

27-10-2017

Dear Complainant

**Complaint against the Financial Conduct Authority**  
**Reference Number: FCA00310**

Thank you for your letter of 2 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. I am sorry that it has taken longer than I would have liked – the reasons for this were explained in my colleague's letter of 10<sup>th</sup> July.

**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 make further reference to them below.

**Your complaint**

On 2 March 2016 you complained to the FCA that it had allowed Lloyds Banking Group (LBG) to redeem your holding of 8420 Enhanced Capital Notes (ECNs) at par when LBG had made a tender offer in 2014 at £1.05. You said that there were apparently over 120,000 retail investors affected and that you thought it was the FCA's role to see that retail customers are treated fairly. The FCA initially failed to notice that your letter was a complaint and on 15 March 2016 you wrote again, reiterating your allegations and stating that the remedy you sought was "*preferably that [LBG] are made to restore my 8420 ECNs, or failing that, that they are made to provide compensation which has been objectively determined to be equitable.*"

On 29 March 2016 the FCA Complaints Team wrote to you setting out its understanding of your complaint and confirmed that it was accepted for investigation under the Complaints Scheme (the Scheme). The FCA identified your complaint as follows:

You allege that the FCA has failed to protect consumers by allowing Lloyds Banking Group to redeem the ECNs at par and thus not ensuring that consumers have been treated fairly.

We believe this to be an allegation of mistakes and lack of care on the part of the FCA.

On 6 February 2017 the FCA Complaints Team wrote to inform you that your complaint was not upheld. You are dissatisfied with this response and have asked me to investigate and to secure you appropriate redress from either the FCA or LBG. You consider that the FCA has let the existence of the UK Government's shareholding in LBG determine both its authorisation decisions and its review of individual complaints about its actions. You have asked me to consider the following specific points:

1. Your financial loss, which you consider to be not less than £421 plus interest at 8% per annum since redemption, being the difference between the tender offer and what you received, although you believe that the market value was much higher.
2. Why it was equitable for LBG and the FCA to proceed as they have, given the dissenting judgment in the Supreme Court, where Lord Sumption said:  
*These were long-dated securities, which cannot have been intended to be redeemed early except in some extreme event undermining their intended function and requiring their replacement with some other form of capital. The function of the notes was to be available to boost the Bank's top tier capital in the hypothetical event that the ratio of top tier capital to risk-weighted assets fell below the conversion trigger. They have always served that function and still do. Whether that function remains as important to the Bank as it was in 2009 is irrelevant.*

You have told me that you bought the ECNs in good faith when LBG was in difficulties, and that although you were aware their value could fall as well as rise, you had no expectation that they "*would not run to term in 2024 unless, of course, [LBG] went under the waves.*"

### **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 Exchange Offer Memorandum (EOM) dated 3 November 2009 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.

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>. The FCA's complaint response to you, 6 February 2017, also set out a detailed background.

In my earlier decision, I accepted that, although the FSA (as it then was) supervised the design and execution of the ECNs in 2009, principal responsibility for this rested with LBG. I also concluded 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”.*

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. Although there were clearly arguments for the FCA to intervene further, as you would have wished, I do not consider that the FCA’s decisions were unreasonable.

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 asked a number of questions regarding 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 answer further questions and provide further evidence which I have considered in detail.

You have informed me that you did not receive or have access to the LBG ECN Exchange Offer Retail dated 6 March 2014, the cover-letter sent to eligible holders of the same date, both addressed to “Eligible Retail Investors” (as defined), or the Tender Offer Memorandum dated 20 March 2014, which included details of the relevant Risk Factors. You provided me with a copy of Corporate Action Notices dated 12 and 14 March 2014 that were sent to you by a UK stockbroker you were dealing with, together with information produced by another UK stockbroker in connection with the LBG ECN tender offer. You have said that none of these documents referred to the risk factors or gave clear warnings of the possibility of a par call at a later date. It therefore remains your position that the FCA failed to protect consumers by allowing LBG to redeem the ECNs at par, did not ensure that consumers were treated fairly, and, given that the FCA knew that a large number of retail investors held these notes, its oversight of LBG’s actions (and inactions) was astonishingly casual and ineffectual.

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 satisfied itself that LBG did what it could to ensure retail investors’ attention was drawn to the risks of a regulatory par call.

- 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 reasonable for the FCA, and indeed LBG, to rely on the obligations, regulatory as well as contractual, that advisers owed to their retail clients.
- 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.
- Regulatory News Service announcements were issued and were very public. The FCA monitored closely the extensive media coverage of the exchange/cash offer.

Having considered all the further information supplied, I am satisfied that the FCA has provided reasonable explanations for its actions and the decisions that it took about this issue. I note that both the Corporate Action Notices you sent to me state that the details supplied of the LBG offers “must be read in conjunction with the official document that may be found on the company’s website”. This would have directed you to the relevant information on LBG’s website. I am also satisfied that the FCA carried out some due diligence around this issue and that its actions and response to you were not unreasonable.

With regard to the Prospectus issues, 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. However, I do not consider that these subsequent events mean that the FSA failed in its responsibilities. Although you have said you had no expectation that your investment would not run to term, I am satisfied that early redemption for regulatory purposes based on a CDE was clearly highlighted as a risk factor even if that is not something that you focussed on at the time.

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, as you have pointed out. However, I think the main point to emphasise here is that the Supreme Court majority 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 an issue for the FCA. 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. Given this, I do not consider that there is any basis to say categorically that the FCA made a mistake or acted with lack of care. I therefore consider the FCA's complaints response to you to be reasonable and I do not uphold your complaint.

### *Delay*

As noted above, you first complained to the FCA in March 2016 but did not receive a final response to your complaints until February 2017. During this time, you raised concerns with the FCA about the lack of substantive progress and failure to update you. I note that the FCA's complaint response acknowledges and apologises for the length of time taken to complete its investigation into your complaint. I have considered whether that is an acceptable response to the delay 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. However, I also note that at times the FCA failed to send you regular updates or keep you informed generally about progress.

I have concluded that overall there were unacceptable and avoidable delays by the FCA in dealing with your complaint and 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 your complaint.

### **Conclusion**

In conclusion, for the reasons set out above, I have not upheld your substantive complaint. It follows that I have not recommended that you should receive financial redress from either the FCA or LBG in connection with the redemption of your shareholding. I have however concluded that there was avoidable delay in responding to your complaint. 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.

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.