they

stand in terms of regulatory protection, in view of the FCA's statutory duty to protect consumers and to statements by both HM Treasury and the FCA that it is not feasible for retail investors to challenge banks through the courts on complex legal matters. You consider that I have not addressed a fundamental issue, that the FCA's initial decision not to intervene to ensure that the matter would be heard by the High Court cannot be said to be reasonable. You say that I have not addressed the evidence you provided, that the FCA changed its position on whether to intervene, or commented on whether this was reasonable given the position it put you in to ensure that the matter could be heard by the High Court.

As you have observed in your complaint submission to me, the substantive, practical consequences arising from these issues have been overtaken by the Supreme Court decision of June 2016 in LBG's favour. Having considered the information supplied by the FCA, including internal briefings, I am satisfied that the situation was fluid and that the FCA kept its options and objectives under review, in accordance with its regulatory remit. Relevant criteria were considered, including the need to balance fairness between institutional and retail investors. After LBG was successful in the Court of Appeal it reapplied to the PRA for permission to redeem the ECNs, which had lapsed. The FCA was in contact with all relevant parties during December 2015 and January 2016 and eventually decided that the FCA should not object to the proposed redemption, but it is important to note that this decision was based on assurances from LBG to protect investors by agreeing to indemnify the Trustee and pay compensation if LBG lost in the Supreme Court. Ultimately, the FCA's continued decision not to intervene was one that the FCA was entitled to make, however unpopular.

In summary, as was the case in relation to the earlier complaint case which I refer to above, I am satisfied that the FCA carefully considered its options, took full account of the interests of retail investors, and reached a rational decision. From the internal information I have seen, it is evident that the FCA engaged actively with you about the LBG ECN situation and took your views into account even where it disagreed with you. I recognise that you, and others, consider that the FCA should have intervened further, and there were clearly arguments for that, but I do not consider that the FCA's decisions were unreasonable.

You have also said that my preliminary decision has not addressed whether it was reasonable for the FCA to use section 348 of the Financial Services and Markets Act 2000 (FSMA) to decline to share any detail of what happened. You have referred me to another complaint where you say the FCA has gone further than it did in its response to you. I am obviously unable to comment on another case, which does not appear to have been referred to me. However, although I consider that the FCA should take every opportunity to be as transparent as possible within its remit and the legislation, I am satisfied that the FCA Complaints Team correctly referred to s348 when responding to you.

In my preliminary decision, I also said that "It is important to remember also that LBG had already made a 'buy back' offer to retail investors with clear warnings that a par call was likely if investors declined and ECNs were disqualified. My understanding is that around 75% of investors took up that offer". In response to this, you have said that you strongly dispute the accuracy of this statement (which formed part of my earlier decision in case FCA00053) and its use to justify the position of the FCA with respect to retail investors. In view of this, I asked both you and the FCA to provide further evidence which I have considered in detail.

You argue that this 'buy back' offer, in March/April 2014, deliberately excluded a large number of retail investors by design and was inferior in value to a parallel offer made to institutional investors. You have submitted evidence which you consider supports your contention that the acceptance rate from retail investors was much less than 75% and closer to 25%, based on the value of the total acceptance of the offer and the criteria for eligible retail investors. You also disagree that the offer to retail investors contained clear warnings that a par call was likely if investors declined and ECNs were disqualified. You consider that there was Market Price Manipulation by LBG that 'talked down' the price of its ECNs and that this led to unfair discrepancies in the value being offered between different issues with unfavourable tax consequences for many retail investors that devalued the retail cash offer. You say that having failed to ensure that retail investors were treated fairly and not disadvantaged as opposed to institutional investors in these offers the FCA cannot reasonably use them as a reason not to intervene to protect retail investors at a later date.

The FCA says that:

- It believes it (and LBG) took appropriate steps to ensure that the maximum number of retail investors possible could participate in the cash offer in 2014, and satisfied itself that the take-up rate after the exchange was as good as could reasonably be expected. It determined that LBG offered a price that reflected the prevailing market value of the bonds at the time. It also reviewed your claim that the price had been "manipulated" by an investor briefing but found no evidence to support further action. It does not accept a direct comparison between the cash offer with the exchange for AT1s without factoring in the risk exchange involved in both transactions. When factoring in all risks, the FCA concluded that the terms were not unfair to retail investors.
- Its view remains that around 75% of retail investors by value took up the offer or traded away before the exchange. The FCA accepts that you may have a different starting point for how many retail investors held instruments in March 2014. Neither the FCA nor LBG recognise your figure of 123,000 as accurate.
- LBG (like all issuers) had commercial arrangements with securities clearing firms, brokers, wealth managers and the like to pass on information about the exchange to ultimate bond-holders. It was not reasonable, given the complexity of distribution and management of securities, for LBG to guarantee all bondholders were aware that the exchange was happening. Its role was to ensure it had the infrastructure in place to allow communications to flow to ultimate bondholders. The FCA was satisfied it did.
- The FCA monitored closely the media coverage of the exchange/cash offer.
- The FCA satisfied itself that LBG did what it could to ensure retail investors' attention was drawn to the risks of a regulatory par call.
- Some retail investors (including you) argued at the time that LBG was not legally entitled to call the ECNs. The FCA considered this was likely to result in a lower take-up of the cash offer than would otherwise have been the case.

Overall, I am satisfied that the FCA has provided reasonable explanations for its actions and the decisions that it took about this issue. It is not possible under the Complaints Scheme to resolve the different understanding you have of the numbers of retail investors involved or the take-up of the offer. What you mainly seem to be objecting to is the inclusion of this issue as a 'mitigating' factor for the FCA which you had not raised. However, the fact is that the 'buy back' offer was made and it is a relevant factor in the overall picture. I am satisfied that

the FCA carried out some due diligence around it and that its actions were not unreasonable. I am also satisfied that it has considered and responded to the allegations that you made.

Finally, I am satisfied that, in responding to your complaint, it was reasonable for the FCA to refer to my earlier decision. The evidence I have seen does not support your claim that it did so without reference to your own submissions. In addition, I do not agree that elements of your complaint have been ignored, since the response addresses both the creation of the ECNs and the FCA's regulatory decisions and actions, including its decision not to seek a declaratory judgment. Although you find the FCA's complaint response regarding Martin Wheatley's emails to be inadequate and unreasonable, I am satisfied that the issues you raised were fully considered and I find the complaint response to be reasonable and consistent with the position the FCA took in response to my earlier decision, where I was critical of the FCA's lack of care over some aspects of Mr Wheatley's statements.

I have therefore not upheld these complaints.

Element Two

In relation to Element Two of your complaint the FCA Complaints Team noted "*your email of 6 February 2017 where you say points of complaint such as these are not particularly relevant now because of the amount of time it has taken to investigate them. You go on to say they were intended to get the FCA to step in. I appreciate your frustration with this and I am sorry for the time it has taken. Due to the technical nature of the complaints, the number of complaints that were received and the volume of information to review, it was not possible to respond to them before the Supreme Court action was completed. That said, there is also nothing I can see from the information I reviewed to suggest that my opinion on the complaint would have been any different had my investigation been completed earlier*".

As you have not referred the substantive aspect of this complaint to me I will not comment further; I deal with the question of delay below.

Element Four – the Prospectus Issues

I note that in responding to Element Four of your complaint the FCA Complaints Team amended the wording of your complaint as set out in its complaint acknowledgement letter dated 11 March 2016 (see above). I believe this was done to align the wording with complaints made by other complainants on similar themes. Although I consider this was acceptable in the circumstances, in my view it would have been better if, in responding to you, the FCA had kept to the wording originally established with you.

The revised wording of the complaint and the FCA's response were as follows:

> a) The FSA made a mistake and exercised a lack of care by, in your view, failing to ensure the prospectus was presented in a form which was easily analysable and comprehensible. *I have not upheld this part of your complaint as I am satisfied the UKLA has not made a mistake, or acted with a lack of care in approving the EOM.*
>
> b) The FSA approved a prospectus which contained a material mistake which you say the FSA should have spotted and of which the FSA should have been aware. *I have not upheld this part of your complaint as I am satisfied that the 'material mistake' referred*

to by the Court of Appeal was not something the UKLA/FSA should have been aware of and should not have stopped the EOM from being approved.

c) The FSA approved a prospectus with material information omitted which the FSA should have been aware of. *I have not upheld this part of your complaint as I have not found sufficient evidence to show that the FSA was, or should have been aware that the effect of the changes proposed by Basel to the capital adequacy requirements were such that it would trigger the CDE clause.*

Regarding Element 4a), the FCA complaint response said as follows:

Article 5.1 of the Prospectus Directive requires all prospectuses, including a non-equity retail prospectus, to be 'easily analysable and comprehensible'.

There isn't any guidance available from 2009 about what an 'easily analysable and comprehensible' prospectus should look like – but the FCA issued guidance in 2014, which can be found here: https://www.fca.org.uk/static/documents/ukla/knowledge-base/tn-632-1-final.pdf.

As an example, you allege the Prospectus is not easily analysable and comprehensible because the first attempt at explaining a CDE is on page 99 of the Prospectus with the definition on page 210. You also note the key information on LBG's claimed intention for the CDE clause would not be found until getting to page 1033 if all the documents incorporated by reference are read in order. The examples given are mostly related to where key information is placed in the Prospectuses, rather than the actual language used.

The UK Listing Authority (UKLA) is part of the FCA. It oversees the listing of shares and other securities on the UK Official List and, as the competent authority in the UK under the Prospectus Directive, reviews and approves prospectuses published by issuers and offerors. From the discussions I have had with the UKLA, the approach to approving a Prospectus as 'easily analysable and comprehensible' would have been the same in 2009 as is described in the guidance note from 2014.

In my opinion, relevant key terms are clearly explained and accessible in the documents. For example, in the EOM the CDE is defined first at page 99, but direction on where to find the definition is given as early as page 22 (in the Risk Factors section). In relation to the stress test threshold, this is explained in the LBG rights issue prospectus, which is published on the same day as the EOM and is incorporated by reference into the EOM. The information about the stress test threshold was, as it would normally be, in the capital and liquidity section of the LBG rights issue prospectus.

The Prospectus Directive and the Prospectus Rules do not set a numerical limit on the number of pages that can be incorporated by reference and so it would seem arbitrary and inconsistent with the approach of other competent authorities for the UKLA to seek to do so. I also note that the Prospectus clearly states it is to be read in conjunction with the documents incorporated by reference, which is permitted by the Prospectus rules.

I appreciate the point about the number of pages involved in finding definitions of certain key terms, such as the CDE and the stress test threshold, but this, in itself, is not a breach of the Prospectus Directive. The 'easily analysable and comprehensible' requirements cannot always be readily applied to legal language without potentially changing the meaning of what is being said. Overall, I am satisfied that the UKLA's judgement that the Prospectus was easily analysable and comprehensible was a reasonable one in the circumstances.

In response to this element of your complaint, you have made the following points:

- There was guidance, in the form of the EU Prospectus Directive (required to be incorporated into national law of Member States by 2005) and the Prospectus Rules.
- The FSA was aware that the Prospectus was inviting retail investors to exchange their existing instruments and required a high acceptance level to meet LBG's needs.
- Prospectus Rule PR 2.4.6 in force at the time states: *When incorporating information by reference, issuers, offerors or persons asking for admission to trading on a regulated market shall endeavour not to endanger investor protection in terms of comprehensibility and accessibility of the information.* Key information relevant to understanding the terms of the ECNs which, under the Prospectus Rules, should have been included in the body of the prospectus was only included in the information incorporated by reference. This information - the FSA's indication that it expected banks to maintain a CT1 capital ratio of at least 4% in the stress scenario - was key to understanding the CDE clause as LBG claim it was intended. This points to a serious mistake by the FCA.

I have looked at the EOM in the light of these points. The EOM was issued on 3 November 2009 with an expiry date of 20 November. The General Notice on page 4 makes it clear that "each prospective investor should consult their own legal, financial, accounting or tax adviser for advice." A summary of Key Features on page 9 includes a CDE as an event that would render the ECNs redeemable before the Maturity Date. A summary of the Risk Factors is set out on pages 11 and 12 and this is followed by Part II, which sets out the Risk Factors in detail (pages 13 to 25). Paragraph 5.10 (page 22) sets out the Redemption Risk, including the occurrence of a CDE as set out more fully in Part A of Appendix 6. This lists the Terms and Conditions of the ECNs: 8(e) deals with Early Redemption for Regulatory Purposes and the Definitions are listed in 19. The Terms and Conditions set out here are qualified by reference to Schedule 4 of the Trust Deed, which it is clearly stated will prevail in the event of any dispute. Part VII of the EOM gives an overview of the ECNs (pages 96 to 103) and pages 98 to 99 deal with Early Redemption for Regulatory Purposes. (For ease of reference, I have attached as Annex 1 to this decision some relevant extracts from the EOM.)

I appreciate that the meaning of these terms has been subject to scrutiny by the courts and that different interpretations have resulted, including Lord Neuberger's comments on whether there was in fact an error in the Trust Deed. I acknowledge your point, made in response to my preliminary decision, that LBG's written and oral submissions to the courts stated that there was a mistake in the drafting of the CDE clause of the ECN terms. However, I do not consider that these subsequent events mean that the FSA failed in its responsibilities in relation to the issuing of the prospectuses. Although you have said no reasonable investor would have accepted the offer to exchange if they had understood the ECNs were intended to be redeemed early, I am satisfied that early redemption for regulatory purposes based on a

CDE is clearly highlighted as a risk factor even if that is something that you did not focus on at the time.

Overall, I am satisfied that the EOM adequately described the instruments being offered, set out the complexity and risks attached, and included warnings to obtain professional advice. Given this, I do not consider that there is any basis to say categorically that the FSA or the UKLA made a mistake or acted with lack of care when approving the EOM. I consider the FCA's complaints response to you on this element of your complaint to be reasonable and therefore I do not uphold this aspect of your complaint.

Regarding Element 4b), the FCA complaint response said as follows:

> *This element of the complaint arises from the Court of Appeal judgment where it refers to an 'obvious mistake' in the Trust Deed by which the ECNs were constituted in relation to the construction of the CDE clause. The error referred to is that the definition of a CDE fails to make adequate provision in the clause for future changes to the capital rules.*
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> The role of the UKLA
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> *The role of the UKLA in approving a Prospectus is to check that the documents comply with the Listing and Prospectus Rules and that the required disclosures have been made.*
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> A mistake in the Trust Deed
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> *The UKLA has reviewed this point internally and I have had access to its comments. The FCA's view is that the clause is referred to as a mistake in the context of an assessment of the Trust Deed from the perspective of contract law. On that point, I think it is also worth noting how the majority view of the Supreme Court was more open to interpretation on the question of a mistake in the drafting of the relevant CDE clause.*
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> *In the leading judgment, Lord Neuberger, when discussing whether the drafting does involve a departure from the literal meaning of the clause, he says at paragraph 38 of the Supreme Court Judgment that:*
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> *"It may involve a departure from the literal meaning, but, if it does, it is on the basis of a rather pedantic approach to interpretation."*
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> *This, in my view, does not mean the FSA made a material mistake in approving the Prospectus. The Prospectus was required to be reviewed in line with the Listing and Prospectus Rules and to check that the required disclosures had been made. From what I can see, the Prospectus accurately summarises what is in the Trust Deed and the mistake in the Trust Deed referred to by the Court of Appeal does not represent a breach of the Listing and Prospectus Rules in force at the time.*
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> *Also, in considering the role of the UKLA in approving a Prospectus and the differing viewpoints on the drafting mistake at both Court of Appeal and Supreme Court level, I*

do not think it is reasonable to have expected the UKLA, or the FSA to have picked up on it at the time.

In response to this element of your complaint, you have made the following points:

- The reference to the Trust Deed is irrelevant because the Prospectus Directive requires the prospectus to contain all necessary information in an easily analysable and comprehensible form
- The FCA's arguments that the UKLA does not sign off or verify accuracy does not stand up to scrutiny because the FSA was heavily involved in the design and structure of the instruments and exchange offer
- If the Supreme Court could not agree on the interpretation of the documentation, how could it have been 'easily analysable and comprehensible' to 123,000 retail investors?

This aspect of your complaint was made in February 2016 after the decision of the Court of Appeal. As noted above, when the matter went to the Supreme Court in June 2016, Lord Neuberger questioned whether there was indeed a drafting 'mistake'. Even if there was, the Court concluded that it was what LBG had intended. There was of course a dissenting judgment on this issue. However, I think the main point to emphasise here is that the Supreme Court decision upheld LBG's interpretation of the circumstances under which a CDE could occur and said that it would be too pedantic to interpret this narrowly. Although this is undoubtedly hugely disappointing to investors, in my view it is not ultimately either a 'prospectus' issue or an issue for the FCA. A problem with later interpretation of the contractual terms in the Trust Deed does not mean that the FSA did anything wrong or that the prospectuses failed the tests under the Prospective Directive. As noted above, that the Trust Deed would prevail in the event of any dispute was made clear in the EOM.

I have not seen any evidence to support the contention that the UKLA or FSA approved a prospectus that contained a material mistake. Furthermore, the principal responsibility for the documents lay with the issuers: it is not the FCA's role to 'copper bottom' every document produced. These were inherently complicated products with clear warnings as to the risks. The need to obtain professional advice was clearly indicated on all the relevant investor documents. I consider the FCA's complaint response to you on this element of your complaint to be reasonable and therefore I do not uphold this aspect of your complaint.

Regarding Element 4c), the FCA complaint response said as follows:

You allege the FSA would have been aware that the intention of the CDE clause was for a CDE giving rise to a right to redeem if the 'stress test' threshold was raised above the 5% Core Tier 1 equity conversion trigger. You have said the FSA should have ensured this information was included in the EOM.

LBG said in the Prospectus that the CDE provision could be triggered 'as a result of any changes to the Regulatory Capital Requirements or any change in the interpretation or application thereof by the FSA'. This seems to indicate that LBG knew some sort of change was possible. It also doesn't seem unreasonable for the clause to be drafted with the future in mind – especially as ECNs were designed in part to assist LBG in passing the stress tests that banks were subjected to by the relevant regulators. It follows that if the regime changed then a situation may arise where ECNs were no longer serving the purpose of assisting LBG in passing a stress test.

I note the FSA published Consultation Paper 09/29 – "Strengthening Capital Standards" on 3 December 2009 and the Basel Committee for Banking Standards issued a Consultation document on 17 December 2009 titled "Strengthening the Resilience of the Banking Sector" – which are both around the time the ECN prospectuses were issued.

It is clear from this that changes were in the air but having reviewed internal documents analysing this point, the documents referenced above did not seem to contain the level of detail that would have made the trigger of a CDE in the medium term immediately obvious.

You say that the FSA could have ensured that a supplementary prospectus was issued immediately after the Basel Committee met on 8 and 9 December 2009. The obligation on an issuer to file a supplementary prospectus occurs when a 'material mistake' is discovered [or a 'significant new factor' arises]. This would be after the publication of a prospectus but before the closure of any public offer or admissions to trading made pursuant to a prospectus.

The supplementary prospectus would correct the material mistake. In the case of the LBG EOM of 3 Nov 2009, the period during which the prospectus would need to be updated by a supplementary prospectus ran from 3 Nov 2009 to 1 Dec 2009. In this case, the changes to the rules that rendered the CDE clause unclear occurred years later.

There has been significant work involving the Supervision, Markets and UKLA departments at the FCA to establish if there is evidence of whether LBG or the FSA knew of the effect of the Basel Committee's proposed changes to the bank's capital regime ahead of their publication.

I appreciate the point that there were members of FSA staff on the Basel Committee at the time and clearly, this suggests that there were individuals within the FSA who were aware of the direction of the Basle Committee's policy on regulatory capital. However, I do not think it necessarily follows the FSA knew of the effect of the changes to the extent that it should have required LBG to make an amendment to the Prospectus.

This is because, from the analysis contained in the internal documents I have seen, none of the published material from Basel in 2009 and 2010 has enough detail to suggest that the effect of the changes could have been predicted. Also, I am satisfied the FSA was unaware – as it was not agreed until 2013 – that the PRA would pursue an early adoption of the Basel Standards, which subsequently triggered the CDE.

In response to this element of your complaint, you have made the following points:

- The FCA's complaint response ignores the Supplementary Prospectus dated March 2010.
- The Basel Standards published on 8 December 2009 had clear detail of the precise changes which could lead to a CDE being triggered but this information was omitted from the prospectus. The changed calculation of core capital came from these standards and at the time the ECNs were offered, the FSA was aware that those standards would be implemented by the end of 2012.

The risk of early redemption for regulatory purposes, including following a CDE "*occurring as a result of **any*** [my emphasis] *changes to the Regulatory Capital Requirements or any change in the interpretation or application thereof by the FSA*", was one of the risk factors identified in the EOM. What you appear to be saying is that if there was knowledge within the FSA about the impact of changes arising from the Basel standards while the prospectus was live, this significantly increased the risk and should have been drawn to the attention of prospective investors. The Basel Committee on Banking Supervision's Consultative Document *Strengthening the resilience of the banking sector* was dated December 2009 and issued for comment by 16 April 2010, shortly after the prospectus was released. It was a consultation document and I accept the FCA's complaint response that the effect of the changes could not have been predicted in 2009/10, particularly as it was not decided until 2013 that the PRA would pursue an early adoption of the Basel Standards. Although it might have been helpful for the FSA to have referred to the existence of emerging new standards, I am not persuaded that the fact that it did not do so represents a significant regulatory failing. Overall, although I agree with you that the FCA's complaint response did not specifically refer to the Supplementary Prospectus of March 2010, I am satisfied that it was reasonable for the FCA complaint response to say that none of the actual changes to the regulatory regime made from 2013 onwards were clear and crystallised when this or the EOM was issued. For these reasons, I consider the FCA's complaint response to be reasonable and I do not uphold this aspect of your complaint.

Delay

As noted above, you first complained to the FCA in January 2016 but did not receive final responses to your complaints until February to April 2017. During this time, you raised concerns with the FCA and my office about the FCA's lack of substantive progress. We monitored the situation from time to time and, while understanding your frustration, explained that it was preferable to allow the FCA to conclude its investigation.

I note that the FCA's complaint responses acknowledge and apologise for the length of time taken to complete its investigation into your complaint. I have considered whether that is an acceptable response to the delays or whether it would be appropriate for me to recommend that a small payment is made to you. I am aware that this was a complex matter requiring detailed review and liaison with staff across the FCA at senior level. During the period of the FCA's complaints investigation the substantive issues were also being considered by the Supreme Court, which issued its judgment on 16 June 2016. I also note that the FCA sent you regular updates and generally kept you informed about progress.

Nevertheless, I have concluded that overall there were unacceptable and avoidable delays by the FCA in dealing with your complaint between May and November 2016, such that you quite reasonably contacted my office for assistance. There were then further delays until February 2017 when the FCA issued its first two complaints responses to you and again in March and April 2017 when the responses were issued on the remainder of your complaints. In view of this, I **recommend** that the FCA offers to pay you the sum of £100 in recognition of the distress and inconvenience that has been caused to you by its repeated failure to meet its own deadlines in handling these complaints.

In my preliminary decision, I recommended that the FCA should also offer this sum to the members of the group complaint for whom you are acting. I note your comment that the FCA should be made responsible for identifying who is within this group as only the FCA has this

information. In its own response to the preliminary decision, the FCA has said that although it accepts that the delays were frustrating, there is little evidence to show that group members were inconvenienced and that its apologies should be sufficient. It also says that in any event the offer should not be extended to those members of the group complaint who did not first approach the FCA under Stage 1 of the Complaints Scheme. I also note that several complainants have contacted me since the issue of my preliminary decision (that is beyond the timescales laid down in the Scheme) asking to be included in the group complaint.

I have considered these points and concluded that a fair outcome would be for the FCA to offer the sum of £50 to those members of the group who underwent Stage 1 (and therefore experienced the delays) and who also approached my office within the timescales indicated in the FCA's complaint response letter to them. I am happy to assist with identifying and contacting those affected. I consider this to be a proportionate response taking into account the FCA's comments on the impact of such an award under paragraph 7.14 of the Scheme.

Conclusion

In conclusion, for the reasons set out above, I have not upheld your substantive complaint. I have however concluded that there was avoidable delay in responding to you. I recommend that:

- The FCA offers to pay you the sum of £100 for distress and inconvenience caused to you by its complaints handling delays.
- The FCA offers to pay the members of the group complaint I have identified the sum of £50 each for distress and inconvenience caused by its complaints handling delays.

Yours sincerely

Antony Townsend
Complaints Commissioner

ANNEX 1 – RELEVANT EXTRACTS FROM LBG Exchange Offer Memorandum (EOM), dated 3 November 2009

Early Redemption for Regulatory Purposes If, immediately prior to the giving of the notice referred to below, a Capital Disqualification Event has occurred and is continuing, then the relevant Issuer may, subject to Condition 8(b) and having given not less than 10 nor more than 21 days' notice to the 98 Trustee, the Principal Paying and Conversion Agent, and the ECN Securityholders (which notice shall, subject as provided in Condition 8(f), be irrevocable), redeem in accordance with the relevant Conditions at any time (in the case of a Fixed Rate ECN) or on any Interest Payment Date (in the case of a Floating Rate ECN) all, but not some only, of the relevant series of ECNs at their principal amount (or at such other amount as may be specified in the relevant Pricing Schedule), together with any accrued but unpaid interest to (but excluding) the relevant redemption date. See Part A of Appendix 6 (''Terms and Conditions of the ECNs – Redemption and Purchase – Redemption for Regulatory Purposes''). A ''Capital Disqualification Event'' is deemed to have occurred (1) if, at any time LBG or, where LTSB is a or the Guarantor, LTSB is required under Regulatory Capital Requirements to have regulatory capital, the ECNs would no longer be eligible to qualify in whole or in part (save where such non-qualification is only as a result of any applicable limitation on the amount of such capital) for inclusion in the Lower Tier 2 Capital of LBG or, as the case may be, LTSB on a consolidated basis; or (2) if as a result of any changes to the Regulatory Capital Requirements or any change in the interpretation or application thereof by the FSA, the ECNs shall cease to be taken into account in whole or in part (save where this is only as a result of any applicable limitation on the amount that may be so taken into account) for the purposes of any ''stress test'' applied by the FSA in respect of the Consolidated Core Tier 1 Ratio.

8(e) Redemption for Regulatory Purposes If, immediately prior to the giving of the notice referred to below, a Capital Disqualification Event has occurred and is continuing, then the Issuer may, subject to Condition 8(b) and having given not less than 10 nor more than 21 days' notice to the ECN Securityholders in accordance with Condition 17, the Trustee, the Principal Paying and Conversion Agent and the Registrar (which notice shall, subject as provided in Condition 8(f), be irrevocable), redeem in accordance with these Conditions at any time (in the case of a Fixed Rate ECN or in the Fixed Interest Rate Period in the case of a Fixed/Floating Rate ECN) or on any Interest Payment Date (in the case of a Floating Rate ECN or in the Floating Interest Rate Period in the case of a Fixed/Floating Rate ECN) all, but not some only, of the ECNs at their principal amount (or at such other amount as may be specified in the relevant Pricing Schedule), together with any accrued but unpaid interest to but excluding the relevant redemption date. Upon the expiry of such notice, the Issuer shall redeem the ECNs as aforesaid.

19 a ''Capital Disqualification Event'' is deemed to have occurred (1) if, at any time LBG or, where LTSB is a or the Guarantor, LTSB is required under Regulatory Capital Requirements to have regulatory capital, the ECNs would no longer be eligible to qualify in whole or in part (save where such non-qualification is only as a result of any applicable limitation on the amount of such capital) for inclusion in the Lower Tier 2 Capital of LBG or, as the case may be, LTSB on a consolidated basis; or (2) if as a result of any changes to the Regulatory Capital Requirements or any change in the interpretation or application thereof by the FSA, the ECNs shall cease to be taken into account in whole or in part (save where this is only as a result of any applicable limitation on the amount that may be so taken into account) for the purposes of any ''stress test'' applied by the FSA in respect of the Consolidated Core Tier 1 Ratio;

''Core Tier 1 Capital'' means core tier one capital as defined by the FSA as in effect and applied (as supplemented by any published statement or guidance given by the FSA) as at 1 May 2009; ''Lower Tier 2 Capital'' has the meaning given to it by the FSA from time to time; ''Regulatory Capital Requirements'' means any applicable requirement specified by the FSA in relation to minimum margin of solvency or minimum capital resources or capital;
''Tier 1 Capital'' has the meaning given to it by the FSA from time to time; and ''Upper Tier 2 Capital'' has the meaning given to it by the FSA from time to time.