Complaints Commissioner

Office of the Complaints Commissioner
3rd Floor
48–54 Moorgate
London EC2R 6EJ

Tel: 020 7562 5530
Fax: 020 7256 7559
E-mail: complaintscommissioner@fscc.gov.uk
www.fscc.gov.uk

24th June 2014

Dear Complainant,

Complaint against the UK's Financial Services Regulators
Reference Number: FSA01604

Thank you for your completed complaint form and enclosures dated 15th April 2014 in connection with your complaint against the Financial Services Authority (FSA) and the Financial Conduct Authority (FCA)(the regulator). I am sorry that it has taken two months to consider this matter, but your complaint has raised complex issues which I have needed to consider very carefully.

Before I comment on your complaint I feel that it may be useful if I explain my role and powers. Part 6 of the Financial Services Act 2012 (the 2012 Act) requires the regulators to maintain a complaints scheme for the investigation of complaints arising in connection with the exercise of, or failure to exercise, any of their relevant functions. Section 84(1)(b) of the 2012 Act provides that an independent person is appointed as Complaints Commissioner to investigate complaints about the way the regulators have themselves carried out their own investigation of a complaint that comes within that scheme. The appointment has to be approved by H.M. Treasury. I have held that role since 1st May.

Although the FSA has been replaced, transitional provisions have been put in place to enable the continued consideration of complaints against the FSA. As your complaint relates, at least in part, to the actions or inactions of the FSA, your complaint has been considered by me under the Transitional Complaints Scheme, which is for all practical purposes a continuation of the previous scheme.

Your complaint

In general terms, I understand that you are unhappy with the actions of the relevant regulators for a number of reasons. In your completed complaint form and enclosures you have set out that your particular concerns relate to:

- the regulator's oversight of commercial lending;
- the regulator's general approach to the redress exercise it instigated in relation to arrangement of interest rate hedging products (IRHPs) and the exclusion of certain tailored business loans with embedded IRHPs (TBLs) from that redress exercise; and

- the regulator's assessment of the contracts covered by the EU's Markets in Financial Instrument Directive (MiFID) and its decision that TBLs with an embedded rather than standalone IRHP should be excluded.

Coverage and scope of the Transitional Complaints Scheme

The Transitional Complaints Scheme provides as follows:

> *9.1 The Transitional Complaints Scheme provides a procedure for enquiring into and, if necessary, addressing allegations of misconduct by the FSA arising from the way in which it has carried out or failed to carry out its functions under FSMA. The Transitional Complaints Scheme covers complaints about the way in which the FSA has acted or omitted to act, including complaints alleging:*
>
> *a) mistakes and lack of care;*
>
> *b) unreasonable delay;*
>
> *c) unprofessional behaviour;*
>
> *d) bias; and*
>
> *e) lack of integrity.*
>
> *9.2 To be eligible to make a complaint under the Transitional Complaints Scheme, a person must be seeking a remedy (which for this purpose may include an apology) in respect of some inconvenience, distress or loss which the person has suffered as a result of being directly affected by the regulators' actions or inaction.*

I should also make reference to the fact that my statutory powers contain certain and clear limitations in the important area of financial compensation. FSMA (as the relevant legislation in place at the time) stipulated in Schedule One that the FSA is exempt from "liability in damages". It stated:

> *(1) Neither the Authority nor any person who is, or is acting as, a member , officer or member of staff of the Authority is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of the Authority's functions.*
>
> *(2) (Irrelevant to this issue under investigation)*
>
> *(3) Neither subparagraph (1) nor subparagraph (2) applies*
>
> *(a) if the act or omission is shown to have been in bad faith; or*
>
> *(b) so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the [1998 c.42] Human Rights Act 1998.*

I have referred to FSMA here as it was FSMA which was the relevant legislation when you first raised your complaint and when the actions about which you are unhappy occurred. This exemption has been rehearsed in sections 25(3) and 33(3) of Part 4 of Schedule 3 of the 2012 Act. I would add here for the sake of completeness that you have not alleged that the FSA (or the FCA) acted in bad faith nor have you adduced evidence of any act of bad faith on the part of the FSA which would have the effect of bringing 3(a) above into play.

The Transitional Complaints Scheme nevertheless goes on to provide in paragraph 6.6 that:

> *Where it is concluded that a complaint is well founded, the relevant regulator(s) will tell the complainant what they propose to do to remedy the matters complained of. This may include offering the complainant an apology, taking steps to rectify an error or, if appropriate, the offer of a compensatory payment on an ex gratia basis.*

If you were to take the view that Schedule One referred to above was relevant in the context of the Human Rights Act 1998 I should explain that Section 6(1) of that Act that is referred to, provides as follows:

> *It is unlawful for a public authority to act in a way which is incompatible with a Convention right.*

The only Convention rights that I consider may be relevant are contained in Article 1 of the First Protocol set out in the Human Rights Act of 1998.

Article 1 of the First Protocol provides:

> *Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.*
>
> *The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.*

It is my view, given my conclusions in this matter, that Article 1 of the First Protocol has no application in your case. There is no act taken by the regulator (either the FSA or the FCA) which is incompatible with the Human Rights Act 1998. My rationale for arriving at this decision is set out below.

My Position

I have now had the opportunity to consider the issues you have raised and review fully the regulator's complaint file, a full copy of which has been given to me. From this it is clear that the gravamen of your complaint relates to the terms of your commercial business loan which I understand is a TBL which includes an embedded, rather than standalone, IRHP.

It is also clear that in February 2013 you challenged the FSA, as the then Regulator, over the terms of the redress scheme. In its response of 6th March 2013, the Regulator set out that:

> "*The agreement the FSA has made with the banks only covers the review of IRHPs that were agreed separately to a loan, this means that agreement the FSA has signed with the banks only includes interest IRHPs sold separately to a lending agreement.*
>
> *Loans with embedded IRHPs are not covered by the agreement and are therefore not subject to the scope of the review. This is because the agreement is focused only on the review of the sale of certain products that are regulated by the FSA, for which issues had been identified. Standalone IRHPs are regulated by the FSA pursuant to European legislation. Commercial loans in their own right (including those with 'embedded' IRHPs) are not generally regulated by the FSA*".

On this basis the FSA decided that it would only seek to engage with the issuers of IRHP contracts to undertake a review and offer redress (in accordance with fixed guidelines) on the contracts which it believed fell within its jurisdiction.

In light of this, when it considered your original complaint, the regulator sought to rely upon paragraph 1.4.2A of the rules of the previous Complaints Scheme, known as Complaints against the FSA (COAF), which was the scheme in place at the time. Paragraph 1.4.2A of COAF stated:

"***1.4.2A Circumstances under which the FSA will not investigate***

The FSA will not investigate a complaint under the complaints scheme which it reasonably considers amounts to no more than dissatisfaction with the FSA's general policies or with the exercise of, or failure to exercise, a discretion where no unreasonable, unprofessional or other misconduct is alleged".

Given that it was the regulator's policy, on the basis which I have set out above, that the redress scheme would apply only to consumers who had taken out standalone IRHPs rather than TBLs, I believe that the regulator correctly relied upon paragraph 1.4.2A of COAF not to investigate your complaint. I should add that although COAF has now been replaced, the new Transitional Complaints Scheme includes a similar provision, and therefore the regulator's decision not to investigate this part of your complaint continues to be well founded.

Although I understand why you are unhappy, the regulator can only operate within the legal boundaries that Parliament has set out within the governing legislation. In this case, the provision of business loans is not a regulated activity under either FSMA or the 2012 Act, and is not therefore an area in which the regulator has any legal jurisdiction to intervene. As such, whilst it is accepted that TBLs may have, to a degree, the same features as a standalone IRHPs, the fact that they are not, in the regulator's view, covered by the Regulated Activity Order (RAO) is an important legal distinction.

Given the regulator's statutory role it has to have regard to the provisions of the RAO which in general terms sets out the type of contracts and activities which fall within its jurisdiction. In this case, as both the commercial lending and the arrangement of TBLs are not, in the regulator's view, covered by the provisions contained within the RAO, it means that the regulator does not have any legal jurisdiction under which it can intervene or instruct the industry to extend the standalone IRHP review to include TBLs.

Given that TBLs are not covered by the RAO, any instruction issued by the regulator requiring firms to undertake a review of TBLs would be likely to be subject to legal challenge through a Court process. Given that the regulator itself has stated that it does not believe that TBLs fall within its jurisdiction, it is likely that any challenge the providers of TBLs were to make through the Courts would result in the regulator's actions or instructions being regarded as *ultra vires* and therefore likely to be set aside by the Court.

I do understand why you are unhappy with the situation and have noted that you have arrived at a different interpretation of the governing legislation to that of the regulator. It is also clear from the extensive file you have presented to me that you have undertaken considerable research in the regulatory landscape surrounding the arrangement of contracts such as the TBL your business holds. Whilst I can appreciate that there may be little practical difference in the manner in which a standalone IRHP and TBLs operate, the legal definition of the two contracts is considerably different.

Although it is disputed by you, I am aware that the EU Commissioner has explained in a written answer to a question in relation to TBLs that:

> *"Directive 2004/39/EC (MiFID) applies to the provision of investment services and activities in relation to financial instruments. The list of financial instruments covered under MiFID is set up in Annex 1, Section C of MiFID. Loans are not financial instruments under MiFID. A mechanism to calculate interests that uses an embedded hedging product does not change the nature of the loan and therefore does not turn the loan into a financial instrument*"**.**

Likewise the Regulator, in its response to you of 28th November 2013, set out that:

> "*In order to address this element of your argument we have set out below the basis on which the scope of the IRHP review was determined.*
>
> *The IRHP review covers sales of those IRHPs that are classified as "derivatives" for the purposes of the FCA rules and which were sold separately to a lending arrangement for the purpose of managing interest rate fluctuations (i.e. standalone IRHPs). The FCA position is that standalone IRHPs are Contracts For Difference (CFDs) for the purposes of article 85 of the Regulated Activities Order (RAO). A CFD includes rights under a contract "the purpose of which is to secure a profit or avoid a loss by reference to fluctuations in … an index or other factor designated for that purpose in the contract". Where interest rate contracts are purchased separately to a loan which a client wishes to hedge, they are a form of CFD as the purpose, from the customer's viewpoint, is to avoid a loss by reference to interest rate fluctuations. Where such terms are included in a loan agreement, it does not have the effect of turning the loan into a contract 'the purpose of which is to obtain a profit or avoid a loss' – the contract remains a contract, the purpose of which is to lend money on specified terms. Sales of such commercial loans are not regulated by the FCA*".

I appreciate that you feel that the regulator's assessment and interpretations of both the Regulated Activity Order and MiFID are incorrect and that, in your view, TBLs are regulated contracts as defined by the legislation. It is extremely unfortunate that this difference of opinion has occurred, particularly given the underlying circumstances which have generated your complaint. However, the aim of the Transitional Complaints Scheme which I oversee is to allow "*the investigation of complaints arising in connection with the exercise of, or failure to exercise, any of [the regulators'] relevant functions*". In this case the regulator has undertaken action which it believes is appropriate in light of its understanding of its relevant functions and legal jurisdiction. The fact that you feel that the action is insufficient does not make the regulator's position incorrect.

Your complaint amounts to a dispute between the regulator and an affected party in relation to the interpretation of governing legislation (namely in this case the RAO in relation to both the Financial Services and Markets Act 2000 and the Financial Services Act 2012 and MiFID). This is not an issue which I can consider under the rules of the Transitional Complaints Scheme. Disputes such as this can only be determined through a Court process.

I hold this view as any assessment of the interpretation of any governing legislation will require the presentation of legal argument and possibly challenge over what will certainly be different views and/or interpretation of both UK and EU legislation. Such legal argument can only be undertaken and definitively settled by a judicial process, and is not something which could be achieved by a paper based review of papers and arguments presented to me by both parties, as required by paragraph 6.3 of the scheme rules which state:

> "*The investigation of complaints will involve a paper-based review considering any documents supplied by the complainant, and any relevant documents held by the relevant regulator".*

Finally, I draw your attention to paragraph 3.6 of the rules of the Transitional Complaints Scheme which supports my views in this regard. Paragraph 3.6 of the Transitional Complaints Scheme states:

> "*Complaints that are more appropriately dealt with in another way*
>
> *The regulators will not investigate a complaint under the Scheme which they reasonably consider could have been, or would be, more appropriately dealt with in another way (for example by referring the matter to the Upper Tribunal or by the institution of other legal proceedings)*".

I recognise your displeasure with the limitations of the regulator's jurisdiction in relation to commercial loans. In the correspondence you received from HM Treasury in February 2014, it was confirmed that TBLs are not an arrangement covered by the RAO. HM Treasury confirmed this view to you in the following terms:

> "*It is important to recognise that the FCA does not have regulatory powers over business loans. As a result, the FCA supervised review can only cover interest rate hedging products that were agreed separately to a business loan.*
>
> *Business lending is not, and never has been, within the scope of the FCA's Conduct rules. Bringing business lending into the scope of the FCA's powers could therefore only change the future not the past*".

I have noted your comments that the RAO should be extended to cover the arrangement of business lending (and specifically the issuance of TBLs) but this is not something which the regulator or my office can do. As I have indicated above, and which was confirmed by H.M. Treasury in its February letter, the extension of regulation to cover business lending would require an amendment to the RAO which, as it is a statutory instrument, could only be done by Parliament. (Such an extension would also mean that the principles of Treating Customers Fairly would be formally applied – currently, those principles do not apply to unregulated activity.)

I appreciate that you have also raised concerns over the regulatory status of your lender as you believed that it was regulated by the regulator. From the papers you have presented to me I understand that your lender was a Dutch Bank which was authorised and regulated by the Dutch Central Bank and operated in the UK on an EEA issued Branch Passport. As the bank had a physical presence in the UK, the bank was also subject to regulation by the UK regulator, although the UK Regulator's jurisdiction *only extended to the regulation and supervision of the bank's conduct when undertaking regulated activity (as defined by the RAO) within the UK* .

In this instance, whilst you do not believe that the bank has treated you fairly (by not explaining fully the contract terms) this does not on its own mean that the regulator is able to intervene in your dispute with it. As the regulator has explained, it is unable to intervene in individual disputes between regulated firms and consumers (including small businesses).

If you feel that the manner in which the loan was explained to you was incorrect then this may be something that you can pursue through either the Financial Ombudsman Service or the Courts. I would add here that, prior to seeking recourse to the Courts I would strongly recommend that you obtain your own independent legal advice (which will be at your own expense).

I appreciate that you feel that the regulator has not acted upon the concerns which have been raised with it in relation to TBLs, but this is not the case. It is clear from the papers which you have provided that the regulator is aware of your concerns (and the position of SME generally) and has some sympathy with your position.

It is also clear that the regulator has genuine concerns over the sale of TBLs, given its limited jurisdiction, and has raised these concerns with Parliament (on at least two occasions). Unfortunately, as I have indicated above, as the regulator has to act within the jurisdiction given to it by Parliament, unless Parliament amends or extends the existing legislation to cover commercial lending and specifically TBLs, the regulator is legally unable to act to offer assistance to either you or other SMEs.

I would also add that even if Parliament was to take action which would result in the RAO being amended it is unlikely, for policy and market certainty reasons, that the changes would have retrospective effect. As such, the changes are likely to only bring future commercial lending into the RAO, with existing commercial lending remaining an unregulated activity which would therefore not alter your personal position.

Conclusion

The manner in which the regulator has acted is, in my opinion, fully consistent with the objectives and obligations imposed upon it by the relevant legislation. As I have set out in considerable detail above, the provisions contained within paragraph 3.5 of the Transitional Complaints Scheme prevent adoption of a particular policy by the regulator from being considered under Transitional Complaints Scheme.

Likewise, whilst I appreciate that you and/or your advisers have arrived at a different interpretation of the governing legislation to that of the Regulator, the interpretation of the governing legislation is something which can only be achieved through a judicial process. I cannot therefore consider that matter further.

It is my decision that I do not conclude that either the FSA or FCA have acted inappropriately or, as a result, that they have failed to handle both your enquiries and complaint appropriately. I am therefore copying this letter to the regulator and I am filing my papers.

In doing so, I would, however, like to make it clear that – although I do not consider that the regulator has acted inappropriately – as a result of the jurisdictional issues which I have described in great detail above, you have been placed in an invidious position. The fact that the product which you purchased falls outside the current jurisdiction of the regulatory system, thus reducing your protections, does not absolve the bank from its professional and ethical duty to treat you fairly. I therefore place on record my hope that the bank will look very carefully and sympathetically at whether you should be recompensed for the problems which have arisen in relation to your loan. The issue of whether there should be jurisdiction to prevent such problems in the future is an issue for the Government but is, as I have indicated above, something which the regulator has already raised with it.

Yours sincerely,

Antony Townsend
Complaints Commissioner