Banks gamed FCA-supervised interest-rate swap redress scheme; Complaints Commissioner found systemic issues

May 23 2019 Rachel Wolcott, Regulatory Intelligence

Banks gamed the UK Financial Conduct Authority-supervised interest-rate hedging product (IRHP) redress scheme by excluding victims and falsifying information, lawyers and consultants said.

Banks used various techniques to reduce IRHP liabilities which included switching victims into new and inappropriate products then paying token redress as well as falsifying information in review files to have cases excluded. There was also poor communication with victims.

"Were people in the banks pressurised to behave in a way to avoid giving redress to customers? Yes. The FCA didn't do any real work on determining redress under these schemes. The banks and their so-called 'independent reviewers', that were in fact connected to the major banks, set up this review scheme and the FCA simply rubber-stamped it. That's my view of the reality of what happened, based on my experience and interaction with the FCA," said M Ali Akram, partner and barrister at LexLaw Solicitors & Barristers of Middle Temple in London, which represented hundreds of IRHP victims.

The Complaints Commissioner said that, in one case it reviewed, the FCA advanced Barclays' arguments against a complainant instead of addressing the systemic issues the complaint raised. The FCA could have done more to address systemic issues in the scheme.

"I am concerned that the FCA's approach throughout this matter has been to advance arguments for why the bank's rejection of your client's claim might have been justified (which is not its role), rather than addressing the systemic issues which the complaint raised (which is)," the Complaints Commissioner wrote in a December 18, 2018 letter.

Allied Irish Bank UK, Bank of Ireland, Barclays, Clydesdale & Yorkshire Banks, Co-operative Bank, HSBC, Lloyds, Royal Bank of Scotland and Santander were all part of the IRHP review scheme which commenced in 2013 and has so far refunded £2.2 billion to customers.

"The redress scheme was designed to deliver fair and reasonable redress to customers as quickly as possible, without the need to spend time and money building and arguing cases for

themselves. However, the IRHP Review does not remove or replace customers' rights to go to the Financial Ombudsman Service or through the courts. Should they decide not to accept the bank's offer, customers who are eligible can of course refer their complaint to the Financial Ombudsman Service, or pursue their case through the courts. We would advise anyone with information in the examples you have raised to approach us directly," the FCA said in response to issues raised in this article.

The FCA recently announced it would hold senior managers accountable for misconduct in non-regulated business lines such as small and medium-sized enterprises (SME) lending, which includes IRHP.

Banks have mishandled other redress schemes

Banks have mishandled redress schemes previously. The FCA has fined Lloyds twice, £4.3 million and £117 million, in 2013 and 2015 respectively, and Clydesdale Bank £20 million for mishandling payment protection insurance (PPI) claims in 2015.

The FCA is meanwhile quietly allowing firms which have overcharged customers to return the money "voluntarily". The regulator will not disclose the number of such voluntary redress schemes it has sanctioned, nor the names of the firms operating such schemes.

FCA scheme managers criticised

IRHP scheme participants were also critical of the revolving door between the FCA's IRHP review scheme team and banks. In 2013, Christina Sinclair, the FCA's acting director of retail who oversaw the IRHP pilot scheme, joined Barclays in a compliance role.

Most recently David de Souza, IRHP review manager, one of the FCA's main points of contact on the review, joined RBS' corporate governance and regulatory affairs department. RBS was one of the biggest mis-sellers of IRHP.

A spokesman for the FCA said: "[W]e can confirm that the potential risks of conflicts were managed in accordance with our policies and that David de Souza acted appropriately."

Akram expressed concern about de Souza's handling of cases, however.

"If you complained to the FCA about the conduct of the review the response was almost universally from one man, David de Souza, in spite of the many thousands of cases in the review. It seemed to me that he was sending copied and pasted emails in response. For example, on consequential losses he seemed to hold the view that the return of capital employed during the period most of the mis-selling occurred was such a low percentage that the 8% interest banks were offering was usually adequate. Lack of regulatory interest and oversight are the key reasons the scheme was a failure for unrepresented claimants and it is clear that the major banks largely got away without paying proper consequential losses," he said.

Akram called this approach naïve and indicative of the scheme's mishandling.

The FCA declined to comment. De Souza referred emails to an RBS spokesman, who declined to comment.

Poor bank communication was a systemic scheme issue

Banks' poor communication with customers regarding the IRHP redress scheme was one way customers' claims were dismissed or reduced. A customer complained to the FCA about Barclays refusing to acknowledge a consequential loss claim because it did not respond to a letter within 40 days.

The FCA agreed Barclays' letter did not "specifically warn your client about the consequences of not sending a consequential loss claim within the 40-day period" but the regulator ultimately sided with the bank. It said the information had been in the redress offer pack and the customer should have known about it.

But Antony Townsend, the Complaints Commissioner, disagreed with the FCA. Guidance for consequential loss claims said only that the bank "may" not consider claims after the 40-day deadline (i.e., it was a discretion), he said. Townsend also said Barclays' letter was unclear.

The Complaints Commissioner said banks' communication with customers "was not as good as it should have been". It was a "systemic issue" and Townsend criticised the FCA for not dealing with the issue.

The FCA argued it was not responsible for overseeing that communication, but the Complaints Commissioner rejected that view. He cited para 4.1 of the appendix to the scheme that said firms should agree in advance the content of all customer communication with the regulator.

"In my view, there is considerable material to suggest that the information between the bank and its customers was not as good as it should have been. In my view, that ought to have been a matter of legitimate concern to the regulator, not least because of its responsibilities for oversight of the scheme," the Complaints Commissioner said.

The FCA published a response last year disagreeing with the Complaints Commissioner's findings.

RBS altered margin credit lines to exclude customer

Last year Steve Middleton, an independent adviser to SMEs, gave evidence to the FCA of "a rigging or an error in relation to swap credit line" in a case reviewed by RBS.

Middleton explained his position at the FCA's 2018 annual public meeting (pages 8-9), alleging that before the review file was prepared, RBS treasury contacted the local relationship manager and asked to reduce the credit risk on the file from £3.7 million down to £1.4 million.

That information was then submitted in a file note for the review, and the review decision, which denied the claim. Middleton argued that decision was based upon erroneous information. Weeks after the independent review made its decision, RBS treasury told the relationship manager to put the credit risk back up to £3.5 million.

Middleton told the annual public meeting the FCA and RBS "admit there is an error, which is

slightly coincidental error, shall we say, at the same time the file review is being prepared, but none of them were interested in taking any action".

Despite an intervention by the FCA, the customer, a GP practice, was forced to sell its property to pay off the loan, the swap and penalties, which left it with nothing. Middleton said the FCA could have asked RBS to not take action on the swap, even though the property was sold, but declined to do so.

Middleton has said he believes the practice of altering swap credit lines may have been commonplace and urged the FCA to investigate the case and others.

"You can't produce misinformation for the review to mislead the reviewer and say that's an acceptable practice. Any skilled person who actually understands their role would have looked at the file, seen a £5.2 million loan with £3.8 million contingent liability and all the red lights should have gone off. This kind of contract in most cases would have been torn up and the customer would have gotten £3 million plus interest back. What the file said was contingent liability — £1.44 million, break costs — £1.44 million, which looked like market rate break costs," he said.

The FCA declined to comment, saying it did not address individual cases.

An RBS spokeswoman declined to comment, citing client confidentiality.

Excluded claimant informed after legal rights expired

The Coin Group, a care home company, took part in the FCA pilot IRHP review scheme without any legal assistance, on the basis of what Errol Bland, director, called its faith in the financial regulator. It was then excluded by Lloyds due to a scheme change excluding "sophisticated" customers.

"Notably, communication of that ejection decision was delayed by Lloyds for several months for no valid reason except perhaps the hope that the care home's legal rights would become time-barred. Indeed, the decision letter from Lloyds that labelled our client as 'sophisticated' finally arrived, seven or so months late, just weeks after our client's primary legal rights had expired by virtue of the Limitation Act. Fortunately, having taken legal advice in time, an urgent protective claim form was issued, and litigation commenced," said Akram, who represented the Coin Group in court.

The Coin Group won £893,500 from Lloyds in a settlement, the details of which it was permitted to make public. Akram said this kind of behaviour before the scheme even got started allowed banks to exclude up to half of claimants.

"Banks set up the review scheme as a way to spend millions of pounds to save billions of pounds that was truly owed to victims. They sold around 40,000 of these products during the period the review scheme covers. Around half of those — which would have been the most expensive to redress — were wiped out after adjusting the review scheme rules. They whittled down the claimants to 18,200 and then did their utmost to avoid paying them as well. It was a redress avoidance scheme," he said.

Victims put into new, inappropriate swaps

Akram, who was directly involved in the review process, said banks used pressure techniques to get customers to agree alternative products and accept minimal financial compensation. They then claimed they were back at their original position.

"There was mis-selling in over 90% of cases the FCA sampled but rather than redress customers fairly by tearing up the mis-sold derivatives, the banks offered costly replacement derivatives and often falsely claimed without adequate investigation that the customer would not have paid a premium for an inexpensive replacement derivative, such as a five-year cap," Akram said.

The banks often tried to insert, as alternative redress, derivative products that were unrealistic, such as 10- or 15-year caps which experts said did not exist in the marketplace because they would be overpriced. Such costly "fictional" products may have helped the major banks save millions of pounds in redress that should have been paid to unrepresented claimants, Akram said.

FCA plans lessons-learned report

The FCA is preparing to launch an independent "lessons-learned" review of its supervisory intervention on IRHP. The FCA conducted a call for input for topics and issues to be covered in the review.

Those involved with IRHP from the victims' side, however, say they did not learn about the call for input for the review until it was too late.

"I was going to make a lengthy submission to this, but I only found out about it through the [All-Party Parliamentary Group on Fair Business Banking] website and it was too late. I have huge issues with the [IRHP review scheme], the way it was run, and how I think it was drafted to get around the rules. I've been arguing with the FCA for five years now," Middleton said.

Akram was surprised the FCA did not contact him or other lawyers as part of its call for input and would have liked to make a submission.

The Complaints Commissioner said in its December letter: "I can only hope that the FCA will undertake its lessons-learned exercise in a more open-minded fashion [than it did a complaint the Commissioner reviewed]."

- ***Rachel Wolcott*** *is risk management and financial regulation correspondent for Thomson Reuters Regulatory Intelligence.*