

17th December 2013

Dear Complainant,

Your complaint against the UK's Financial Services Regulators
Reference Number: FSA01575

I refer to your letter and enclosures dated 11th November 2013, which was received in my office on 25th November 2013, in connection with the above.

Part 6 of the Financial Services Act (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 charged with the task of investigating those complaints made 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 currently hold that role.

From 1st April 2013, as part of the changes implemented by the Government, the FSA was replaced by the FCA, the Prudential Regulation Authority (PRA) and the Bank of England as regulators of the UK's financial services industry. I would add that 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 to the inactions of the FSA, in relation to its objectives and duties under the Financial Services and Markets Act 2000 (FSMA) your complaint has been considered by me under the new Transitional Complaints' Scheme.

As set out in the consultation paper (CP12/30 Complaints against the regulators) and confirmed in the policy statement (PS13/7 Complaints against the regulators), any complaints which have not been concluded as of 1st April 2013 will continue to be investigated by the FCA Complaints Team with the cooperation of the PRA if needed and my office. In practice, this means that, although the governing legislation will have changed there will be no change to the manner in which, or the terms under which, your complaint is investigated.

Your complaint

In general terms you are unhappy with the guidance the Regulator has issued in relation to the review it has instructed the industry to undertake in relation to loans linked to interest rate hedging products (IRHPs). Specifically you state:

- You say that you are not questioning or challenging the Regulator's ruling making powers of its ability to issue codes or general guidance. Instead, you say that you are challenging the contents of the guidance as, in your opinion, the guidance the Regulator issued was misleading. As such you believe that the Regulator, by issuing two pieces of conflicting information, has "*failed in its general duty of professionalism and care to the public*".
- You stated that are not questioning the Regulator's 'internal procedures and process' as you accept that the Regulator has considered the submissions you have made. However you say that what you "*would question is the rigor and open-mindedness (i.e. to accept that error is possible and to embrace and correct it, where it occurs) that has been applied to [your] questions*".

As you do not feel that the Regulator has considered adequately of appropriately the issues you have raised you remain unhappy with the outcome of the Regulator's investigation and have referred the matter to me for attention.

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.*
- 9.3 *The transitional complaints scheme does not apply to the Bank's functions under Part 5 of the Banking Act 2009 (overseeing inter-bank payment systems) as this was not previously subject to these complaints arrangements.*

I should also make reference to the fact that my powers derived as they are, from statute 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 then 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 I find your complaint justified, it is to that paragraph that I must refer in order to decide any question 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 views in this matter, that Article 1 of the First Protocol has no application in your case. There is no act taken by the Regulators (either the FSA or the FCA) which is incompatible with the Human Rights Act 1998. The actions about which you are unhappy are, in my opinion, the manner in which the Regulator drafted the report which revised its initial guidance and that it will not agree that your understanding of the guidance is correct (i.e. that the ‘sophistication test’ guidance is misleading).

My Position

As part of my investigation into your concerns I have obtained and reviewed the FCA’s investigation file. In reviewing your complaint I have considered the comments you have made when corresponding both with the Regulator’s Complaints Team and my office.

I appreciate that you are unhappy with the manner in which the Regulator issued its guidance in relation to the review of IRHPs. I understand that when considering your complaint, the Regulator felt that as your concerns related to the manner in which the guidance was issued, it related to its legislative function. As such it felt that, in accordance with Paragraph 10.1(c) of the rules of the Transitional Complaints Scheme this was not something which it could consider under the rules of the Transitional Complaints Scheme. I would add for the sake of completeness that Paragraph 10.1(c) of the rules of the Transitional Complaints Scheme states:

10 Exclusions to the transitional complaints scheme

10.1 Each of the following is excluded from the transitional complaints scheme:

- (c) complaints in relation to the performance of the FSA's legislative functions under FSMA (including making rules and issuing codes and general guidance);

I appreciate that you remain unhappy with the manner in which the guidance has been issued but, when referring the matter to my office, you have clarified your concerns and, as a result, feel that the Regulator incorrectly relied upon Paragraph 10.1(c) to exclude this part of your complaint from its investigation. When referring your complaint to my office you have stated that you are not questioning or challenging the Regulator’s ruling making powers or its ability to issue codes or general guidance. Instead you say that you are challenging the contents of the guidance as, in your opinion, the guidance the Regulator issued was misleading. As such you believe that the Regulator, by issuing two pieces of conflicting information, has *“failed in its general duty of professionalism and care to the public”*.

Whilst I can appreciate your position, in my opinion, the fact remains that it is not possible to separate the contents from the guidance from the issue of guidance. Put simply, a complaint about the contents of the guidance is a complaint about guidance which has been issued. As such, I concur with the Regulator’s view as your complaint ultimately relates to the issue of guidance by the Regulator it is not something which I can consider under the rules of the Transitional Complaints Scheme.

Although, under the rules of the Transitional Complaints Scheme, I am not able to consider complaints about the issue (or phrasing) of guidance in an attempt to assist you I have read both the “Interest Rate Hedging Products – Pilot Findings” and the ‘sophisticated investor flow chart’. In this case it is clear that, as a result of the ‘Pilot’ the Regulator identified that the guidance it had issued had created some anomalies. Specifically the Regulator set out (on page 11)

“Findings on the original sophistication test

*During the pilot exercise, we observed that the original sophistication test, specifically the application of the three ‘objective’ criteria, did not always achieve the outcome we expected. For example, a farmer or a bed and breakfast business with a large balance sheet (by virtue of owning property, land and/or machinery) and a large seasonal workforce could have been excluded from the review under the original test because the balance sheet and employee numbers exceeded the relevant thresholds. However, farmers and bed and breakfast businesses are examples of the types of non-sophisticated small businesses that should be included in the scope of the review. We have therefore amended the sophistication test to ensure that these types of ‘non-sophisticated’ customers **can be included** in the review.*

*Conversely, there were businesses who were classified as ‘non-sophisticated’ under the original test that we thought were likely to have understood the risks associated with IRHPs and should not be included in the review. Specifically, as the three criteria were applied to the individual legal entity that purchased the IRHP, the potential existed for small subsidiaries of large multi-national corporations to be included within the review, as they did not necessarily in their own right have a large turnover or substantial numbers of employees. Similarly, the test also allowed specially constituted entities (e.g. Special Purpose Vehicles (SPVs)) that were either part of a Companies Act 2006 group or nevertheless were connected entities to be included. These structures are common in large property development or property investment businesses. We have therefore amended the sophisticated customer criteria to ensure that these types of sophisticated customers **are not included** in the review”.*

As a result of these findings, the Regulator amended how the sophisticated investor criterion was applied to certain businesses. In doing this the Regulator *did not alter how a sophisticated investor was defined* (my emphasis). Instead the Regulator *amended* (my emphasis) the criterion which affected whether certain business were eligible to be included in the review population. In doing this, the Regulator set out (on pages 11 and 12) that:

“Specifically, we have amended the way the three criteria can be applied to different to types of businesses to help ensure that:

- *customers who meet (only) the balance sheet and employee number criteria are included in the review where the total value of their ‘live’ IRHPs is equal to or less than £10m;*
- *subsidiaries of large groups and SPVs forming part of a large group are likely to be excluded from the review;*

- *company groups that are not able to take advantage of the lighter reporting requirements under the Companies Act 2006 for small groups are likely to be excluded from the review; and*
- *SPV customers that are constituted in a way that falls outside the Companies Act 2006 definition of a group but are nevertheless connected entities are likely to be excluded from the review where the total value of their 'live' IRHPs is more than £10m.*

The second element of the original sophistication test, related to the experience and knowledge of the customer, has not changed as a result of the pilot”.

I would add that the flow chart is not, as far as I am aware, designed to indicate whether a business is or is not included within the IHRP Review, but is only designed to establish whether the business is or is not a sophisticated investor under the general description. The revised guidance has not changed the general assessment of a sophisticated investor but has only amended the eligibility criterion for some businesses who may meet only *the balance sheet and employee number sophisticated investor criteria* (my emphasis). I would also add that this is something which *is* (my emphasis) also referred to on the flowchart.

I know that you feel that you are also unhappy with the manner in which the Regulator has dealt with your correspondence and that you question *“the rigor and open-mindedness (i.e. to accept that error is possible and to embrace and correct it, where it occurs) that has been applied to [your] questions”*. Whilst it is clear that you are unhappy, the concerns you raise could be seen to have arisen from a difference of opinion over a publication the Regulator has issued.

In this case you feel that the Regulator’s publication is unclear whereas the Regulator holds the view that it is not. It is unfortunate that you hold a different interpretation to that of the Regulator. Whilst you suggest that the Regulator has failed *“to accept that error is possible and to embrace and correct it, where it occurs”* this is only something which the Regulator can do if it concurs that an error has been made. In this case, the fact that the Regulator has arrived at a different conclusion to you does not mean that the Regulator lacks *“rigor and open-mindedness”* but rather that, in this case, it does not believe that any correction or revision of a document is necessary.

Conclusion

I have set out above, in considerable detail, why I feel that the Regulator has acted appropriately when assessing your complaint and relying upon Paragraph 10.1(c) of the Transitional Complaints Scheme to exclude the first part of your complaint.. Whilst I can appreciate why you remain unhappy that the Regulator has not considered your complaint as I have explained, the manner in which the revised guidance has been drafted (specifically relating to an amendment of the ‘sophisticated investor’ test to review eligibility for the IRHP review), still amounts to guidance and is therefore not something which can be considered under the rules of the Transitional Complaints Scheme. In addition, I would also specifically draw your attention to paragraphs 6.14 and 6.8 of the complaints scheme which states:

- 6.14 The Complaints Commissioner will not investigate any complaint which is outside the scope of the Scheme, but the final decision on whether a particular case is so excluded rests with the Complaints Commissioner.

In my view, your second complaint relates to your displeasure that the Regulator holds a different view to you and, as a result, will not undertake the action you feel is required, namely the amendment of the 'sophisticated investor' flowchart. While I understand your view, it does not bring the issue into the new Transitional Complaints Scheme.


I should point out that whether a complaint is within the new Transitional Complaints Scheme is at my sole discretion. Currently, for the reasons explained above, I do not believe that this case justifies an investigation by me.

- 6.8 Complainants who are dissatisfied with the outcome of an investigation, or who are dissatisfied with the relevant regulator(s)' progress in investigating a complaint, may refer the matter to the Complaints Commissioner, who will consider whether to carry out his own investigation.

This is a relevant provision as it gives me an unfettered discretion as to whether or not I carry out an investigation. On what I have read there is no evidence of any wrong doing by the Regulator as your complaint ultimately stems from your displeasure with the way it has drafted guidance and what can be described as a difference of opinion between you and the Regulator. Whilst it is unfortunate that you disagree with the Regulator's conclusion, a difference of opinion is not evidence of wrong doing.

I am sorry, but there is nothing to indicate that the Regulator has failed to investigate adequately your complaint or that it has failed to act appropriately upon the concerns you have raised. With this in mind, I do not feel that further investigation or comment by me is necessary and I am therefore filing my papers.

Yours sincerely



Sir Anthony Holland
Complaints Commissioner

