Complaints Commissioner

Office of the Complaints Commissioner
23 Austin Friars
London EC2N 2QP

Tel: 020 7562 5530
E-mail: complaints@frccommissioner.org.uk
www.frccommissioner.org.uk

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Final report by the Complaints Commissioner

Complaint number FCA00641

The complaint

1. You originally made a complaint in September 2013 alleging regulatory failures over a number of years by the Financial Services Authority (FSA) and later the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) (the Regulators collectively) in the supervision of the Co-operative Bank (the Bank), as well as a failure to protect consumers like yourself, who had invested in the Bank, over a number of years.

2. You also allege that these regulatory failures significantly contributed to several problems arising at the Bank, resulting in it facing a capital short-fall of £1.5 billion in 2013, which in turn led to the collapse of the Bank's shares and bonds value and a significant loss to investors such as you, who held preference shares in the Bank.

What the complaint is about

3. Your original complaint set out seven complaint points, followed by an email addendum on 24 September 2013. You were informed by the FCA on 10 October 2013 that the investigation of your complaint would be deferred under paragraph 3.7 of the Complaints Scheme (the Scheme) because there was continuing Enforcement action. Paragraph 3.7 provides that:

> *A complaint which is connected with, or which arises from, any form of continuing action by the Regulators will not normally be investigated by either the Regulators or the Complaints Commissioner until the complainant has exhausted the procedures and remedies under FSMA (or under other legislation which provides for access to the Scheme) which are relevant to that action. The complainant does not have to be*

the subject of continuing action by the Regulators for this provision to be engaged. An investigation may start before those procedures are completed if, in the exceptional circumstances of the case, it would not be reasonable to expect the complainant to await the conclusion of the Regulators' action and that action would not be significantly harmed.

4. You accepted the decision of the FCA to defer its investigation at that time. However, you approached my office on 5 April 2016, following a letter from the FCA dated 22 March 2016, and raised a complaint about the actions and failures of the Regulators, as well as the continuing deferral of investigating your complaint.

5. I did not investigate the substantive elements of your complaint at that time, but I did consider the reasonableness of the deferral. I concluded that, ultimately, it was the right decision to make, with some caveats about reviewing the deferral within six months or when the Enforcement action concluded, whichever was the sooner (FCA00143).

6. Enforcement action ultimately concluded on 6 March 2018 and you were notified by the FCA then that your complaint would be investigated. You responded with a further email on 2 April 2018, setting out some additional concerns and the Regulators identified and investigated 15 issues raised by you. These issues are:

   - *The alleged failure by the FSA to identify problems at the Bank, including, the problems that allegedly prompted Mr Richardson's resignation (**Issue 1**)*
   - *The alleged failure by the FSA to follow through on explicit warnings over Project Verde (the proposed acquisition of Lloyds Bank branches) (**Issue 2**)*
   - *The alleged failure of the FSA to follow through on warnings to the Bank to increase its capital resources (**Issue 3**)*
   - *As part of the group-wide consolidation known as Project Unity, the FSA allegedly failed to properly consider the suitability of the members of the Group Board (**Issue 4**)*

- *Whether the timing of the call for increased provisioning against doubtful loans was unreasonable (**Issue 5**)*
- *Whether the extent to which the PRA increased the Bank's capital adequacy requirements was unreasonable (**Issue 6**)*
- *The alleged failure to investigate misleading statements in the Bank's Accounts (**Issue 7**)*
- *The alleged failure of the PRA to direct the Bank's ultimate parent company to remediate (**Issue 8**)*
- *The FSA's alleged forfeiture of its ability to influence the Group by issuing the Group with a waiver from being considered a financial conglomerate (**Issue 9**)*
- *The FCA's alleged failure to intervene to support investors and to require the Bank to treat retail investors fairly (**Issue 10**)*
- *The FCA's alleged delay of a market abuse investigation to take into account the Bank's recapitalisation proposals (**Issue 11**)*
- *Whether the October 2015 investigation regarding Paul Flowers should have commenced at the same time as the April 2015 investigation regarding other individuals (**Issue 12**)*
- *Whether the Complaints Team ignored concerns raised by the Complaints Commissioner in June 2016 about the commencement of the Complaints investigation being delayed by potential overlap with the HMT- directed investigation (**Issue 13**)*
- *Whether the FCA should have conducted the Enforcement and Complaints investigations in parallel (**Issue 14**)*
- *Whether the FCA should have prioritised the complaints investigation over the Enforcement investigations (**Issue 15**)*

7. The FCA and PRA completed their investigation and provided you with their final decision on 28 June 2019. The FCA answered the prudential issues relating to the FSA (Issues 1-6 and 9) but liaised closely with the PRA. The PRA answered the prudential issues relating to the PRA (Issue 8), but for

convenience the answer was incorporated into the FCA's letter of 28 June. The remaining issues were answered by the FCA.

8. You were dissatisfied with the outcome and you formally referred your complaint to me on 21 August 2019.

What the FCA and PRA decided

9. The FCA upheld your complaint about the failure to investigate misleading statements in the Accounts of the Bank, published on 21 March 2013, until June 2013 (Issue 7).

10. It found that considering the FSA's serious concerns about the Bank's capitalisation, the Bank's systemic importance, the fact that the Bank had sent the FSA a preview of its proposed Q&A messaging to accompany the financial statements which gave a misleadingly optimistic impression of the Bank's financial position, the fact that Moody's downgraded the Bank by six levels on 9 May causing a significant fall in the Bank's securities, and the fact that the PRA identified a £1.5bn shortfall in the Bank's capital adequacy on 4 June 2013, it was unreasonable for Supervision not to review the Bank's Capital Adequacy Statement until consumer complaints started arriving on 19 June 2013. It was also unreasonable for Supervision not to engage with the UK Listings Authority (UKLA) on the matter.

11. The FCA made a recommendation for an apology to be issued to you for any inconvenience and/or losses you may have suffered as a result of its shortcomings, but found that its failure to review the Capital Adequacy Statement in good time was not the *direct* cause of your losses, because the responsibility for the misleading statements lay with the Bank's directors and the auditors. The FCA therefore did not make an ex-gratia monetary award.

12. The other 14 complaint points raised in Issues 1-6 and 8-15, set out in detail throughout this report, were not upheld.

Why you are unhappy with the Regulators' decision

13. Whilst you recognise that the final decision letter demonstrates an attempt to deal with your complaints separately and in some depth, in your view it fails to

recognise the cumulative effects on investors like yourself of the individual alleged failures by the Regulators.

14. In your letter dated 21 August 2019, you set out point by point why you are not satisfied with the conclusions of the Regulators, including the decision not to offer you compensation. I shall address these points in this report, following the Regulators' numbering style for ease of reference.

Preliminary points

15. Your complaint relates to the well-publicised and long-running problems at the Co-op Bank and the alleged failures of the Regulators over a number of years.

16. Two separate inquiries (the Kelly Review dated 30 April 2014 and the Zelmer Review dated March 2019) were set up to look into the actions and/or lack of action by the Bank and the Regulators, spanning two sets of regulatory bodies - initially the FSA - and from April 2013, the FCA and the PRA. Some of the issues were also considered extensively by the Treasury Select Committee (TSC).

17. Those inquiries represented an in-depth analysis of the problems which arose. The FCA's investigation into your complaint was extensive and thorough, and resulted in a 32-page decision letter which was, in my view, a comprehensive analysis of the facts relating to your complaint. I have studied the reports and the FCA's investigation report. Although I have consulted background documents to check the FCA's analysis, I have not considered it necessary to rehearse all the factual background here. It seems to me that the reason for your dissatisfaction with the FCA's response to your complaint centres upon the interpretation of the Regulators' responsibilities and exercise of their discretion, rather than upon disputes about facts.

18. Nonetheless, I set out below a very brief summary of the general background, because without it it is not possible to explain why the Regulators acted as they did, nor is it possible to assess whether or not their actions or inactions were reasonable. Much fuller explanations of this background are contained in the Kelly and Zelmer Reviews.

19. Following the financial crisis of 2008, the Regulator, then the FSA, was under serious pressure in trying to deal with the fall-out of the crisis as well as

working towards strengthening the regulatory regime in order to be able to better maintain the stability of the financial services system in future, one of its core objectives, and consequently, better protect consumers from market volatility and the risk of firms failing.

20. As a result, the regulatory landscape changed significantly over the period related to your complaint, including the formation of two separate regulatory bodies to replace the FSA: the FCA, responsible for conduct matters, and the PRA, responsible for prudential matters. There was also a change in approach from prudential risks assessments being based on past performance of assets to forward looking valuations.

21. Finally, it is important to emphasise that it is not my role to say what I might have chosen to do had I been in the Regulators' shoes at the relevant times. The Regulators have been given considerable discretion to decide how and when to deploy their regulatory powers: this is right and inevitable, given the scale and complexity of the task which the Regulators are expected to perform, and the competing priorities which they face. The question which I have to address under this Complaints Scheme is not whether the Regulators might have done things better, but whether their actions or inaction were of a kind which fall outside the bounds of reasonableness.

My analysis

Issues 1, 2 and 3

22. I am going to address these three issues as one because they are so closely related.

23. You allege that the FSA failed to identify problems at the Bank over several years, as and when they were developing, and failed to prevent things getting worse. Furthermore, even with the issues the FSA was aware of, such as two major change projects going on when a third one was proposed by the Bank (as well as other major work at Group level), you say that the FSA admitted that "prevailing practices were not adequate to deal with the issues" at the time they were arising. (*Issue 1*)

24. You believe the FSA failed to follow through on warnings to the Bank about the need to increase its capital resources. You have seen a chronicle of

warnings from the FSA to the Bank from July 2011 to 2013 about increasing its capital resources, but no effective action was taken by the Bank and the capital position worsened. (*Issue 3)*

25. You also allege that the FSA failed to take follow-up action related to explicit warnings about Project Verde, the proposal that the Co-op Bank should buy a significant number of Lloyds Bank branches. Co-operative Financial Services (CFS) Group and Co-Op Group overruled the CEO, Neville Richardson, who raised concerns about the management overstretch in the Bank given the number of major change programmes proceeding in parallel, and who subsequently resigned – but the FSA accepted the Bank's word that it was taking appropriate action to address concerns raised and did not carry out due diligence. You have drawn attention to the fact that following Neville Richardson's departure, a number of other senior managers left and some key roles were occupied on an interim basis. You believe that the Zelmer Review is incorrect in concluding that this was reasonable in light of the prevailing practices at the time. (*Issue 2)*

Project work

26. The Bank had undertaken a number of projects from 2009 onwards, the main ones being:

    (a) The Bank Transformation Programme (BTP), intended to integrate the systems used by the Bank and Britannia Building Society (Britannia) following their merger,

    (b) Project Unity, which was aimed at streamlining certain functions and cross-selling products across the Co-operative Group, and

    (c) Project Verde, which was the attempt of the Bank to purchase the Lloyds branches forcibly put up for sale in 2011, with direction from the Co-op Group and strongly championed by the Group CEO.[1]

27. Both the Kelly and Zelmer Reviews concluded that the Bank had too many projects going on at the same time, which distracted senior management and their teams at the Bank and to some extent the Regulators, who were

[1] Kelly Review – para 13.10

contending with several supervisory issues and lines of enquiry. This resulted in insufficient attention being given to some of the major concerns.

28. Sir Christopher Kelly places the responsibility for this at the door of the Bank, as pursuing these projects was a business decision made by a Bank that "failed to understand the limits of its own capability"[2]. He stated that "however attractive individual projects may be on a stand-alone basis, attempting to pursue too many at the same time can risk failure of all", which is what ultimately happened at the Bank.

29. There were also problems at the FSA. In addition to the fact that the Supervisory team at the FSA was stretched by the sheer number of issues at the Bank and more generally from the financial crisis, the documents I have reviewed also paint a picture of Supervisors lacking a sufficient level of expertise to be able to identify the "big picture" concerns, as well as being affected by high staff turnover and no permanent senior manager being in place during much of 2010.

Warnings over capitalisation

30. You are unsure if all actions available to the FSA were taken to press this issue, but you believe that they should have been able to force the Bank to deal with the concerns in a more robust way than it did. You believe that had the FSA taken appropriate and timely action to challenge the Bank robustly, and had carefully considered and examined the information they were being given, the process to address the capitalisation issue would have been started earlier than late 2012 and early 2013; and what you see as the disastrous effects of the Liability Management Exercise (LME) in December 2013 would have been mitigated.

31. The Zelmer Review covered the issue of the supervision of the Bank by the Regulators, as well as the actions of the Bank. I do not believe that setting out all of the same information here is necessary, but I will highlight what I consider to be the key points.

[2] Kelly Review – para 14 I.

32. The Zelmer Review sets out in considerable detail that the FSA team responsible for the supervision of the Bank had several issues and concerns to contend with, in relation to both conduct and prudential matters, from when the financial crisis hit the UK and the rest of the world in 2008. They continued to have their attention divided by these issues at the Bank from the date of the Britannia merger in 2009 to the problems crystallising at the end of 2012/beginning of 2013.[3] My review of the documents provided to me by the Regulators confirmed this.

33. In June 2009 the FSA, as part of its work to assess and shore up all major financial institutions in the UK, carried out a mini stress test at the Bank, in line with reviews at other banks and building societies, and identified that the wholesale loan book of Britannia was of poorer quality and more prone to loss than that of the Bank.[4] .

34. The FSA decided to approve the Co-op-Britannia merger, because it corresponded to the benchmark in the building society sector but also because there were no apparent viable alternatives for Britannia. This seems to have been a judgement made by a Regulator which was having to weigh up its competing objectives of consumer protection and ensuring market integrity and financial stability in the UK, in unprecedented conditions affecting financial services in the UK and globally.

35. A Full-Broom stress test carried out at the end of 2009 confirmed that the worst-case scenario was more likely to happen as it identified a “far higher level of risk weighted assets” in the Britannia loan book. The Regulator was now on full notice that there were serious capital adequacy concerns at the Bank, as well as other supervisory concerns to do with risk management and data quality (the Regulator found that its efforts to carry out accurate assessments were hampered by the Bank’s management information and internal rating systems being limited).

36. Because of the concerns identified, in November 2009 the Regulator asked for outside assistance from Price Waterhouse Cooper (PwC) to carry out a

[3] Zelmer Review – para 155
[4] Zelmer Review – para 158 - 161

further assessment. This confirmed that the FSA's concerns were well founded, and a further, more formal, review was undertaken by PwC, although this was not a formal section 166 review. Zelmer viewed this as a weakness as the terms, whilst referencing the FSA's specific concerns, were agreed between the Bank and PwC, which removed control from the FSA. The terms of the review were not focused on the credit risk management processes at the Bank or the valuation of assets, and therefore the adequacy of capital provisioning.[5] This was common practice at that time, although would not be now.

37. Nonetheless, the capital and management risks were identified and notified to the Bank, including in the 2010 Advanced Risk-Responsive Operative Framework (ARROW) report. It is noteworthy that as Kelly and Zelmer had found, and as stated above, both senior executives at the Bank and members of the Supervision team at the FSA were stretched and distracted at this time by the various projects going on at the Bank, including the Britannia integration work, the IT re-platforming project, and trying to implement a more robust risk management structure.

38. Zelmer also concluded that the "supervisors did not sufficiently focus on the inherent refinancing risks in the loan book" which was identified in Q4 2009, and placed too much reliance on external reports and expert opinions, rather than detailed assessments of data.

39. This is of relevance as the complaint response to you states that "In terms of historical concerns regarding capital adequacy, in circumstances where the Bank was not in breach of its minimum capital requirements before June 2013, the powers available to the FSA were not triggered because no Threshold Condition was breached."

40. It is the case that the Threshold Conditions were not breached. Zelmer noted that, had the Regulator been forward looking at this time in its assessment of the Britannia loan book quality and refinancing risks and challenged the

[5] Zelmer Review – para 163 - 164

adequacy of capital provisioning appropriately, it could have imposed regulatory capital consequences on the Bank.[6]

41. Following these reports, the Bank appeared to be co-operating with the FSA on all issues raised and put forward a management action plan that was deemed sufficient to address any issues arising in a stress scenario. Senior FSA management decided to give the Bank credit for these proposed management actions. Zelmer concluded that on these grounds, the FSA should have questioned how feasible the implementation of these management actions would be in the case of a stress scenario.

42. Had the FSA not given the Bank credit for its proposed management actions, the assessment of the capital position of the Bank would have been very different as early as 2010 and the FSA might have been in a position to take regulatory action to address the capital adequacy issues.

43. Whilst therewas continuing supervisory work, the supervision team's focus was split across many different issues and various group entities during 2009-2013. The forward-looking plan of the Regulator in 2010 was to allow the Bank to continue with Project Unity and maintain the stability of the Bank, and review the capital position again in Q2 of 2012.

44. It was clearly understood at this point that the Bank was capital constrained and there remained a credit risk from the Britannia loans. In an attempt to deal with some of the concerns, the FSA encouraged the injection of capital from other entities within the group, which resulted in the injections of £180 million from CFS in 2010, £87 million from CIS General Reserve in 2011 and £80 million by way of CIS dividend in 2012.[7]

45. It is clear from the files that the supervisory work related to the Bank was continuous, reviews and discussions were had about the position of the Bank and the concerns identified by the FSA were communicated to the Bank in an effort to have them addressed. In addition, the FSA was also given reassurances by the Bank, such as at meetings in February and May 2011,

[6] Zelmer Review – para 162
[7] Zelmer Review – para 174

that its Board was aware of the problems of adequate capitalisation and was taking steps to deal with this matter, and that other projects were going well.

46. It seems to flow from all of the above that the FSA did not give sufficiently sophisticated consideration to the capital adequacy of the Bank following the merger with Britannia. Had it imposed regulatory capital consequences on the Bank earlier, which it might have done if more detailed attention had been paid to the capital position and the impact of the Britannia corporate loan book, some of the Bank's projects would not have been feasible from the outset and so would not have been undertaken at all, or the Bank might have taken more decisive corrective action and corrected the capital position, placing it in a stronger position to take on the challenges these projects brought.

Project Verde

47. It was against this backdrop that the Bank told the FSA in May 2011 of its interest in purchasing the 632 Lloyds branches to further its strategic plan to increase its market share.

48. For this purchase to go ahead, the Bank was aware it would require the FSA's approval and it was advised by the FSA that it would need to demonstrate an ability to manage its capital position in a 'steady state' and that "the application would also need to be considered against the FSA's financial stability and consumer protection objectives". This was confirmed both in writing and through a presentation to the CFS Board in June and July 2011.

49. It was in the course of this correspondence that the FSA also made it clear that it had doubts about the Bank's ability to complete such a transaction successfully, and that it was necessary for the Bank to achieve and sustainably manage a Core Tier 1 ratio of 10%, which under Basel III could amount to as much as £900 million before the Verde purchase and £2 billion if that went ahead. The Bank carried on reassuring the FSA that it was aware of the capital position and was taking steps to ensure it was addressed.

50. In September 2011 an FSA senior management review identified that supervision should be more focused on capital adequacy, because there was a risk of the capital buffer eroding due to economic conditions and the Bank's

inability to raise equity capital. It was also identified that the Bank had the highest risk portfolio and lowest Capital Tier 1 ratio compared to its peers.

51. Alarm bells kept ringing at the FSA about the Internal Audit function of the Bank not being robust enough, the lack of financial experience of its directors, a number of key roles remaining unfilled by a permanent and suitably qualified person, and the unique corporate status of the Bank, which would cause difficulty in raising, under Basel III, capital sufficient to sustain a much larger bank, which it would become if the Verde transaction were to go through. These points were made to the Bank by letter in December 2011 and the FSA required the Bank to share this letter and its substantive concerns with Lloyds.

52. This was a change in regulatory approach, showing more willingness to engage closely in what was at this point a commercial negotiation, not normally a matter the FSA would take a stance on. Despite this, Lloyds announced on 13 December 2011 that it was entering exclusive negotiations with the Bank for the Verde transaction.

53. The FSA required the Bank to demonstrate its ability to address the capital requirements issue, risk management matters and its ability to deliver Verde on time and within budget.

54. Whilst the Bank gave reassurances and reported progress to the FSA by letter in February and April 2012, I find it surprising that the issues of capital adequacy and concrete steps taken by the Bank to address the FSA's concerns do not seem to have been discussed in any detail at the 2012 ARROW review, especially in light of the fact that the FSA had already identified in late 2011 that the Bank was showing resistance to feedback and had a tendency to report only positive matters.

55. The 2012 ARROW assessment did, however, identify that the concerns raised by the ARROW assessment of 2011 had not been fully addressed and that the board membership needed strengthening.

56. It seems it would have been a logical step to continue paying close attention to the capital position of the Bank in light of the above, coupled with the shortfalls exposed by the stress tests in 2009, the need for Core Tier 1 capital increase already estimated at £900 million before and possibly £2 billion after

Verde, the continuing impact of a high risk legacy loan book of Britannia and the limited capital raising ability of the bank as well as the Bank's lack of progress in addressing regulatory concerns.

57. The Zelmer Review also found that

> *with the knowledge of the stress test results, and given the increasingly clear direction of travel towards higher capital requirements and more stringent future loans loss provisioning expectations for banks, I firmly believe that there should have been a greater focus by FSA senior supervision management and the supervision team on reviewing the quality of the loan book and its valuation and ensuring adequate capital was in place to cover potential losses. The fact that the Co-op Bank's capital raising options were limited, given the mutual status of its parent, should have made capital planning more of a focus*.[8]

58. Furthermore, Kelly found "it slightly surprising that in 2011 the FSA should have regarded its relationship with the Bank as generally good in the light of what we now know of the Bank's attitude to regulatory correspondence, its slowness in dealing with some regulatory concerns and its incomplete transparency on some important matters."[9]

59. The Bank in turn was returned to the Regulator's Watchlist[10] due to the capital adequacy issue and lack of progress with addressing risk management matters, although the Bank did take some steps to address some of the concerns.

60. The Kelly review describes the events surrounding the Verde transaction in paragraphs 9 to 9.42 in great detail. The assessment of the individuals on the Bank and Group Boards is damning, as Kelly identified that they lacked the necessary financial services experience, were not capable of effectively challenging the Group CEO and had effectively allowed the Verde process to carry on despite the reservations of Board members with banking experience,

[8] Zelmer Review – para 197
[9] Kelly Review – para 10.12
[10] The Watchlist is a list of firms maintained by the FSA, and subsequently the PRA, of those firms the Regulator is most concerned about from the perspective of meeting its statutory objectives. The Watchlist helps the Regulator's management to monitor progress made on mitigating risks in these firms

warnings from the Regulator and a “glum” assessment by KPMG. None of these warnings had any notable impact on the Verde process, which ought to have been halted much earlier with all the information available to the Bank.

61. The FSA had increased the Bank’s capital requirements dramatically in January 2013 but nonetheless it continued with the Verde acquisition process. KPMG then explicitly advised the Bank not to proceed with the deal. The fact the Group CEO and some others remained supportive of the deal even at this time demonstrates the clear lack of appreciation for the difficulty the Bank was in by this point.

62. It is correct to say that the process did not get to the stage where the FSA had to make a formal decision about the viability of the Verde project. However, there had been clear warning signs about the capital adequacy issues at the Bank from as early as 2009, with the FSA identifying that under Basel III it might have to raise as much as £900 million in mid-2011. It is therefore arguable that the FSA should have taken more decisive and directive action to head off the problems, especially in light of the Bank’s inability to raise capital in the same way as many other banks due to its ownership structure. I recognise, however, that judgements about the point at which a regulator intervenes in the governance of a bank are often difficult and finely balanced.

63. My conclusions, and those of Kelly and Zelmer, have been made with the benefit of hindsight and in full knowledge of the Bank’s attitude to the Regulators, but we all concluded that there had been several missed opportunities in addressing the Bank’s valuation and risk management practices, the number of large and complex projects going on at the same time distracting both the key personnel at the Bank and the supervisors at the Regulator, the lack of financial services expertise at the Bank and Group Board level (see further at paragraph 76 below) and its capital adequacy issues, all of which contributed to the capital shortfall.

The resignation of Neville Richardson

64. You have cited the resignation of Neville Richardson in 2011 as an example of a warning signal which should have alerted the FSA to the seriousness of the

problems at the Bank; and you have drawn my particular attention to the evidence which he gave to the Treasury Select Committee.

65. While I agree that his resignation was inevitably a cause for concern, I have studied the FCA's records, including the record of his exit interview with the FSA. It appears to me that the FSA responded appropriately to that resignation, including considering the matters raised by Neville Richardson during the exit interview. As I have described throughout this report, the FSA was well aware of the key issues facing the Bank, and had numerous interactions with the Bank on those subjects. The issue is not whether the FSA was oblivious to those issues – it was not – but whether its actions were reasonable given the circumstances which it faced – a matter to which I return later.

66. I agree with Zelmer that the regulatory approach at that time was very different to today. The FSA had taken steps to flag up concerns and had asked the Bank for action to resolve them from an early date, but these were not robust enough and were not always sufficiently followed up. Over a number of years the Bank failed to respond effectively to warnings about its capital adequacy, and its governance and reporting structures. What the Kelly Review describes as the Bank's lack of transparency and willingness to engage promptly and meaningfully with the Regulator greatly contributed to the outcome that has so badly affected preference shareholders like you, and resulted in the Bank no longer being wholly owned by the Co-op Group[11].

67. However, Zelmer concluded that earlier action by the Regulator would not have mitigated the outcome (the capital shortfall crystallising and the Verde deal falling through), but just brought it to a head more quickly, as the capital position was compromised from the time of the Britannia merger.[12]

68. The issue here is not whether the Bank and the Regulators could have handled matters better – no one contests that they could have done so – but whether in the circumstances of the time – a sector and regulator under stress, and a different approach to regulation – the approach taken was within

[11] Kelly Review - para
[12] Zelmer Review – para 287

the bounds of what a reasonable regulator might have done. The FSA undoubtably identified the key risks, and undoubtably flagged them repeatedly to the Bank's management, with whom the primary responsibility clearly rested. Lessons have clearly been learned from the experience of the Co-op, and carried forward into the new regulatory system. I recognise that you consider that no reasonable regulator could have acted as the FSA did, but I see no reason to disagree with the Zelmer analysis, and in the circumstances, I do not uphold these elements of your complaint.

Issues 4 and 9

69. You allege in Issue 4 that in light of the Co-op group-wide consolidation programme known as Project Unity, which sought to integrate various parts of the Group including the Bank, the FSA failed to consider properly the suitability of the members of the Group Board.

70. The FCA concluded that the "failure of the FSA to separately assess the members of the Group board as approved persons was not unreasonable" because there was no regulatory requirement to do this, it was already aware of the governance risks posed by Project Unity and had taken steps to address these and "virtually all of the key members of the Group board who exercised influence over the Bank were approved persons".

71. It is clear from the documents I have looked at that the FSA was aware of and concerned about the potential impact of Project Unity on the management and reporting structures. For example, Neville Richardson had to report to Peter Marks, who was both CEO of the Co-op Group and also an Approved Person (APER) as a Non-Executive Director of CFS, which was seen as a potentially significant change.

72. The Kelly Review dealt with this issue in some detail[13]. It found that the project "paid insufficient attention to the differences between the Group's trading businesses and a bank operating in a regulated environment". It also distracted senior management and their teams when they were dealing with already existing challenges and was a factor in the departure of the Bank's Chief Executive, Neville Richardson, which in turn started a chain of events

[13] Kelly Review – part 8 – Project Unity

that contributed to the significant problems at the Bank, and which crystallised in 2013.

73. Kelly identified that people within the Group viewed Peter Marks, the Group CEO, as "first amongst equals"[14]. Internally, Project Unity was viewed as a vehicle to allow the Group CEO to take control of the Bank[15] and solidified this position, as the Bank CEO would sit on the Group Executive Committee and report to the Group CEO once it was implemented.

74. However, records indicate that the FSA was not made aware of the proposed changes to reporting lines at the early stages and when the Project was presented to it, it queried the impact of it on the Approved Persons' roles. The Group CEO and Chair (Peter Marks and Paul Flowers) assured the FSA that the changes would not be significant[16].

75. It appears that the FSA relied on this assurance and no further action was taken. Enquiries were being made about the structural changes to the CFS board and reporting lines but not much emphasis was placed on these.

76. The Kelly Review makes a number of criticisms of the Group Board's lack of banking experience and expertise[17], the lack of clear reporting lines and structures and the Group Board's failure to install a strong and competent Executive leadership team[18], as well as its approach to the FSA, which seems to provide some insight into why the information flow from the Bank to its regulator was limited: Peter Marks is quoted as stating to the Group Board in October 2012 that "the FSA is pulling CBG in a direction which conflicts with the Group Board objectives for Unity, which we cannot allow"[19].

77. Whilst it appears that risks were identified by the FSA in relation to the changes in reporting lines and the possible impact of these on the Approved Persons and SIF regimes and some challenges were made, some of these were not followed through and no significant action resulted from them.

[14] Kelly Review – part 8.10
[15] Kelly Review – part 8.12
[16] Kelly Review – 8.15
[17] Kelly Review – 13.21
[18] Kelly Review – part 14
[19] Kelly Review – 8.16

78. I have to consider the reasonableness of the FSA's actions in light of the facts available to them at the time the issue arose, as well as the applicable standards at the time. It was not best practice for Approved Persons to report to non-Approved Persons but it does not appear to have been contrary to the regime applicable at the time[20]. However, the records I initially reviewed did not provide a full explanation of the steps which the FSA took to address the issue.

79. I asked for additional documents in my preliminary report (PR), issued in March 2020, which the FCA did not think were necessary for me to see to conclude my investigations. I further pressed the issue from the date of its response to my PR in July 2020, but it was only in October 2020 that the FCA provided some of the documents requested. I note the difficulties arising from the impact of COVID-19, but even in light of this, the time taken to supply information was too long.

80. The documents I received did not include everything that I asked for. The way in which this request for further information was responded to by the FCA is not acceptable and does not aid the effective operation of the Complaints Scheme.

81. However, I can see from the documents that were provided that the FCA took steps to address and deal with the issues raised in this complaint point. The FSA might have acted more quickly on the concerns raised in 2011. However, I do not think that it would not have made a material difference to the outcome.

82. Linked to the above is Issue 9, where you alleged that the FSA "forfeited its ability to influence the Group by issuing the Group with a waiver for being considered a financial conglomerate".

83. Whilst you have concerns about the FSA's decision to issue the waiver, the final decision letter provided you with some detail about the background of this decision which you were not aware of before. I understand you now accept

[20] Kelly Review – 8.14

that the decision did not entirely tie the hands of the Regulators and was not "inexplicable".

Issues 5 and 6

84. In Issue 5 you complained that the timing of the Regulator's request for the Bank to increase its capital was unreasonable. You qualified this point slightly in your complaint to me and stated that your concern was the fact that the Bank's accounts painted a picture of a healthy balance sheet as late as March 2013, but only three months later the PRA was calling for a £1.5 billion increase in capital.

85. Furthermore, in your view the Regulators' complaint response does not explain why it took "no firm action at all" to address the need for increasing the Bank's capital significantly before June 2013.

86. Finally, you believe that it was unreasonable for the FSA to allow only three months for the Bank to come up with a plan to address its capital position and raise £1.5 billion, without giving any thought to the impact of a mutual having to raise such large amounts of capital, which had serious effects for investors like you.

87. The questions of the financial position presented by the Bank in its 2012 accounts, published in March 2013 is dealt with in more detail under Issue 7.

88. The Regulators' response sets out that the work undertaken to review the financial position of "high impact" firms, which resulted in a letter being sent in December 2012 to 21 banks and building societies, as prompted by the Interim Financial Planning Committee (FPC), which had found that "expected losses on loans were in some cases greater than current provisions and regulatory capital held to meet UK banks' expected losses". This concern was particularly relevant for the valuation of commercial loans, such as the Britannia loan book, as the value of commercial properties in the UK had fallen significantly, which "would imply that the banking book valuation of banks' assets were overstated" [21] and if that was the case, the capital buffers of banks would need to be strengthened to be able absorb any future losses.

[21] Interim FPC meeting on 21 November 2012, TSC Report para 98

89. It is important to note here that it was the Bank itself that prepared an Impairment Adequacy Report following the FSA's letter of December 2012 (sent to all large banks and building societies) and the more specific letter of January 2013, address to the Bank directly; and it was the Bank that calculated that its loan impairment charge would increase by in excess of £350 million. Factors that contributed to the worsening capital position included costs associated with the costs of Payment Protection Insurance mis-sales, an aborted IT re-platforming exercise, and the increase of loan impairments in the Britannia loan book.

90. The Zelmer Review explains in detail the capital position the Bank found itself in and how it came about, so I will not do so here. It also concludes that the request set out in the FSA's December 2012 letter (as set out in para 89) came as a surprise to the Bank[22] and it had contributed greatly to the resulting dramatic increase in its provisions. Whilst the FPC, or the FSA, did not undertake a detailed impact analysis at the time they set about the shoring-up exercise to address the capital position of UK financial institutions, this was not a requirement at that time.

91. The level of the impairment increase was significant, exacerbated by the PRA's capital shortfall review which ended with a public announcement in June 2013, concluding that a number of the banks and building societies that formed part of the review fell short on capital requirements, including the Bank. The Britannia loans/assets impairments accumulated by this time, the Impairment Adequacy Report prepared by the Bank, the adjusted funding level requirements set by the PRA, following a recommendation by the FPC at its meeting on 19 March 2013, that "banks should attain adequate capital levels (capital equivalent to at least 7% of risk weighted assets) as a near-term objective by the end of 2013", resulted in the capital shortfall of £1.5 billion, with the Capital Planning Buffer increasing significantly to £1.8 billion.

92. However, it is clear from the records that the capital adequacy issues were being raised by the FSA for an extended period, albeit not in the strongest of terms until the December 2012 letter. These warnings and red flags seem to

[22] Zelmer Review - para 187

have been ignored by the Board of the Bank and the Co-op Group and no meaningful steps were taken to heed the FSA's warnings over a number of years.

93. Furthermore, lessons were being learned by the Regulators following the financial crisis and it was in the course of this, and in an attempt to strengthen the biggest and most important UK financial institutions to prevent any future shocks to the markets and therefore to consumers, that the letter was issued when it was.

94. My view is that the Regulator's decision to require the entities it regulated to strengthen their capital positions was reasonable: it had to balance the risks of requiring significant additional capital adequacy against the risks of allowing the situation to persist for an extended period. I recognise that you consider that the action was disproportionate, particularly in the light of your view that the Bank was not a 'systemic' risk. That is a valid point of view, but I do not think that the FSA's judgement was inherently unreasonable. I therefore do not uphold this element of your complaint.

Issue 8

95. In Issue 8 you complained that the PRA failed to intervene in matters and direct the Bank's parent company to step in and protect consumers, a group which included investors from 1 April 2013.

96. As set out in Issue 9 above, whilst the Group was identified as a financial conglomerate, it was given a temporary waiver, subject to conditions, from becoming a mixed financial holding company.

97. There is a link between the number of options available to the Regulator to direct the Co-op Group to take remediation action to protect the investors of the Bank and the fact that the Group is essentially mostly made up of a chain of food stores and funeral outlets and therefore it is not a regulated financial services business.

98. In addition to the Group not being a regulated financial services business, the FCA pointed out in its decision letter that one effect of the purchase of the Somerfield stores on the Group finances was that any injection of capital from the Group to the Bank through its immediate parent companies was subject to

approval of 75% of the syndicate of bankers who provided the finance. It is not clear from the records if the FSA or the Bank explored whether it could secure the approval of these bankers.

99. You accepted the reasoning as to why the Group was issued a waiver to becoming a mixed financial holding company and recognise that this waiver was subject to the caveat that the position would change if the Verde transaction were to go ahead. The result of the waiver was, however, that the options open to the Regulators to require the parent company to take action to protect investors in the Bank were very limited.

100. Despite this, the FSA encouraged the injection of capital from other entities within the group and £180 million was injected into the Bank from CFS in 2010, £87 million from CIS General Reserve in 2011 and £80 million by way of CIS dividend in 2012.

Issue 10

101. In Issue 10 you allege that the FCA failed to intervene to support investors and to require the Bank to treat retail investors fairly. You believe that the Regulator's decision not to intervene implies that in fact it was aware it could intervene and that failing to do so amounts to a failure to meet its objective of protecting consumers.

102. The FCA's complaint response stated that the Bank's Exchange Offer, the aim of which was to raise sufficient capital to meet the Bank's capital requirements set at a higher level as a result of the updated valuations of the corporate loan book, the IT project write-off and other factors, was considered by the Regulators at a number of meetings and ultimately it was decided that the recapitalisation plan was acceptable.

103. The Regulators considered whether there were any potential mis-selling or any other concerns from the point of view of protecting retail investors who would be affected by the plan. They found that overall there were no concerns, especially in light of the fact that this was a voluntary recapitalisation exercise, done in the manner suggested by the Bank. The affected bondholders and preference shareholders voted overwhelmingly in favour of the plans, with 99.89% of the votes in support.

104. You have said that the bondholders and shareholders were faced with a 'Hobson's choice', and that this was the result of cumulative failures to intervene over a period. It is true that the options by this stage were inevitably limited by the circumstances, but I do not think that that means that the Regulators were at fault: while you may disagree with their decisions, it seems to me that the Regulators carefully considered their options at each stage. You have also criticised the Regulators' decision to allow the Bank to undertake the exercise, but it is not the Regulators' role to manage the banks.

105. It is clear from the documentary evidence that the Bank made it clear to the Regulators that the Exchange Offer was the only viable option available to it to raise the required capital.

106. It seems to me that on balance, and in light of the facts set out above, the Regulators decided to allow the Bank to carry out its own plan for recapitalisation, supported by the overwhelming majority vote of its bondholders and shareholders, as without this plan of action the Bank most likely would have failed, which would have resulted in a complete loss of investments and caused larger problems in the UK financial system. Therefore, I do not uphold your complaint: the FCA's decision not to intervene was not an unreasonable judgement to make.

Issue 11

107. In Issue 11 you set out your concerns that the FCA delayed a market abuse investigation to take into account the Bank's recapitalisation proposals.

108. The FCA concluded that there was no evidence that there were delays in commencing the market abuse enquiries and investigation and did not uphold this element of the complaint.

109. It is clear from the documentary evidence that steps were taken and enquiries were made by the FCA from when the first allegation of market abuse in relation to the accounts published in March 2013 was made.

110. The teams within UKLA, Supervision and Enforcement were working on various lines of enquiries to establish whether the Capital Adequacy Statement was misleading and what further action was necessary to deal with the issues identified.

111. You wrote to Mr Wheatley's office (the then CEO of the FCA) on 11 July 2013, expressing your concerns about the lack of information for preference shareholders and about potential "false market in [the Banks'] shares".

112. You received a response dated 15 July 2013 from Mr Wheatley to this letter, but it was a stock response that was sent to all individuals raising concerns about the Bank and it did not deal with your specific concerns about lack of information and market abuse. This was an oversight by the team that was sending this letter.

113. Whilst you carried on corresponding and raising complaints in relation to your preference shares and allegations of market abuse, your complaints were deferred due to the continuing regulatory action and not investigated as they were deemed to relate to your dissatisfaction with the PRA's general policies.

114. In light of the above, it is not surprising that you would have been left with the impression that the Regulators were not taking sufficient action or were delaying the market abuse investigations. But having reviewed the documentary evidence, I cannot find any evidence that there was a public announcement to the effect that the investigations would be delayed until after the recapitalisation exercise, and it is clear to me that steps were being taken to address the concerns raised by consumers about the misleading nature of the Capital Adequacy Statement made in the March 2013 accounts and other concerns about the events that unfolded at the Bank, culminating in the capital shortfall.

115. The FCA also ensured that it received regular updates about the interim findings of the Kelly Review, despite the Bank stating that it found this problematic from a resourcing point of view. This further demonstrates that following the reports by consumers from June 2013, and once the concerns were identified, the FCA started work on investigating these and did not agree to any delays requested by the Bank. I do not uphold this element of your complaint.

Issue 12

116. In Issue 12 you state that in your view there was no reason to delay the start of the investigation into Paul Flowers until October 2015 and that it should have started at the same time as the investigations into other individuals in April 2015.

117. In your complaint to me in relation to this issue you also stated that in your view the FCA took too long to commence investigating your complaint and should have run the investigation parallel to the Enforcement action and the Zelmer Review being conducted. I shall address your comments about delay in Issues 13, 14 and 15 below.

118. The FCA did not uphold your complaint as it found that the reason for the delay in investigating the other aspects of Mr Flowers' conduct was the fact that other individuals bore greater responsibility for things going wrong at the Bank and the resulting capital shortfall, and that once it was found that an investigation should be carried out into his actions, it was started immediately.

119. Having reviewed the relevant documents, it is clear that the Regulators were undertaking a significant amount of work in terms of the Enforcement investigations. Not only did they review internal documents, they made requests to the Bank and reviewed the transcripts and notes generated in the course of the Kelly Review in order to build as full a picture as possible and to enable them to make a decision about investigating SIF holders within the Bank.

120. It was following this initial assessment that a decision was made to commence formal investigations into Barry Tootell, Keith Alderson and Kevin Blake as the individuals most responsible for the capital shortfall at the Bank, as well as Len Wardle and Peter Marks for their failings in reporting to the FCA the Board's concerns about Paul Flowers. The Regulators deemed that these were the individuals against whom the evidence was strongest in relation to the capital adequacy issues.

121. In your response to my preliminary report, you maintain that the Regulators should have undertaken investigations against all the key individuals (including Paul Flowers) at the same time. Clearly, that was an option, but the Regulators had to decide where to concentrate their resources,

and it does not seem to me that it was inherently unreasonable for them to decide to stagger the starts of the investigations.

122. However, the Regulators did not dismiss the prospect of investigating the other SIFs, and the view taken was that any new information and evidence emerging would be reviewed and if the balance of probabilities for a successful case against any other SIF changed, new cases could be commenced then.

123. The Regulators reasonably exercised their judgement, based on the information available and using expert advice, in determining which individuals should be investigated, on what grounds and when. For these reasons, I uphold the FCA's decision that it did not act unreasonably in commencing an investigation against Mr Flowers in October 2015, rather than April 2015.

Issue 13

124. In Issue 13 you complained that the Complaints Team ignored concerns raised and recommendations made by me in my final report dated 5 July 2016 (FCA00143), in which I recommended that the FSA's decision to defer should be reviewed within six months or when the Enforcement investigation completes, whichever is the soonest.

125. As stated in your comments about Issue 12 and in relation to this matter, you believe that the amount of time you had to wait for the Regulator to commence its investigation into your complaints, five years, was unreasonably long and unfair to you.

126. In my final report about your complaint into the delays, I expressed concerns about the manner of the deferral, and the possibility that you could end up in a loop of having your complaint deferred perpetually without the FCA assessing whether deferral remained the right decision.

127. Furthermore, insisting that the complaint investigation was delayed until the independent investigation (eventually undertaken by Mark Zelmer) was concluded, without knowing whether the terms of that investigation would address your specific complaint points, seemed unreasonable.

128. Therefore, I recommended that*:*

a. The deferral of your complaint should be reviewed within six months or when the continuing enforcement action has been concluded, whichever is the sooner;

b. If, in six months' time, the continuing action has not been concluded, there should be a new assessment of whether it remains reasonable to expect you to continue to wait and a detailed assessment of whether, in practice, investigating the complaint would significantly harm the continuing action;

c. Additionally, at the point that the deferral of the complaint is reviewed, the relationship between this complaint and the forthcoming independent investigation into the crisis at the Co-operative Bank should be considered

129. As a result of my recommendations, the FCA began preparatory work to facilitate the independent investigation, despite the continuing Enforcement action, which led to the conclusion, in conjunction with HMT, that the complaints investigation possibly ought to take precedence over the independent inquiry.

130. Both you and I were provided with an update on 9 January 2017, which did not provide you with much information due to the sensitive nature of the matter, but the FCA did set out to me in some detail its plan for taking the complaints and the independent investigation forward, including the fact of the continuing discussions with HMT.

131. I also had an additional update in February 2017 stating that it appeared the complaints would be prioritised over the independent investigation and that steps were being taken to facilitate this, but this was subject to agreement from HMT. Another update was promised for March 2017.

132. Having reviewed my records, I can see that a further update was not provided in March or at all until the following year, when it was confirmed that the enforcement action had concluded, and that the investigation of your complaint commenced on 6 March 2018.

133. Whilst the FCA correctly concluded that it complied with my recommendation to review the deferral position after six months, it left the job half done. I was told that discussions were being had with HMT and plans were awaiting Ministerial sign-off, but I can see no record that the promised update followed.

134. Furthermore, I cannot see any evidence that, having identified that the continuing action would not be concluded in the foreseeable future, a meaningful review into the impact of commencing the Complaints investigation on the Enforcement action was undertaken, as per my **recommendation in point b** of my findings in FCA00143**.** It was merely stated that Enforcement action was continuing, and it could not be determined when it would conclude.

135. Neither can I see any evidence about the decision by HMT as to which investigation should take precedence. In fact, the email referenced in support of the liaison between HMT and the FCA is dated 7 March 2016, some four months before the above-mentioned final decision was issued.

136. Your complaint and the linked complaints about the same issues at the Bank at the time were intertwined. There was a failure by my Office to set a follow-up date for checking the outcome of the FCA's six months review.

137. In addition to concluding that the FCA did not comply with my recommendation to complete a detailed review of the potential impact on Enforcement of commencing the complaint review and the reasonableness of the deferral in all the circumstances, I would also like to apologise to you as we promised that we would seek regular updates on whether it remained appropriate to continue deferring your complaint in light of the continuing Enforcement action and the independent review, but we did not seek an update following the one in February 2017, until you contacted us in January 2018.

138. This was a failure by us, as well as that of the FCA, and as it might have contributed to your distress over the lack of updates and progress with your complaint, I would like to offer you a discretionary payment of £250 for the distress and inconvenience caused.

139. Furthermore, I would like to assure you that we have since, without then being aware of the issues in your complaint, implemented a more stringent and consistent system for tracking outstanding actions and chasing responses. We are also reviewing how my recommendations are implemented by the Regulators and what we can do to ensure that nothing

slips through the net and goes unimplemented, unless the Regulators expressly tell me that they will not follow a particular recommendation.

Issues 14 and 15

140. These two issues are related to each other as well as to Issues 12 and 13, because they cover the questions of whether the Regulators should have conducted the Enforcement and Complaints investigations in parallel (Issue 14), whether the Regulators should have prioritised the Complaints investigation over the Enforcement one (Issue 15) and whether the continuing delays were reasonable overall.

141. The FCA's response to Issues 14 and 15 of your complaint states that "a Complaints investigation…has the potential to prejudice the conduct of an Enforcement investigation" and as such, it was not unreasonable to conduct sequential investigations; and that paragraph 3.7 of the Complaints Scheme "endorses" this sequence, which was also expressly stated to be preferred by the Chancellor in November 2013.

142. In my final decision, dated 6 July 2016, in your previous complaint I concluded that the Complaint Scheme requires the application of a three-fold test to determine whether a decision to defer an investigation is reasonable. The test is "whether, in the **exceptional** circumstances of the case, it would not be **reasonable** to expect the complainant to await the conclusion of the Regulators' action **and** that action would not be **significantly harmed**".

143. I concluded that the exceptional circumstances test was met in your case; that "there must come a point at which the length of the delay beings to outweigh the other considerations [but that] must be considered in conjunction with the third point – would the continuing action be significantly harmed?".

144. The FCA did not provide any evidence in 2016 that it had undertaken a recent assessment of the extent of the impact the diversion of its resources might have on the continuing Enforcement action. However, on balance, I found its explanation reasonable at that time.

145. My report also states that, should a further significant delay in the conclusion of these actions occur, "the onus would fall upon the FCA to

demonstrate that the continuing action would be significantly harmed by undertaking the complaint investigation in parallel."

146. The FCA found in January 2017 that it had no sight of the end to the ongoing Enforcement action but, as set out in paragraph 132 above, it did not follow through with its plan to provide a further update and neither did it provide any evidence as to why the continuing Enforcement action might be harmed by the investigation of your complaints. There is no evidence on the files I have reviewed that any consideration was given to the above points and those set out in Issue 13.

147. In your complaint to me, you state that you understand the reasons behind deferring your complaint about the Regulators until the completion of their Enforcement action related to the Bank. However, you do not believe the further deferral until the conclusion of all Enforcement action related to individuals at the Bank was reasonable or justifiable.

148. You found it even more unreasonable that the PRA should be responsible for investigating Issue 6 of your complaint and that it insisted on awaiting the outcome of the Zelmer Review, causing a further delay as that was only concluded in March 2019, making the total time taken to review and respond to your complaints six years.

149. You then made the point that whilst paragraph 3.7 sets out which complaints "may be deferred" and that complaints connected with or arising from continuing actions by the Regulators will not usually be investigated by either the Regulators or me, in your view this does not mean that regulatory action can be prioritised unreasonably.

150. I accept the general premise that Complaint investigations should not be prioritised over Enforcement action, for the various reasons set out in my final decision in FCA00143. However, I consider that the FCA incorrectly stated in its final decision dated 28 June 2019 that "it was not open to the Complaints Team to reverse" the sequence in which investigations take place.

151. Paragraph 3.7 of the Scheme should not be used to defer complaints indefinitely without giving due consideration to the reasonableness and impact

of the delays on complainants as well as to what extent a Complaint investigation would actually affect the continuing Enforcement action.

152. In terms of the continuing work of the FCA, the information I have seen suggests that at the time of its complaint review in January 2017 the only continuing Enforcement action was in relation to Paul Flowers, which was expected to conclude within a reasonably short amount of time (around three to four months). A draft Warning Notice in relation to him had been finalised by the relevant team by the end of July 2017, although there were several delays in progressing this work to completion, it ultimately taking place in March 2018.

153. Nevertheless, the Regulators should have carried out a meaningful review as to the reasonableness of the delay for the complainants and the actual impact of the Complaint investigation commencing in January 2017 on the Enforcement action, rather than assuming that it was acceptable to await the end of all Enforcement action.

154. It was open to the Complaints Team to reverse the sequence of Complaints and Enforcement investigations if it found, applying the three-part test in paragraph 3.7 of the Complaints Scheme, that exceptional circumstances existed, that it would not be reasonable to expect the complainant to await the conclusion of the Regulators' action and that action would not be significantly harmed.

155. As this test seems not to have been applied at the relevant time, I cannot conclude with certainty whether it would have been appropriate for your complaint to be investigated earlier, although it seems possible that this would have been the case.

156. However, I recognise that my Office bears some responsibility for this missed opportunity to carry out a meaningful review into the deferral. We have tightened our protocols on the follow-up of investigations. I **recommend** that the Regulators put in place steps to do the same on their end. Furthermore, I **recommend** that all complaint investigators are provided with clear guidance on the meaning of paragraph 3.7 of the Complaints Scheme to ensure they fully understand their powers and duties set out by it.

157. Finally on this matter, in your response to my preliminary report you have complained that, setting aside the question of when they should have started, the regulatory proceedings against Paul Flowers simply took too long, thus further delaying the investigation of your complaint. The proceedings were prolonged, but an investigation into that matter would be a significant further undertaking, and goes beyond the scope of this complaint.

Issue 7

158. In this Issue you alleged that the FSA failed to investigate the misleading statements in the Bank's accounts published in March 2013, including the accuracy of the Capital Adequacy Statement.

159. The FCA took this complaint to be focused on the fact that, in your view, the statements found to be misleading in the Final Notice dated 11 August 2015 should have been identified by the FSA when it was provided with the accounts for preview in March 2013, rather than when consumers started complaining about them in June 2013.

160. The FCA's response goes into great detail about the events preceding the publication of the Accounts, the level of work undertaken by the FSA in relation to the capital position of the Bank and other continuing concerns, and concludes by upholding this complaint point because it found that it was unreasonable for the FSA to fail to identify and investigate the misleading Accounts and Capital Adequacy Statement.

161. The FCA recommended an apology to you and your wife but concluded that "the facts do not satisfy the requirements for an ex gratia payment" because the Bank was the author of the misleading statements and the responsibility lies with the Bank's Board, its Audit Committee and its auditors.

162. You are not satisfied with this response as in your view the Regulators are the "backstop on which [investors] rely" and they had multiple warnings ahead of the Accounts being published that there were serious issues at the Bank. Furthermore, you also state that your decisions about making investments were directly affected by the FSA's failure to take appropriate action and in a timely manner, as you relied on the information published in the March 2012 Accounts.

163. The Regulators have taken responsibility for the failures on this issue. They admitted that whilst it was not the role of Supervision to review the accounts of banks for misleading statements, the position of the Bank by the time of the publication of the accounts was not normal as the "financial position…was extremely precarious and….there were significant (adverse) changes in the financial position of the Bank in the months preceding publication of the Accounts". It was also found that it was unreasonable for the Supervisors not to engage with UKLA in light of all the concerns.

164. Parliament has given the FCA protection from being sued for damages, save for cases involving bad faith or a breach of human rights. The Complaints Scheme cannot be used to undermine that protection, but it can offer generally modest ex gratia payments for administrative shortcomings. The FCA's explanation for refusing your request for an ex gratia payment – that the responsibility for the financial statements rested with the Bank and its auditors – seems to me misplaced, since while the FCA is right about the Bank's responsibilities, that does not preclude the possibility that the FCA, having been found to have fallen short in its responsibilities, might consider offering an ex gratia sum.

165. Having said that, I should also say that I do not accept your view that the Regulators can be seen as a 'backstop' upon which investors are entitled to 'rely' – investors in bonds are not offered financial guarantees of the kind given for depositors in bank accounts. That being the case, while I do not consider that the FCA should have dismissed the notion of any form of ex gratia payment, I agree with the FCA that you would not be entitled under this Scheme to an ex gratia payment which amounted to compensation for the financial losses arising from the financial statements.

166. In your response to my preliminary report, you say that while you accept that the responsibility for the financial statements rested with the Bank and its auditors, "I am not clear why the Regulators did not advise investors of the possibilities of compensation (or not) from those sources for its effect on investors", and you ask me for my advice on compensation for investors. On

the first matter, I consider that this goes beyond the scope of this complaint, and on the second I am afraid that it is not my role to give advice to investors.

167. Therefore, in my preliminary report I recommended that the FCA consider whether to offer you an ex gratia payment for the distress and inconvenience which its failure to take earlier action may have caused. In recommending this, I recognised that any such payment would not come anywhere near to addressing the financial losses which you have suffered, the responsibility for which lies with the Bank. The FCA, in its response to my report, said that it continued to believe that an apology was the appropriate remedy.

168. Finally, in your response to my preliminary report, you have made the general point that, under the new regulatory regime which established the FCA and PRA, investors were included within the definition of consumers – and you consider that the Regulators need to be reminded of this fact.

My decision

169. In conclusion, as set out above, I am sorry it has taken this long to conclude the investigation of your complaint. I appreciate that the process as a whole has been drawn out and stressful for you.

170. Having reviewed your complaint and the FCA's responses, overall I do not uphold your complaints, although I do conclude that there was a failure by the FCA to undertake the review of the deferral of your complaint (issues 13-15), and a related failure by my office to monitor the situation.

171. I recognise that you would like me to go further than I have done, and address additional points of detail. However, I have had to strike a balance between a proper consideration of your complaint and not undertaking an exhaustive inquiry of the kind already undertaken in the Kelly and Zelmar reviews.

172. You have raised a complaint that the PRA has not addressed some points which you had been told would be addressed in the FCA's decision letter. The PRA has acknowledged this fact, and is pursuing it.

173. I make the following recommendations:

i. my Office offers you £250 for the distress and inconvenience caused by our failure to follow up on the review of the deferral of your complaint, and that the FCA considers also offering you a sum for its delays in the handling of your complaint;

ii. the Regulators are to put in place measures to ensure recommendations are followed up and complied with (the FCA has accepted this recommendation);

iii. all complaint investigators are to be provided with clear guidance on the meaning of paragraph 3.7 of the Complaints Scheme to ensure they fully understand their powers and duties set out by it (the FCA has accepted this recommendation);

174. In my preliminary report I recommended that the FCA consider whether to offer you an ex gratia payment for the distress and inconvenience which its failure to take earlier action on the published Co-op Bank accounts may have caused. The FCA has considered this recommendation, but has concluded that it considers an apology sufficient.

Antony Townsend
Complaints Commissioner
30 October 2020