

30<sup>th</sup> April 2009

Dear Complainant

Thank you for your letter of 22<sup>nd</sup> March 2009, which details the elements of your complaint against the FSA. This letter sets out my final decision on the complaints you have raised.

At this stage I think it would be worth explaining my role and powers. Under the Complaints Scheme (Complaints against the FSA-known as COAF) my role is as an independent reviewer of the FSA's handling of complaints. I have no power to enforce any decision or action upon the FSA. My power is limited to setting out my position on your complaint based on its merits and then if I deem it necessary I can make recommendations to the FSA. Such recommendations are not binding on the FSA and the FSA is at liberty not to accept them. Full details of Complaint Scheme can be found on the internet at the following website; <http://fsahandbook.info/FSA/html/handbook/COAF>

The Complaint

Your complaint refers to the decision taken by the Firm to start the practice of stock lending. In your complaint to the FSA submitted electronically on the 29<sup>th</sup> October 2008 you have helpfully set out your complaint into four elements. These are;

“1) Stock lending carries risks that ordinary investors may not understand, and possibly would not wish to take, as in the case of this complainant. A “yes” vote to the Firm's circular is often one of uninformed support of the company. The Firm's letter to shareholders dated 04/08/08.

2) If investors (ordinary) did so wish to accept such risk they would invest in hedge funds, merchant banks etc not companies dealing in unit trusts, ISA's etc

3) It is likely that the true motivation for stock lending is commissions for operators within the system.

4) This must be set against the possibility that after short selling the investors (ordinary) returned holding may be less than it was, or even non-returnable. This must be considered against the current global scene.”

You seek as remedy to your complaint that the FSA “cease to support, and to withdraw support for stock lending by investment companies dealing with the private citizen.”

The FSA issued its decision with regard to your complaint in its letter dated 25<sup>th</sup> February 2009. In this letter the FSA did not uphold your complaint and addressed the four issues you raised.

You wrote to this office on 22<sup>nd</sup> March 2009 asking me to review the FSA's decision. In this letter you did not highlight which areas of the FSA's decision you disagree with. However you did refer to your response to the FSA decision set out in your letter to the FSA dated 13<sup>th</sup> March 2009. The thrust of your letter was that the FSA's following of its rules is insufficient, as you imply that such rules are of concern to you. You feel that the rules are unsuitable to achieve the FSA's stated aims. One of those stated aims is as you have indicated includes "protecting the public interest". It is relevant in general however that the FSA's regulatory objectives also includes that of market confidence in the financial system overall. I believe this objective has some relevance in the scenarios that concern you. You go on to make some further personal and general comments which I feel achieve little with regard to the important issues that you raise.

#### My view

Firstly I would like to address the issue of liability. From your correspondence you have explained that you have withdrawn "virtually all of the holding with (the Firm)". Clearly that decision and any consequential loss are yours, and your advisors', responsibility alone.

In your letter of 13<sup>th</sup> March 2009 to the FSA you have opined that the rules that the FSA follow, which are set out in its handbook, which is itself a Parliamentary Statutory Instrument created under the Financial Services and Markets Act 2000 (hereafter the Act), are unsuitable for dealing with the issue of stock lending specifically in relation to the turbulence apparent in global financial markets. I do not intend to make any investigation or comment into this specific allegation. This is because under the COAF rules complaints about the rules of the FSA are specifically excluded. I quote;

*COAF 1.4.2 Each of the following is excluded from the complaints scheme:*

- (1) complaints about the FSA's relationship with its employees;*
- (2) complaints connected with contractual or commercial disputes involving the FSA and not connected to its functions under the Act;*
- (3) **complaints in relation to the performance of the FSA's legislative functions under the Act (including making rules and issuing codes and general guidance);**(my emphasis) and*
- (4) complaints about the actions, or inactions, of the Financial Ombudsman Service or the Financial Services Compensation Scheme.*

Turning to the elements of your complaint, as set out earlier, I think it is worthwhile making some points that might not necessarily be clear to you or that warrant repetition.

- 1) Stock lending is participated in by companies in their own right, using stocks under their control. Companies do not assign such stock lending deals to individual holdings of private investors. As a consequence any profits or losses made during stock lending by companies are attributable to the company in question as a whole. Such profits and losses do not necessarily directly impact upon private holdings with that company. As such gains and losses are distributed across the company and these

impact more directly upon shareholders and the employees of the company than those with private holdings of investments with the company concerned.

- 2) Many companies already stock lend and short or long sell those investments which you and other private citizens have invested in through the Firm, as they are freely available in the market place. As a consequence the market value of your holdings is already affected by other firms' stock lending and third parties shorting and long selling them. The fact that the Firm has decided to enter this market does not, *per se*, necessarily mean that the market values of your holdings will have their prices affected by this decision.
- 3) It may be that ordinary investors, as you refer to them, may not fully understand the ramifications of investment decisions which they agree to vote for. However such investors do have a responsibility to themselves and their investments to make informed decisions. If companies provide such investors with the information required to make an informed decision and those investors choose not to acquaint themselves properly with the information provided directly and any other information that they may seek out themselves, that is hardly the company's fault (let alone the fault of the FSA).
- 4) As I have explained the risks associated with stock lending do not directly impact upon the private investor's holdings. They may have some indirect impact. As such this change will have limited impact on the day to day values of individual holdings with the Firm, especially when viewed in the light of the fact that the holdings are already affected by many outside influences such as other firms shorting and long selling those particular stocks, their intrinsic value and the drivers that set that value.
- 5) I do not consider the level of risk of unit trusts, Open ended investment companies (OEICS) and Individual Savings Accounts (ISA's) whether with firms that stock lend, or not, comparable with investment in hedge funds or merchant banks. Hedge funds in particular generally require a substantial opening investment by investors and are normally of a far higher level of risk than those investments more specifically designed for the ordinary investor (as you refer to them).
- 6) It is clear that a motivation for entering the stock lending market is "extra returns for minimal additional risk" (as per the Firm's letter dated 15<sup>th</sup> August 2008 to you). Clearly as an investor such returns may well be of benefit to you. I do not see why such returns would be a cause of complaint if they led to increased profitability to the Firm with which you are invested. As you are already exposed to the negative effects on investment value through shorting and stock lending by other parties I see little argument from you with regard to how you are potentially further disadvantaged by the Firm taking up this practice?
- 7) It is of course possible that on the return of stock, that has been lent, that the stock values may have fallen. However the Firm with which you invested is not the sole owner of such stocks. As a consequence those stocks in your holdings are being traded currently and your stocks values are being affected as a consequence during every moment that the markets are open. Before the Firm took this decision the Firm received no benefit from stock lending. It now does, in the shape of the charge it makes to lend stock. This leads to possible profits to which you may now receive

benefit from whilst you stocks continue to be affected by market forces in the same manner as they were prior to this decision by the Firm.

#### Conclusion

From the evidence you have submitted you have not demonstrated any failing statutory or otherwise on behalf of the FSA. Furthermore you have not demonstrated how you have been disadvantaged by this change in how the Firm uses its stocks and whether it lends them or not. For these reasons my view is that I do not uphold your complaint at this time. I am however grateful to you in bringing this complaint to my office.

Yours sincerely

Sir Anthony Holland  
Complaints Commissioner