Reference Nos. UT-2026-000045
UT-2026-000046
UT-2026-000047
UT-2026-000048

IN THE UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN:

(1) CA AUTO FINANCE UK LIMITED

(2) CONSUMER VOICE LIMITED

(3) MERCEDES-BENZ FINANCIAL SERVICES UK LIMITED

(4) VOLKSWAGEN FINANCIAL SERVICES (UK) LIMITED

Applicants

-and-

FINANCIAL CONDUCT AUTHORITY

Respondent

REPLY OF THE FIRST APPLICANT

INTRODUCTION

1. At least seven fundamental errors run through the FCA's response to the challenges in relation to both Schemes:

   (1) **First**, the FCA's rule-making powers are constrained by clear legal limits. The powers conferred on the FCA under FSMA are not subject to its "*regulatory discretion*", "*predictive discretion*", or "*speculative discretion*". Instead, there is a careful and balanced scheme in ss.404-404D FSMA, in which Parliament has specifically limited what the FCA can do to make rules that require firms to establish and operate a consumer redress scheme ("**CRS**"). That approach is reflected in the wording of s. 404 FSMA as to each of the three key stages of a scheme by which a firm must (i) investigate whether it has failed to comply with applicable requirements, (ii) determine whether the failure has caused loss or damage to

consumers, and (iii) (if causation of loss or damage is established) determine what redress should be made in respect of the failure and make the redress. The central role that the firm is required to play in a CRS places *vires* limits on the FCA in making the rules.

(2) **Second**, the FCA's role is further limited at each stage in the following ways:

(a) the only examples of things done, or omitted to be done, that the FCA can specify as constituting a failure to comply with a requirement are those that a court or tribunal has held, or would hold, to be such (ss.404(5) and 404A(2));

(b) in relation to causation of loss or damage, the powers of the FCA are expressly limited to setting out matters to be taken into account (or steps to be taken) by firms; it cannot prescribe outcomes (ss.404(6) and 404A(1)(c)); and

(c) even when it is permitted to specify matters to be taken into account, the FCA cannot do so if the specified matters have not been or would not be taken into account by a court or tribunal for that purpose (s.404A(3)).

Whether the FCA has complied with these requirements when designing the Schemes is a question of *vires* and not of discretion.

(3) **Third**, the FCA has acted *ultra vires* by proceeding on the incorrect basis that it is empowered by FSMA: (i) to establish a CRS to address circumstances that are "*capable*" of being found by a court or tribunal to be a failure to comply with an applicable requirement, or to be evidence of causation of loss, in equivalent civil proceedings; and (ii) to require redress to be made where it only "*appears*" to the FCA that consumers "*may*" have suffered actionable loss or damage in respect of which a remedy or relief "*might*" be available in civil proceedings. This is simply not what s.404A(2) or s.404A(3) FSMA say. There is no warrant for reading them down by reference to the 'gateway' provision in s.404(1): that is concerned with the FCA's discretion to make a scheme <u>at all</u>, not the limits on the detailed rules that can be made by the FCA once it has decided to introduce a scheme. Again, these limits are a question of *vires* not discretion.

(4) **Fourth**, in the event of a dispute about whether the FCA has complied with these limits, the final arbiter of the matter is the Tribunal and not the FCA. Questions of

vires are questions of law; and thus for the Tribunal. Moreover, the Tribunal is not required to give – indeed cannot lawfully give – any margin of appreciation to the FCA in relation to compliance with them. The Tribunal must decide for itself whether the FCA has gone beyond those limits. The Tribunal also has a primary (i.e. full merits) jurisdiction to determine for itself whether the FCA came to the correct view as to (a) whether a thing done or not done by a firm "*constitutes a failure to comply with [a] requirement*" and (b) what matters "*should be taken into account*" by a firm when assessing evidence of a failure to comply with a requirement and determining whether such failure has caused loss.[1] This necessarily involves determining what a court or tribunal would decide. As it is put in CONRED 1.7.6G: "*In relation to these two aspects, the FCA is restricted to what a court or Tribunal would do. As such, the Upper Tribunal's role will be to check whether the FCA came to the correct view.*" The Tribunal's role is not limited to deciding whether the FCA understood the law correctly; the Tribunal must also decide whether the FCA's application of the law to the facts was correct.

(5) **Fifth**, the FCA's approach misunderstands and understates the limits imposed on its powers by the requirement for actionable loss or damage. In order to receive redress, a consumer must have suffered loss or damage caused by the relevant failure;[2] and the FCA must exercise its powers with the object and effect of compensating consumers for that loss or damage.[3] Indeed, compensation for actual loss or damage is inherent in the very concept of "*redress*". It is unlawful for the FCA to require firms to pay redress that by design is structurally divorced from, or not rationally connected to, such loss or damage. It is also irrelevant whether - or to what extent - the remedial options available to a court under s.140B of CCA are constrained by concepts of loss or damage. Those constraints do exist under s.404 and s.404A FSMA and they cannot be read down by reference to ss.140A-B CCA.

(6) **Sixth**, the FCA in any event incorrectly downplays the relevance of loss or damage under the unfair relationship provisions of the CCA. The question of loss or damage (or its absence) is relevant both to whether, in a particular case, a relationship is unfair and what remedy is appropriate. Further, any remedy under s.140B CCA

[1] FSMA ss. 404D(6)-(7).

[2] FSMA ss.404(4)-(7).

[3] This is clear from the structure of s.404 and reinforced by s.404A(5) FSMA.

"*should approximate, as closely as possible, to the overall position that would have applied had the matters giving rise to the perceived unfairness not taken place*".[4] A court would therefore take into account whether the consumer would have got a better overall deal if the Relevant Arrangements had been adequately disclosed.

(7) **Seventh**, the FCA's powers enable it to establish a scheme that facilitates the efficient, timely and cost-effective determination of civil liabilities of firms arising from widespread and regular industry-wide failures. However, the FCA deliberately chose to impose a level of redress that went far beyond compensating for recoverable financial loss and which inevitably exceeds the quantum of any remedy that a court would ever be likely to award in the vast majority of cases within the scope of the Schemes. The FCA's powers cannot be used in this way.

2. These errors have led the FCA to assert in these proceedings that the Schemes were never intended or required to target financial loss. It says that:

(1) the applicants proceed on "*the erroneous assumption that the FCA is required to "target" financial loss, and restrict "compensation" in the case of any given consumer to the actual loss incurred*";[5]

(2) the applicants' challenges suffer from the "*central flaw*" that "*they proceed on the basis that the object of using the APR adjustment was to ensure that the outcome in each case would approximate actual financial loss as closely as possible.*"[6]

(3) "[Approximating actual loss] *was neither the FCA's duty nor its objective, nor was it the FCA's intention in selecting the APR adjustments either in principle or at the levels set*".[7]

3. This is to misunderstand the basic purpose for which the statutory rule-making powers may lawfully be exercised. The central purpose of a CRS, as is evident from the legislation, is to make rules for securing that redress is made to consumers who have

[4] Black Horse Limited v Angel [2026] EWCA Civ 831 at [57].

[5] FCA GOR ¶156.

[6] FCA GOR ¶161.

[7] FCA GOR ¶161.

actually suffered (or may suffer) loss or damage for which a court would grant compensation: see e.g. ss.404(1)(b)-(c), 404(6)-(7), 404A(1)(c)-(d), 404A(5) FSMA.

4. It is also a re-writing of history.

5. The FCA's public-facing and internal documents previously acknowledged the fundamental importance of redress being connected to compensation for actual harm. It is clear from them that the FCA (correctly) understood that the actual financial loss suffered by consumers as a result of any alleged failure to comply with a requirement is of central importance to establishing a lawful CRS under s.404 FSMA. For example:

   (1) In a CBA panel early engagement slide deck, the FCA noted that "*understanding the existence and extent of harm leading from the poor disclosure of DCAs is important in justifying and informing the amount of redress paid under any redress scheme implemented by the FCA.*"[8]

   (2) In an FCA Executive Committee ("**ExCo**") paper on redress methodologies dated 11 July 2025, the FCA noted that its approach to redress for unfair relationships "*aims, so far as possible, to restore the consumer to <u>the position they would have been in if the firm had disclosed commission arrangements adequately</u>, i.e. the basic objective of redress as set out in DISP and other provisions.*"[9] (emphasis added).

   (3) In an FCA ExCo paper on redress methodology options dated 14 August 2025, the FCA recognised that: "*The question for a court under the CCA – which is our starting point in determining what is "just" redress for the purpose of a CRS – would be what remedy is appropriate to "<u>reverse any damaging financial consequences to the debtor of that unfairness</u>".*"[10] (emphasis added).

   (4) In the Consultation Paper dated October 2025, the FCA acknowledged that it was under a duty to "*show that we took financial loss into account*"[11] and claimed that, reflecting this duty, it had considered how "*an appropriate remedy for the scheme based explicitly on financial loss could be constructed for inadequate disclosure of*

[8] FCA00000503, page 26

[9] FCA1/691-692.

[10] FCA1/747.

[11] Consultation Paper, paragraphs 8.3, 8.22

each relevant arrangement."[12] The Consultation Paper also contained repeated references to the APR adjustment remedy being "*based explicitly on financial loss*".[13] The FCA also expressly stated in the Consultation Paper that: "*[t]he hybrid remedy is designed to compensate consumers for financial loss from inadequate disclosure, while also reflecting the broader range of remedies courts could award…*".[14]

(5) In an undated ExCo paper on the APR adjustment in light of the consultation responses the FCA had received, it was explained that: "*The loss-based aspect of the hybrid remedy is <u>intended to focus directly on the quantifiable financial loss experienced by consumers</u>… it is <u>essential</u> that the fair APR adjustment encapsulates an average loss across all relevant dimensions, including the timeframe. This approach ensures that the redress calculation remains fair and <u>representative of consumers' loss</u> throughout the entire CRS period.*"[15] (emphasis added).

(6) In the Policy Statement dated 31 March 2026, the FCA referred to the evidential position on loss in its reasons for recognising DCAs, HCAs and tied arrangements as Relevant Arrangements.[16] On the issue of redress, the FCA continued to present the APR adjustment remedy as reflecting "*estimated loss*"[17] and being "*loss-based*".[18] The FCA also maintained its position that the purpose of the hybrid remedy was "*to compensate consumers for financial loss from inadequate disclosure of a relevant arrangement while also reflecting the broader range of remedies courts could award under section 140B CCA and the uncertainty of the redress which courts may award in unfair relationship cases if the facts do not*

[12] Consultation Paper, paragraph 8.22.

[13] Consultation Paper, paragraph 8.28.

[14] Consultation Paper, paragraph 8.8.

[15] FCA1/3099.

[16] Policy Statement, pages 28 to 32.

[17] Policy Statement, paragraph 1.27.

[18] Policy Statement, paragraph 11.2.

closely align with Johnson"[19], and claimed that it had: "*improved how compensation is calculated to better reflect loss, while respecting the Supreme Court judgment.*"[20]

6. In its response to the challenges, the FCA seeks to shift its position by downplaying the need to (a) establish that consumers have suffered loss or damage, and (b) award redress which seeks to compensate for that actual loss. It is driven to this untenable position by the force of the lender applicants' arguments that:

   (1) the FCA failed to obtain the evidence, or conduct the analysis, that was needed to establish whether consumers actually suffered loss as a result of inadequate disclosure of any of the Relevant Arrangements; and

   (2) the Schemes – both in design and effect – fail to award redress that even remotely corresponds to either actual loss or damage that has been suffered as a result of such inadequate disclosure or the level of compensation that a court would ever be likely to award.

7. **Finally,** the FCA maintains that it has a power to impose a CRS for the period 2007-2014 in respect of credit agreements entered into at a time when this activity was not regulated by the FCA. This rests on the hopeless premise that amendments to the RAO in 2016 had the effect of retrospectively deeming entry into CCA-regulated credit agreements to have been a regulated activity under FSMA ever since 2001. This issue is addressed first, below.

STAGE 1: TEMPORAL SCOPE OF SCHEME 1

8. The question is whether the FCA has the power to make a CRS for alleged failures in carrying on the activity of entering into CCA-regulated credit agreements prior to 1 April 2014, when that activity first became regulated by the FCA under FSMA.[21]

9. The FCA seeks to suggest[22] that the language of s.404 FSMA, read with Article 60B RAO, is "*clear*" in extending the temporal scope of its power to agreements pre-dating April 2014. However, the FCA's professed confidence in its position is belied by the fact that it

[19] Policy Statement, paragraphs 11.10, 11.18.

[20] Policy Statement, paragraph 1.8.

[21] By way of clarification, CAAF's position is that <u>all</u> agreements entered into prior to 1 April 2014 are outside the temporal scope of the FCA's statutory powers. The FCA's suggestion that CAAF's challenge relates only to agreements which <u>started and ended</u> prior to 1 April 2014 is based on a misreading of CAAF's Grounds ¶¶70-71.

[22] FCA GOR ¶58. See also FCA GOR ¶73.1 ("*the statutory language permits of only one interpretation*").

decided to create two schemes, precisely because it recognised that Scheme 1 was vulnerable to challenge.

10. The FCA's position in the GOR is also inconsistent with its own guidance in the current version of CONRED 1.4.4G, which states that "*a consumer redress scheme cannot apply to services that were provided before the activity in question first became regulated by the FSA or FCA*". That guidance could not be clearer but the FCA now breezily dismisses it as "*wrong*".[23] This is surprising given that the FCA issued the guidance under its statutory power in s.139A FSMA, and the FCA has not sought to alter or revoke it (which would require notice to HM Treasury ("**HMT**")),[24] so it remains a live part of the FCA Handbook. In any event, the FCA's new interpretation is fundamentally flawed.

11. The starting point is that Parliament is presumed not to have intended to alter the law applicable to past events and transactions in a manner which is unfair to those concerned in them, unless a contrary intention appears, and the greater the unfairness, the more it is to be expected that Parliament will make it clear if that is intended.[25]

12. The FCA's argument engages this principle by retrospectively deeming the activity of entering into CCA-regulated credit agreements to have been regulated under FSMA even before amendments were made to the RAO to refer to that activity. It thereby purports to apply a different regulatory regime to lenders regarding their entry into all consumer credit agreements between 2007 and 2014 than in fact applied to them at the time when the agreements were concluded. That would be the case even if the CRS merely aggregated existing liabilities.[26] However, as explained below, the Schemes in fact go further than this and seek to impose liabilities on lenders in respect of past conduct that are much more extensive than existing liabilities.

13. CAAF agrees with the FCA[27] that the key definition is that of "*consumer*" and that the relevant question is whether that person used "*services*" provided by authorised persons

[23] FCA GOR ¶73.4.2. (This paragraph refers to Mercedes' reliance on guidance published by the FSA in 2010. However, the current version of CONRED contains the same guidance in materially the same terms.)

[24] FSMA s.139B(1) and (2). Guidance is, according to the FCA Reader Guide, not binding but it is formally published by the FCA and if regulated persons act in accordance with general guidance in circumstances contemplated by that guidance, the FCA will treat that person as having complied with the relevant rule or requirement.

[25] Wilson v First County Trust Ltd (No.2) [2003] UKHL 40, [2004] 1 AC 816 at [19], [98], [153], [186]-[196].

[26] Cf. FCA GOR ¶63.

[27] FCA GOR ¶76.

"*in carrying on regulated activities*".[28] CAAF therefore focuses first on the FCA's arguments in relation to the definition of "*consumer*" [29]. However, the FCA's arguments in relation to the definition of "*relevant firms*"[30] are also wrong and are addressed briefly below.

14. It follows from the reference to "*regulated activities*" in the definition of "*consumer*" that the "*activity*" referred to in s.404(1)(a) FSMA (i.e. the activity in respect of which there has been a failure to comply with requirements) must mean activity regulated under FSMA. In short, the relevant question is whether the failure to comply with a requirement arose <u>in the carrying on of a regulated activity by an authorised person</u>. If not, it falls outside the scope of the FCA's CRS powers.

15. The FCA's argument[31] is founded on the definition of "*regulated credit agreement*" in Article 60B(3) RAO including CCA-regulated agreements entered into before 1 April 2014. That is correct as far as it goes. However, the FCA draws the wrong conclusion from this definition. Article 60B(3) does not set out any regulated activity; that is addressed in Article 60B(1) and Article 60B(2). Accordingly, it is simply wrong to say that, for present purposes, "*regulated activities*" <u>means</u> "*regulated credit agreements*" (cf. GOR ¶75.4). A "*regulated credit agreement*" is a thing, not an activity. The relevant regulated activity must be something that is <u>done</u> by an authorised person in relation to a regulated credit agreement.

16. The only regulated activities in Article 60B are: (a) "*entering into a regulated credit agreement as lender*" (Art. 60B(1)); and (b) "*to exercise, or to have the right to exercise, the lender's rights and duties under a regulated credit agreement*" (Art. 60B(2)). Article 60B came into force on 1 April 2014. Before then, neither activity was FSMA-regulated.[32]

17. When the FCA assumed responsibility for regulating consumer credit activity, there was no obligation on firms to become FCA-authorised. Indeed, the FCA acknowledged and accepted that many firms would not become FCA-authorised because of the higher

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[28] FSMA, ss.404E(1)-(2)(a).

[29] FCA GOR ¶¶67-74.

[30] FCA GOR ¶¶64-65.

[31] FCA GOR ¶¶69-70.

[32] It is also notable that the extended definition of "*regulated credit agreement*" upon which the FCA places such great reliance was not itself introduced until even later and only came into force with effect from 20 March 2016.

regulatory burden under FSMA.[33] Firms that wanted to conduct regulated activities under Art. 60B(1) and/or 60B(2) had to apply for permission to do so and become FCA-authorised. If firms wanted to continue to enter into credit agreements after 1 April 2014 and service existing credit agreements, they had to apply for two separate permissions under Art. 60B(1) and (2). Alternatively, firms could (i) choose not to become authorised at all if they did not want to become subject to the new FCA regulatory regime; or (ii) apply for permission under Art. 60B(2) only, so that they could continue to service existing credit agreements, but not enter new ones (i.e. operating as a closed book lender).

18. Under the Schemes, the alleged failure by lenders is the inadequate disclosure of the Relevant Arrangements <u>prior to</u> the entry into a credit agreement. It follows that the <u>only</u> relevant regulated activity can be <u>the entry into a regulated credit agreement (i.e. the activity under Art. 60B(1))</u>. As has been noted, this <u>activity</u> has only been regulated under FSMA since 1 April 2014. It is impossible for an existing credit agreement to have been entered into again after that date.

19. It must follow from this that CCA-regulated credit agreements already in existence as at 1 April 2014 are unaffected by the introduction, by Article 60B(1) RAO, of the new regulated activity of entry into a regulated credit agreement. Contrary to the FCA's position,[34] this does not involve reading any words into the definition in Article 60B(3) RAO. It is simply the logical consequence of the fact that entry into an agreement can only happen once and is not a continuing activity. Accordingly, the only relevant activity (i.e. entry into the agreement) was only carried on in relation to all pre-April 2014 credit agreements at a time when that activity was not a regulated activity under FSMA.

20. If the FCA's interpretation were correct, it would mean that firms that stopped new lending prior to 1 April 2014 but obtained permission under Art. 60B(2) so that they could continue to service existing credit agreements from that date should in fact have also obtained permission under Art. 60B(1) in order to become authorised by the FCA in relation to their solely historic conduct of entering into credit agreements. That would be

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[33] See for example PS14/3 dated February 2014 on rules for the FCA regime for consumer credit at page 104: "*We accept that market exit will occur as a result of our policy. Our CBA said that this varies between sectors but could be between 5% and 35%, with the highest level of exit being in the HCSTC* [high-cost short-term credit] *market.*" In its consultation paper dated March 2013 on the transfer of consumer credit regulation to the FCA, HMT also recognised that some firms may choose not to incur the costs involved in the FCA regime and exit the market instead (pages 125 and 141).

[34] FCA GOR ¶72.

absurd and was clearly not contemplated by the contemporaneous consultation and policy statements.[35]

21. This conclusion is reinforced by the reference to "*relevant firms*" in s.404(1)(a) FSMA. So far as material, this is defined to mean "*authorised persons*": FSMA, s.404(2)(a). The reference in s.404(1)(a) FSMA to: "*a widespread or regular failure* <u>*by relevant firms*</u> *to comply with requirements applicable to the carrying on* <u>*by them of any activity*</u>" (emphasis added) clearly limits the scope of the FCA's CRS power to activities of an authorised person carried on at a time when they were authorised. The word "*them*" refers back to "*relevant firms*"; and, as explained above, "*activity*" means a FSMA-regulated activity. The firm must therefore have been an authorised person <u>at the time of</u> the relevant activity.

22. No doubt is cast on this conclusion by the fact that the FCA's CRS power is extended by ss.404F(5)-(6) FSMA to include persons who have since ceased to be an authorised person.[36] It is obvious why the FCA's CRS power needs to extend to a firm that was an authorised person at the time when the relevant activity and failure occurred, but is no longer an authorised person when the CRS is put in place. This simply brings a firm back within the FSMA regulatory perimeter for something done by the firm while it was within it. It would be quite another thing to impose regulatory obligations applying only to authorised persons on firms for conduct pre-dating their authorisation by the FCA. This would retrospectively widen the FSMA perimeter.

23. The unacknowledged consequence of the FCA's argument would be that the activity of entering into a CCA-regulated credit agreement is retrospectively deemed always to have been a regulated activity under FSMA (apparently without any limitation of time back to December 2001 when FSMA came into force). This gives extraordinary strength to <u>a</u>

[35] See for example CP13/7 dated March 2013 on high-level proposals for an FCA regime for consumer credit at paragraphs 10.21-10.22, especially "*in relation to a credit agreement already in existence on 1 April 2014, we expect to be able to apply our enforcement powers under FSMA to specified CCA requirements in relation to acts, omissions or events* <u>*on or after that date*</u>*. We do not expect to be able to impose fines for misconduct that occurred before 1 April 2014, other than where these could have been imposed under the CCA*"; and CP13/10 dated October 2013 on detailed proposals for the FCA regime for consumer credit at p143 "*for breaches committed before 1 April 2014 we will only be able to apply the sanctions that were in place at that time*". Consistently with these statements, one of the reasons relied on by the FCA in PS17/3 for not introducing a s.404 scheme in respect of payment protection insurance (PPI) complaints was that "*a s.404 scheme could not apply to PPI sales made before 2005* [i.e., when general insurance became a regulated activity] *or to credit agreements from lenders that did not carry out insurance mediation before 1 April 2014, because of the requirement under s.404 for there to have been a regulated activity.*" (page 37 of PS17/3; see also the similar statements at pages 25 and 134).

[36] FSMA, s.415AA also does not assist the FCA's argument: cf. FCA GOR ¶64. First, as the FCA fails to acknowledge, this does not by its terms apply to the FCA's CRS powers. In any event, the points that are made in this paragraph in relation to ss.404F(5)-(6) apply with equal force to the FCA's reliance on this provision.

definition. The RAO is of general application, so the consequence of this could not be limited to the temporal scope of the FCA's power to make a CRS. In principle, it would retrospectively apply the full gamut of regulatory obligations and powers under FSMA to consumer credit activities at a time when they were outside the regulatory perimeter. This cannot have been intended (and, as set out in paragraph 17 above, it clearly was not).

24. The FCA appears[37] to place weight on the fact that existing credit agreements became regulated under Article 60B(2) RAO from 1 April 2014 in relation to the exercise of, or the right to exercise, rights and duties of a lender. This is unexplained in the FCA GOR. However, Article 60B(2) is irrelevant because the alleged failure - i.e. the non-disclosure of Relevant Arrangements - did not arise from lenders carrying on that activity in the period after 1 April 2014. In any event, even if that were wrong, it provides no basis for the FCA to include agreements that started and ended before April 2014 in Scheme 1.

25. Indeed, it would be a strange outcome if the FCA were to have been given regulatory powers under FSMA where all CCA-regulated credit agreements between the lender and borrower had already come to an end before the FSMA regulatory perimeter was expanded to include such agreements; the FCA's interpretation would mean that an entity which had never been regulated by the FCA would nevertheless have to be FCA-authorised because of purely historic contracts. Neither party would have expected the FCA to have any such powers at any time during the life of their legal relationship. Further, there was no existing credit agreement that required continued regulation at the point of transfer of regulatory responsibilities for consumer credit from the OFT to the FCA. Clear wording would be required to achieve this counter-intuitive outcome. However, there is none.[38]

26. The FCA is wrong[39] to place reliance on the limited retrospective effect of ss.404-404G FSMA under s.14(2) of the Financial Services Act 2010 ("**FSA 2010**"). FSA 2010, s.14(2), states only that those provisions have "*effect in relation to failures occurring*

[37] Cf. FCA GOR ¶74.

[38] Indeed, the limitation of the FCA's powers to authorised persons is significant in this context. In principle, it is possible for CCA regulated credit agreements to have been entered into prior to 1 April 2014 by a firm that never became an authorised person because it did not continue its CCA business after such activities became regulated by the FCA. Even the FCA must be compelled to accept that it has no power to impose a CRS on such firms. This creates an essentially arbitrary distinction between different motor finance lenders in the pre-2014 period.

[39] FCA GOR ¶62.

before the commencement of this section" (emphasis added).[40] This does not answer the question of whether non-compliance with a requirement that occurred before the entry into force of s.14 FSA 2010 is a "*failure*" within the scope of s.404 FSMA. This turns only on the correct interpretation of s.404 FSMA. For the reasons set out above, s.404 FSMA only applies to non-compliance with a requirement by an authorised person in carrying on an activity that was regulated under FSMA at the time when it was carried on, and not if the non-compliance occurred when that activity was not regulated under FSMA.

27. The reason for this limited retrospective effect is obvious. The FCA's power to make a CRS (introduced by the FSA 2010) replaced a similar power of HMT to establish compensation schemes in broadly similar circumstances. The retrospective effect of ss.404-404G meant it replaced the existing regime in its application to regulated activities already carried on by authorised persons. The intention was to ensure continuity, rather than expand the regime to activity not regulated under FSMA when it was carried on.[41]

28. This does not leave any lacuna. FSMA, s.404G gives HMT the power to amend the definition of "*relevant firms*" or "*consumers*" (or both). The FCA recognised internally in August 2025[42] that it would not have any power to impose a CRS for the period prior to April 2014 unless HMT exercised that power. However, it has not done so.

29. The Tribunal should therefore quash Scheme 1 in its entirety.

[40] In this regard, even where some retrospective operation of a statute was clearly intended, there is a presumption that the retrospective operation extends no further than is necessary to give effect to its clear language or its manifest purpose: Arnold v Central Electricity Generating Board [1988] AC 228 at 275, per Lord Bridge.

[41] It is no answer to this to say, as the FCA does at GOR ¶63, that the safeguards provided for by Parliament include that the CRS framework under FSMA only aggregates existing liabilities. CAAF agrees with the FCA that the CRS framework should only be used to aggregate existing liabilities (i.e. legally actionable civil liabilities of firms in respect of loss or damage), but the Schemes as made do not respect those limits. As explained below, the Schemes impose liability to pay redress both in circumstances where a court would not and in a greater amount than a court would order and without reference to the loss actually suffered by consumers as a result of any alleged failures. Moreover, the FCA claims (wrongly) that it is entitled to do this. Further, even if the Schemes did simply replicate existing liabilities, this does not change the fact that it is wrong in principle retrospectively to treat an activity that was not regulated by the FCA at the time it was carried out as if it were regulated by the FCA at the time it was carried out.

[42] FCA00000182, pp.31, 49 and 56. See also the Guidance issued by the (then) FSA when the original section 404 came into force (GN10) at para 9.4 and 9.5: *Where the financial services to which a scheme applies are those provided by authorised persons in carrying on regulated activities, the limitation to "regulated activities" means that a consumer redress scheme cannot apply to services that were provided before the activity in question became regulated by the FSA…That said, it would be possible for the Treasury by order to widen the type of financial services that a consumer redress scheme can apply to in order to encompass the pre-FSA regulation activities (see s. 404G of FSMA)."*

STAGE 2: PRESUMPTION OF UNFAIR RELATIONSHIP

Overview of the FCA's errors

30. The FCA has specified in the Schemes that inadequate disclosure of the Relevant Arrangements, of itself, gives rise to a presumption of unfairness (rebuttable only on narrow grounds). These matters are set out by the FCA as "*examples*" for the purposes of s.404A(1)(b) of things done "*that are to be regarded as constituting a failure to comply with a requirement*". The FCA claims that it was within the scope of its regulatory discretion to design the Schemes in this way and that the rebuttable presumption is a rational exercise of that discretion with which the Tribunal should be very reluctant to interfere.[43]

31. This mischaracterises both the scope of the FCA's powers and the basis on which the applicants may challenge the exercise of those powers in the Tribunal. In particular:

    (1) The FCA has the power to set out examples of things done, or omitted to be done, that are to be regarded as constituting a failure to comply with a requirement.[44] However, such examples must be ones that have been, or would be, held by a court or tribunal to constitute such a failure.[45] This is not a question of discretion, but a hard-edged limit of law and *vires*, which is subject to full merits review under the Tribunal's primary jurisdiction.[46]

    (2) In summary, the combined effect of ss.404A(1)(b), 404A(2) and 404D(6) FSMA is that:

        (a) The FCA does not have the power to include within the scope of a CRS any situation which would not constitute an unfair relationship under s.140A CCA.

        (b) In assessing whether the FCA has acted unlawfully (including *ultra vires*), the Tribunal can determine for itself whether the examples set out "*have been*" or "*would be*" held by a court or tribunal to give rise to an unfair relationship.

[43] FCA GOR ¶¶87-93, ¶110.

[44] FSMA, s. 404A(1)(b).

[45] FSMA, s. 404A(2).

[46] FSMA, s. 404D(6).

The language of "*have been*" and "*would be*" is significant; it must not be watered down to "*might be*", "*could be*" or "*capable of being*".

(c) The FCA therefore has no "*discretion*" or "*regulatory judgement*" to exercise in defining within a CRS the circumstances to be treated as giving rise to an unfair relationship within the meaning of s.140A CCA.

(3) The FCA's reliance on s.404(1)(a) FSMA does not assist it given these clear *vires* limits in s.404A FSMA; s.404(1) deals only with the precondition to the exercise of the rule-making power, rather than the limits on what the rules can do (which is dealt with in ss.404(3)-(7) and 404A).[47] CAAF accepts that the threshold conditions in s.404(1) afford a regulatory discretion to the FCA to determine whether it considers that circumstances exist that justify making a CRS.[48] This is reflected in the language of s.404(1): "*it appears to the FCA*", "*may have been*", "*it considers*", "*desirable*". By contrast, there is no similar language of discretion in s.404A(2). The clear express requirements of s.404A(2) exist to guard against the FCA seeking to redefine or expand what constitutes a failure in law to comply with a requirement.

(4) These safeguards were imposed by Parliament for a reason. It was not intended that firms should be subject to a liability under a CRS that they would not be subject to before a court or tribunal if the alleged failure had been litigated by the consumer.[49]

(5) The fact-sensitive nature of the unfairness test under s.140A CCA does not mean (as the FCA suggests[50]) that the FCA has a regulatory discretion to strike a balance between "*fidelity to that open-textured enquiry and the need to implement rules on liability that can be operationalised at scale in the context of a CRS*".[51] Nor can it

[47] FCA GOR, ¶86.1. See to similar effect FCA GOR ¶45.3 – "*the statutory question of desirability on s.404(1)(c) encompasses not just whether a CRS should be made at all, but also what the terms of that CRS should be*".

[48] Even at this stage, however, the FCA has no "*discretion*" in determining the matters of law as to: (i) the applicable requirements; (ii) what amounts to a failure to comply with such requirements; or (iii) whether and to what extent any loss or damage would be remediable in legal proceedings. Here the FCA is either right or wrong.

[49] See e.g. ss.404(1)(b) and 404A(2) FSMA.

[50] FCA GOR ¶87.

[51] See also e.g. FCA GOR ¶89 ("*a careful balance between the fact-sensitive nature of the s.140A test … and the need to implement workable scheme rules*"); FCA GOR ¶93 ("*the culmination of a highly complex policy-making exercise, which involved a series of considered, evidence-led regulatory judgements balancing the multiple competing factors outlined above*"); FCA GOR ¶109.2 ("*striking a difficult balance between the need to target relationships that are genuinely unfair with the operational exigencies of implementing a scheme that can be operationalised at scale*")

justify a less strict interpretation of the statutory limits on the FCA's powers that would entitle the FCA to exercise "*regulatory judgement*" to determine for itself whether circumstances are "*capable*" of constituting an unfair relationship, or to identify circumstances which "*appear*" to the FCA potentially to give rise to liability.[52] If an example of an unfair relationship is established under the rules of the Schemes where a court would not so find, that is *ultra vires* and unlawful under s.404A(2) of FSMA.

(6) CAAF recognises that circumstances which have not yet been addressed in a judicial decision may be included within a CRS as an example of a failure to comply with a requirement, provided that a court in civil proceedings would find that those same circumstances gave rise to liability. However, this would be subject to exactly the same *vires* limits under s.404A(2) and review by the Tribunal under s.404D(6). As a matter of law, the FCA does not in this situation have any discretion or judgement to make rules that impose liability to pay redress where none would exist under the general law.[53] Indeed, CONRED 1.3.11G states that, if the law is unclear in a particular area, the "*two broad options*" available to the FCA are either: (a) not to develop a scheme, or (b) to take steps to clarify the law.

(7) Ultimately, if a firm (or, in principle, a consumer) disagrees with where the FCA has drawn the line, the Tribunal's jurisdiction may be invoked as a 'safety valve'. The Tribunal will then resolve that disagreement as if it were a court hearing a claim for alleged breach of the relevant requirement. In doing so, the Tribunal may consider any relevant evidence that is put before it, whether or not it was available when the rules were made.[54] The question of whether the rules of the Schemes comply with the statutory safeguard in s.404A(2) is a question of legal fact in respect of which Parliament has given the Tribunal primary (i.e. full merits) jurisdiction under s.404D(6). The FCA is wrong to dismiss this jurisdiction (in a footnote) as a mere "*backstop*" review that does not limit what the FCA characterises as its

[52] Cf. FCA GOR ¶¶46-47, ¶¶86-88.

[53] Cf. FCA GOR ¶86.2.

[54] FSMA, s.404D(13)(b).

"*power*" or "*discretion*" to specify examples of what it considers to constitute a failure to comply with requirements.[55]

(8) In practice, a challenge is only likely to be brought before the Tribunal where, as here, the FCA has overstepped the line by a significant distance. However, if a CRS is challenged and the Tribunal determines for itself that the rules of the CRS require firms to find a breach of the relevant requirement in circumstances where a court would not so find, it is the Tribunal's responsibility to quash those rules accordingly.

32. The FCA claims[56] that the basis on which the Schemes require firms to find an unfair relationship by reference to inadequate disclosure of a Relevant Arrangements is legally correct (or at least rational, if that were the correct test) on the basis of empirical evidence and guidance from the relevant s.140A CCA caselaw. The FCA's approach cannot be justified by these factors either individually or in combination.

33. As noted above, it is common ground that the test of unfairness under s.140A CCA is highly fact-sensitive and that the court will take a very broad range of factors into account.[57] In principle, this must include the presence or absence of financial loss or damage caused by failings of the lender and/or some other form of real harm or prejudice. The FCA's own position in <u>Johnson v FirstRand Bank Ltd</u> [2025] UKSC 33, [2026] AC 877 **("<u>Johnson</u>**"), which was adopted by the Supreme Court,[58] was that non-disclosure of commission does <u>not</u> itself constitute an unfair relationship. It is just one of very many factors that must be taken into account.

34. The FCA's approach under the Schemes wrongly requires firms to presume unfairness, without more, on the basis only of inadequate disclosure of any one of the Relevant Arrangements (i.e. DCA, HCA or tied arrangement). As explained below, there is no proper basis for including tied arrangements or HCAs within the Schemes at all and the approach to DCAs is on any view over-inclusive. In any event, the exclusions from the Relevant Arrangements and the basis on which the presumption can be rebutted are far too narrow. The consequence is that unfairness will inevitably be found in very many

[55] FCA GOR ¶86.2, fn122.

[56] See e.g. FCA GOR ¶91.

[57] See also e.g. <u>Johnson</u> at [297], [319].

[58] <u>Johnson</u> at [319]-[320].

cases under the Schemes where a court would not so find, and the FCA has thereby exceeded the limits on its powers set out above.

35. The FCA's suggestion that its approach is derived from "*empirical evidence*" is also unsustainable. The FCA's own overarching rationale as expressed in its Policy Statement is that inadequate disclosure of the Relevant Arrangements deprived consumers of relevant information and led to them paying higher prices.[59] The Schemes lack any proper or reliable evidential basis for this premise; and it runs counter to the FCA's previous conclusions that it had no evidence that prices in the market were too high and that disclosure of commission arrangements had limited benefits for consumers.[60]

36. In fact, the FCA appears to suggest that it is impossible to test whether inadequate disclosure of any of the Relevant Arrangements affected consumers' behaviour or outcomes because data "*simply does not exist and/or cannot reasonably be obtained*". Instead, the FCA argues that such evidence is not required to establish unfairness under s.140A CCA.[61]

37. CAAF does not accept that the FCA lacked, or could not reasonably have obtained, the data or carried out the analysis that was required to evidence any impact of inadequate disclosure of the Relevant Arrangements. This will be the subject of expert evidence in due course. However, the FCA could for example have carried out analysis on APRs pre- and post- the decision of the Court of Appeal in Johnson to assess the impact on consumers of improved disclosure practices across the industry after that decision.

38. Instead, the FCA took a policy decision at an early stage, prior even to issuing the Consultation Paper, not to obtain further data or carry out further analysis on the basis of an assumption that it would provide "*limited benefit*" and cause "*further delay*".[62] This is despite the fact that such evidence would be highly relevant to any court's assessment of unfairness.

[59] Policy Statement, pages 28 to 32; FCA GOR, ¶124.

[60] PS20/8, pages 9 and 17.

[61] FCA GOR ¶95

[62] FCA1/748, 756.

39. The absence of supporting case law and lack of sufficient empirical evidence to support the FCA's approach to each Relevant Arrangement is addressed further below.

Tied arrangements

40. **Absence of supporting case law**: There is no case authority that provides any support for the suggestion that mere inadequate disclosure of a tied arrangement can ever give rise to an unfair relationship. There was a tied arrangement in Johnson, but that was an extreme case involving positive misrepresentation by the dealer as to its role and relationship with lenders,[63] together with a very high undisclosed commission far in excess of the HCA threshold in the Schemes.

41. **Lack of evidence**: The FCA also accepts[64] that it has no evidence that tied arrangements harm consumers and the evidence it did have suggested that they may actually be neutral or beneficial to consumers. The FCA recognised this shortcoming, but chose not to carry out further work.[65] The further work which the FCA could have carried out will be addressed in expert evidence. It would have included: (i) analysis on APRs pre- and post-the decision of the Court of Appeal in Johnson when disclosure practices improved; and (ii) carrying out more work to seek to identify whether loans with commercial ties exhibited different pricing outcomes compared to those without ties.

42. A principal reason why the FCA nevertheless retained tied arrangements within the Schemes appears to have been its concern that excluding them would place heavy operational burdens on the Financial Ombudsman Service ("**FOS**") in dealing with complaints.[66] However, that cannot justify treating inadequate disclosure of tied arrangements as giving rise to an unfair relationship since no court would ever regard the operational burden for FOS of dealing with unfounded complaints as a relevant factor in determining that an unfair relationship existed or that compensation should be paid.

43. It is also incoherent to limit the captive and white-label exception for tied arrangements to cases where the lender and franchised dealer share common branding with the vehicle

[63] Johnson at [333]-[334].

[64] Policy Statement, pp.31-32.

[65] FCA1/748-749 (14 August 2025); FCA1/1710 (16 January 2026); FCA1/1770-1771 (6 February 2026).

[66] FCA1/1849-1850.

being acquired.[67] Even if there were any proper basis for including tied arrangements at all, the FCA has correctly accepted that there would be no unfairness where the commercial link between the lender and dealer should reasonably have been apparent to the consumer through their common branding.[68] That is the rationale for the captive and white-label exception. This has nothing at all to do with whether the customer appreciated a link between the brand of vehicle and the lender or dealer. On the FCA's own logic, there is no justification for excluding cases from the exception where the link between the lender and dealer was clear from their common branding, but by happenstance the customer buys a vehicle with different branding. This is important because franchised dealers also sell vehicles with different branding or produced by other manufacturers to customers with finance from the lender with whom they have a tied arrangement.[69]

High Commission Arrangements

44. **Absence of supporting case law**: Recently, the Court of Appeal in Black Horse Limited v Angel [2026] EWCA Civ 831 ("**Angel**") at [87] said that it was "*wrong in principle*" in this context to suggest that "*there may be cases where the size of the commission alone would justify a finding of unfairness*". It also made clear that the "*tipping point*" analysis (that was adopted in Plevin v Paragon Personal Finance Ltd[70] ("**Plevin**") for PPI) cannot be transplanted to the very different context of motor finance.[71] There is obviously a huge difference between: (i) a consumer paying a premium for non-essential insurance that consists very largely of undisclosed commission, as in Plevin, and (ii) agreeing to buy a

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[67] FCA GOR ¶109 mischaracterises CAAF's objection as being that this exception should have been extended to "*situations where the lender was linked to dealer*". This makes no sense. The exception already applies where the lender was linked to the dealer. The issue is whether it should be limited to cases where the lender and dealer operate under the same branding as the vehicle purchased by the consumer. FCA has given no reasoned justification in the GOR for its decision to limit this exception in the way that it has done.

[68] Policy Statement, pp 103-104.

[69] See the second witness statement of Alexander Hughes ("Hughes 2") at [76-79]. As Mr Hughes points out, the exception would also, even if available, be very difficult to evidence: Hughes [80] – [81].

[70] [2014] UKSC 61, [2014] 1 WLR 4222.

[71] In Johnson at [324], the Supreme Court referred to the "*tipping point*" analysis in Plevin (i.e. the argument that there is a point at which the commission as a proportion of the premium paid becomes so large that its non-disclosure alone constitutes unfairness). However, it is clear from Johnson at [326]-[327] that the Supreme Court did not carry this approach across to the motor finance context. Instead, the very high level of the commission was regarded by the Supreme Court as no more than a "*powerful indication*" of unfairness in the particular circumstances of that case. It bears emphasis that: (a) the level of commission in Johnson (55% of the total charge for credit and 26% of the total amount of credit – see at [323]) was very much higher than the HCA threshold under the Schemes (39% and 10% respectively); and (b) the Schemes operate on the basis that inadequate disclosure of this factor alone gives rise to presumptive unfairness. This goes far beyond and is not supported by the reasoning of the Supreme Court in Johnson.

car at a known price, for which the consumer needs finance where the loan amount and APR are disclosed.[72]

45. Johnson provides no basis at all for concluding that a court would find unfairness solely on the basis of inadequate disclosure of a high commission. It was the combination of extreme facts that led to the finding in that case (see paragraph 40 above).

46. **Lack of evidence**: The FCA originally proposed to identify HCAs as Relevant Arrangements based on its commission "pass-on" analysis. This approach was flawed in significant respects including because it failed to identify a causal relationship between commission levels and the cost of credit. It was ultimately abandoned by the FCA when concerns raised in responses to the Consultation Paper led the FCA to conclude that "*there was little clear evidence that the association between broker commission and total cost of credit increased with commission level and we could not rely on this analysis to determine the high commission arrangement threshold.*"[73] However, rather than recognise that the evidence did not support the inclusion of HCAs within the Schemes at all, the FCA sought to justify a very similar HCA threshold on the basis of an entirely new "outlier" approach.

47. In relation to the FCA's new "outlier" approach to the HCA threshold, the FCA appears to have considered both the 85th and 90th percentile as possible HCA thresholds,[74] but provides no justification for choosing the lower of these thresholds as the level at which a court would find inadequate disclosure to constitute an unfair relationship, beyond asserting[75] that this is "*materially above market practice*" and "*presents a higher risk of consumer harm when undisclosed*". However, the FCA's reliance on a supposed heightened risk of consumer harm is incoherent in circumstances where it has produced no reliable evidence of any consumer harm resulting from HCAs, still less from inadequate disclosure of HCAs.[76]

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[72] As the Supreme Court recognised in Johnson at [326].

[73] Technical Annex 1 to the Policy Statement, ¶¶4.159 and 4.160.

[74] FCA1/1806.

[75] FCA GOR ¶104.2.

[76] Policy Statement, pp.30-31.

48. The FCA could have obtained further data to assist it in assessing the extent to which non-disclosure of high commissions caused harm to consumers, including by undertaking analysis of APRs pre- and post- the decision of the Court of Appeal in Johnson.

DCAs

49. **Absence of supporting case law**: The case law does not establish that inadequate disclosure of a DCA will inevitably give rise to an unfair relationship unless the consumer gets the lowest possible APR. The FCA has extrapolated too much from R (Clydesdale Financial Services Ltd) v Financial Ombudsman Service Ltd[77] ("**Clydesdale**").

50. That case does not decide that inadequate disclosure of a DCA constitutes an unfair relationship under s.140A either invariably or at all. Clydesdale was a judicial review of FOS. The challenge to FOS's findings on liability was principally concerned with its interpretation of the applicable regulatory rules when the customer took out the loan in 2018. There was no direct challenge in Clydesdale to FOS's conclusion that an unfair relationship existed between the lender and customer as a result of the non-disclosure of the DCA.[78]

51. The court did reject an argument that FOS was not entitled to find a breach of FCA Principle 6 – i.e. "*a firm must pay due regard to the interests of its customers and treat them fairly*" – where the lender failed to give adequate disclosure in relation to a DCA, but the consumer nevertheless got "*a good deal with a market-leading APR*": see at [253]-[255]. However: (1) the existence of an unfair relationship does not follow from a breach of Principle 6; (2) a breach of the FCA Principles is not of itself privately actionable; and (3) the considerations relevant to the existence of an unfair relationship are much broader than those arising under Principle 6 (in particular, it may well be relevant to whether an unfair relationship exists or requires a remedy to ask whether the customer got a good deal overall either because they paid a competitive interest rate or because a higher interest rate was compensated for elsewhere in the deal, e.g. in relation to vehicle price).

[77] [2024] EWHC 3237 (Admin), [2025] Bus LR 1323.

[78] The court did say in Clydesdale (at [368]) that FOS's conclusion that there was an unfair relationship could not be challenged in view of the fact that its interpretation of CONC was correct; and, in any event, that it would have been open to FOS on the facts of that case to find that an unfair relationship existed independently of any breach of a rule. However, this is not the same as a finding that inadequate disclosure of a DCA (at least an established breach of an applicable regulatory rule) will of itself always give rise to an unfair relationship.

52. **Lack of evidence:** The FCA based its final policy on its calculation of APR-17%, as the average difference between APRs on DCA and non-DCA agreements over the period 2017-2021. However, it is a fundamentally flawed measure of consumer harm:[79]

(1) **First**, it purports to measure the impact of the existence of discretion by comparing the APRs on DCA agreements with the APRs on non-DCA agreements. It does not measure the impact of inadequate disclosure. There is no basis for assuming that any (let alone all) harm that is caused by the existence of discretion is attributable to its non-disclosure to the consumer.

(2) **Second**, the FCA's analysis to derive the APR-17% figure appears to have been methodologically flawed even as a measure of the impact of the existence of discretion. Most importantly, there are significant differences between the DCA and non-DCA populations which are likely to have distorted this figure upwards. Moreover, the approach that the FCA took to expanding the data-set to cover 2017 and 2018 gives rise to significant concerns as to its reliability and comparability. These methodological flaws will be the subject of expert evidence in due course.

(3) **Third**, the APR-17% figure is an average that inevitably fails to account for the fact that DCAs do not affect the outcome for all consumers equally. Indeed, the FCA's own analysis suggested that 44% of consumers actually benefitted from DCAs. This is an important point given the FCA's blanket presumption that inadequate disclosure of DCAs gives rise to an unfair relationship in any case where the consumer got anything less than the minimum interest rate available under the DCA.

(4) **Fourth**, the FCA failed properly to consider alternative methodologies that would have addressed both the issues identified in sub-paragraphs (2) and (3) above. The alternative methodologies will be addressed in expert evidence in due course. However, in summary, the FCA could have compared APRs before and after the ban of DCAs in January 2021 and then sought to identify where higher APRs were correlated to sufficiently high commissions such as to indicate that the commission could have been a driver of the higher APR. This would have been a more reliable basis on which to identify the customers who may have in fact been prejudiced by DCAs.

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[79] The APR-21% figure for Scheme 1 is even more flawed for the reasons set out in CAAF's Grounds ¶133-135.

Exceptions and the no better deal rebuttal

53. As noted above, the exceptions and rebuttals are inadequate to prevent the presumption capturing many relationships that are not unfair. In particular:

(1) The de minimis exception and the zero APR exception operate at a level far below where a consumer would realistically be found to have been materially prejudiced by inadequate disclosure of any of the Relevant Arrangements. There will be many cases where the consumer will have suffered no conceivable unfairness, but the total commission was greater than £120/£150 and the APR was higher than zero.

(2) The no better deal rebuttal operates at the next stage of loss or damage, albeit only in respect of HCAs and tied arrangements. However, insofar as it is also relied on by the FCA to justify its approach at this prior stage, it plainly does not go far enough. As explained at paragraph 75 below, even if the consumer might have been able to obtain a lower APR from another lender with whom the broker had a referral arrangement, it would not follow that the consumer has necessarily been prejudiced by inadequate disclosure so as to give rise to unfairness (or at least any unfairness that would justify granting a remedy under s.140B CCA). In any event, this rebuttal is not available at all in cases where there is a DCA.[80] Even where the rebuttal is available, the FCA has imposed extremely onerous evidential requirements, which it is very unlikely that CAAF will be able to satisfy.[81]

Conclusion in relation to unfair relationships

54. The Schemes are therefore *ultra vires* because (even after taking account of the exceptions) the inadequate disclosure of the Relevant Arrangements does not of itself constitute an unfair relationship under s.140A CCA as a matter of law. The presumption of unfairness based on inadequate disclosure of the Relevant Arrangements therefore lies beyond the limit on the FCA's powers under s.404A(2) FSMA (and the Tribunal has a primary jurisdiction to decide this for itself under s.404D(6) FSMA).

55. In any event, even if this aspect of the Schemes is not *ultra vires*, the FCA's exercise of its discretion was unlawful because it was irrational (in particular, because it was not

[80] CONRED 5.3.22R(4)

[81] CONRED 5.3.22R(3) and CONRED 5.3.23R. See Hughes 2 [39] – [44].

properly based on the available evidence establishing the existence of consumer harm caused by inadequate disclosure of any of the Relevant Arrangements) or, alternatively, it was exercised in a manner that frustrated, rather than promoted, the statutory purpose (as to which see paragraphs 111 to 115 below) or gave rise to a disproportionate interference with CAAF's A1P1 rights (see paragraphs 116 to **Error! Reference source not found.** below).

STAGE 3: PRESUMPTION OF LOSS OR DAMAGE

56. The Schemes also require lenders to presume that consumers suffered loss or damage as a result of any unfair relationship, unless the lender can show that the consumer could not have obtained a lower APR from any of the other lenders with whom the broker had a referral arrangement.

57. The FCA's approach to causation of loss or damage is unlawful for the following reasons.

58. **First**, the FCA has no legal power to direct firms to presume causation of loss or damage.

59. Section 404(6) FSMA provides that, if a relevant firm has identified a failure to comply with an applicable requirement "*the next step is <u>for the firm to determine</u> whether the failure has caused (or may cause) loss or damage to consumers*" (emphasis added).

60. This makes clear that this determination must be made by the firm; the FCA has no power under s.404 itself to determine in advance, by way of a presumption, that any particular failure to comply with a requirement must have caused loss.

61. Section 404A(1)(c)(ii) FSMA empowers the FCA to provide for "*matters to be taken into account, or steps to be taken, by relevant firms for the purpose of ... determining whether such a failure has caused (or may cause) loss or damage to consumers*".

62. Accordingly, the limit of the FCA's powers to make rules in relation to causation of loss is to specify matters to be taken into account, or steps to be taken, by firms when they (not the FCA) determine whether a failure has caused loss. The limitation of s.404A(1)(c)(ii) to "*matters to be taken into account*" or "*steps to be taken*" at this stage of the Schemes is in contrast with s.404A(1)(b) which expressly empowers the FCA to set out examples of matters "*that are to be regarded as constituting a failure to comply with a requirement*" at the prior stage of determining whether there has been a failure.

63. The FCA has no power to require firms to presume causation of loss in any case (or, as here, every case); this would amount to the FCA pre-determining causation of loss in circumstances where such determination must be left to the relevant firm.

64. Equally, rules specifying "*matters to be taken into account*" by firms when determining causation of loss cannot pre-determine the outcome of any such determination. To do so would go beyond merely requiring certain matters to be included in the decision-making process and instead prescribe what is to be treated as constituting causation of loss.

65. Moreover, and in any event, even the power to specify matters to be taken into account is subject to s.404A(3), which states that rules made under s. 404A(1)(c) may not require matters to be taken into account "*if they have not been, or would not be, taken into account by a court or tribunal*". This is a matter on which the Tribunal has primary (i.e. full merits) jurisdiction to determine for itself.[82] The points made above in relation to the FCA's attempt to arrogate a discretion to itself to determine what constitutes an unfair relationship at Stage 2 apply with equal force to the FCA's similar approach to the determination of causation of loss or damage at Stage 3.

66. The fact that the FCA has power to specify "*steps to be taken*" for the purpose of determining whether a failure has caused loss does not assist the FCA. The "*steps to be taken*" can only be procedural and cannot be used to pre-determine the outcome of a firm's determination. CONRED 1.5.12G makes clear that: (a) the "*reference to "matters" is to legally relevant considerations*", i.e. in relation to substantive determinations, the FCA may only require firms to take into account matters that a court would take into account; and (b) the reference to "*steps to be taken*" refers to "*procedural steps*" which firms may be required to take, such as gathering evidence or recording their decision, and not the substance of the determination itself. In this respect, it is also to be noted that the primary jurisdiction of the Tribunal under s.404D(7) does not apply to "*steps to be taken*", confirming the procedural nature of the "*steps*" provided for.

67. The Schemes' requirement that firms presume causation of loss goes beyond the scope of the FCA's powers identified above:

[82] FSMA, s.404D(7).

(1) Where an unfair relationship is established under the Scheme, CONRED 5.3.21R[83] provides that "*the lender must presume that the unfair relationship caused the consumer loss or damage*". This presumption is irrebuttable if the Relevant Arrangement is a DCA. If the Relevant Arrangement is an HCA or a tied arrangement, a lender can rebut the presumption of loss only if the lender "*can demonstrate on the basis of evidence that it is more likely than not that the consumer would not, in relation to the same transaction, have been able to obtain a lower annual percentage rate from another lender*" through the same credit broker.[84] The Scheme further limits the forms of acceptable evidence, including that such evidence must show what alternative rates would in fact have been available to the relevant consumer or that the broker would have offered the lowest available rate.[85] The existence of this limited and narrowly circumscribed rebuttal is not sufficient to comply with the requirement that it is the firms who must determine causation of loss under a CRS.

(2) CONRED 5.3.25R provides: "*If the presumption of loss and damage is not rebutted, the lender must determine that the unfair relationship caused the consumer loss or damage*". Therefore, for all those cases where the presumption is not rebutted - and it is difficult to see how it could be rebutted in many cases in practice, given the narrow basis for rebuttal coupled with the evidential requirements - the Schemes expressly require firms to determine that the unfair relationship caused the relevant consumer loss. This wrongfully usurps the firm's role under s.404(6) to make that determination itself.

(3) The Schemes therefore go considerably further than merely making rules about the "*matters to be taken into account, or steps to be taken*" by firms to determine for themselves whether an unfair relationship has caused loss or damage on the facts of each case.

(4) That is not an approach which would be followed by a court for the purpose of determining whether loss or damage has been suffered as a result of a failure (even

[83] In this Reply, references to rules in CONRED 5 include references to the equivalent rules in CONRED 6.

[84] CONRED 5.3.22R.

[85] CONRED 5.3.22R-5.3.23R.

if, which is not the case, a presumption of loss is capable of falling within the concept of merely specifying matters that are to be taken into account).

(5) Indeed, the Scheme Rules make provision for the determination of the civil obligations of firms and represent a restriction on firms' access to court for that purpose. As such, Article 6 of the ECHR is engaged; and the Rules must do so in a fair and proportionate manner. Rules which pre-determine that loss and damage has been suffered in almost every case regardless of the facts, and which preclude firms from relying on relevant evidence showing that loss and damage was not suffered (while also precluding the possibility of any appeal by the firms, either within the context of the Schemes or alternatively through recourse to the courts) are not compliant with Article 6 (nor with A1P1, which is dealt with separately below). In reality, there is no possibility of a genuine determination at all as to loss under the Schemes. Instead, the Schemes fix an outcome that is adverse to lenders in advance in circumstances where there are no grounds for assuming that outcome to be correct. That is neither fair nor proportionate.

(6) The FCA cannot avoid the limit on its powers under s.404A(3) FSMA and the Tribunal's primary jurisdiction under s.404D(7) by characterising the presumption of loss or damage as a mere "*step to be taken*".[86] As set out in paragraph 66 above, this refers to merely procedural steps, which a presumption of loss or damage plainly is not. Nor does s.404A(1)(e), a generic provision which (unsurprisingly) permits the making of rules as to the things which firms are to do or not do in establishing and operating a CRS, permit the FCA to expand the clear and defined limits on its powers in this regard.

68. The FCA seeks to argue[87] that this amounts to letting "*the foxes guard the henhouse*". However, the whole premise of a CRS under s.404 FSMA is that firms must investigate and determine liability and any redress due.[88]

[86] Cf. FCA GOR ¶116.

[87] FCA GOR ¶132.1.

[88] See e.g. s.404(4) FSMA: "*A "consumer redress scheme" is a scheme under which the firm is required to take one or more of the following steps in relation to the activity.*" (emphasis added). Each of s.404(5)-(7) FSMA is then premised on what a firm must do. The CRS rules can guide the firms' process, but cannot pre-determine it.

69. Section 404A simply introduced specific, and carefully limited, features for which the FCA is lawfully permitted to make provision in CRS rules – including, in relation to causation of loss, the limited power to specify matters to be taken into account in s.404A(1)(c)(ii).

70. Section 404A does not qualify or limit s.404, nor, specifically, the basic required structure and nature of a CRS set out in ss.404(3)-(7) (under which it is for <u>firms</u> to investigate and determine failures, causation of loss and damage and redress). The statute is clear. It is the firms who are required to determine whether the failure caused loss or damage, subject to the right of consumers to refer any such determination to FOS and to the FCA's supervision and enforcement powers. So the idiom of foxes guarding henhouses is both misplaced and, worse, indicates a fundamental misunderstanding by the FCA of the nature of its power.

71. **Second**, the rules made by the FCA at this stage must be directed at establishing whether loss or damage has <u>actually been suffered</u> by individual consumers as a result of the relevant failure.

72. The presumption of loss or damage under the Schemes does not seek to do this – and is incapable of doing so. The Schemes instead effectively skip out the loss or damage "step" and move straight to redress, contrary to the sequential series of steps required by ss.404(4)-(7) FSMA. This is not permissible. Firms can only be required to determine whether redress should be paid <u>if</u> the consumer has actually suffered loss or damage.[89] This reflects the fact that the FCA's power to make a CRS must be exercised for the purpose of securing that redress is made <u>for</u> a failure to comply with a requirement which has caused actionable loss or damage to consumers.[90]

73. **Third**, the FCA's suggestion[91] that the presumption of loss or damage is necessary on workability grounds cannot justify its failure to respect the *vires* limits on its powers. The FCA does not have any discretion to expand its statutory powers.

[89] See s.404(7) FSMA ("*<u>If the firm determines that the failure has caused (or may cause) loss or damage to consumers</u>, it must then – (a) determine what the redress should be in respect of the failure; and (b) make the redress to the consumers.*" (emphasis added)).

[90] FSMA, s.404(1)(b)-(c).

[91] FCA GOR ¶133.2.

74. This plea is also untenable in fact. It would have been feasible to make provision for matters to be taken into account by firms in considering whether loss or damage had in fact been suffered by consumers while still leaving the determination of whether loss and damage has been suffered to the firm, as required by s.404 FSMA.

75. **Fourth**, the no better deal rebuttal does not change the analysis:

(1) This rebuttal is not available at all for DCAs. However, as explained at paragraph 52 above, there is no basis for assuming that all DCAs caused loss or damage, still less that non-disclosure invariably did so.

(2) Even in relation to HCAs and tied arrangements, it only applies where the lender can establish that the consumer could not have obtained a lower APR from any other lender with whom the broker had a referral arrangement. In many cases, this will be impossible in practice to establish from records available to the lender (see paragraph 53(2) above).

(3) Further, it does not follow that a consumer suffered loss or damage as a result of inadequate disclosure of a Relevant Arrangement merely because they could in principle have obtained a lower APR. A consumer will only suffer loss or damage if they would have obtained a lower APR had adequate disclosure been given and they were not compensated for the higher APR they paid in the real world by other elements of the transaction, such as a discount to the vehicle purchase price, that would not have been replicated in the counterfactual. Indeed, it appears that the FCA itself acknowledged internally[92] that compensating benefits received by consumers as part of the overall package were likely to be highly relevant to quantifying harm. However, this factor has not been taken into account by the FCA at all at any stage in the design of the Schemes.

[92] FCA00000500. A similar concern was raised by Professor Mark Freeman who commented, in relation to the proposal for a 'market-adjusted APR' in the CP, as follows: "*While this has the benefit of simplicity, whether this truly reflects the economic loss of a transaction that has multiple component parts […] is unclear to me.*": FCA00000032 (containing advice and recommendations of the Cost Benefit Analysis Panel), middle of page 15 through to the top paragraph on page 16.

76. **Fifth**, it is no answer for the FCA to argue that causation of loss or damage plays an "*attenuated role*" in the court's assessment of liability and remedy under ss.140A-B CCA.[93] As to this:

(1) Under ss.404(4)-(7) FSMA, the existence of loss or damage caused to the individual consumer by the relevant failure is a pre-condition to requiring a firm to pay redress under a CRS. Causation of loss or damage is therefore an essential pre-condition for and requirement of a CRS. It is irrelevant whether (or to what extent) a court might award a remedy in an unfair relationship claim under ss.140A-B CCA without proof of loss or damage. That is not an available basis for requiring firms to pay redress under a CRS. There is no basis in the language of ss.404-404A FSMA for the FCA's contention[94] that the concept of "*loss or damage*" therein "*must be viewed through the s.140A lens*", so as to water down this essential requirement of a lawful CRS.

(2) In any event, the FCA understates the role played by the existence of actual loss or damage in determining what remedy is ordered under s.140B CCA. It is clear from Smith v Royal Bank of Scotland,[95] Clydesdale and Angel that the remedy should reverse the adverse consequences for the consumer of the unfairness.[96]

(3) Where the unfairness arises from non-disclosure, the only principled way of addressing this is for the court to ask what would have happened if full disclosure had been given, and then put the consumer in the same financial position. This is clear from the approach of both FOS and the court in Clydesdale[97] to quantum, namely that it was necessary to consider evidence as to what the individual customer in question would have done if adequate disclosure had been given and whether they would have ended up in a better position overall. In principle, this analysis included whether the individual customer would have sought to negotiate down the interest rate and whether they would have been successful in doing so ([270]); and

[93] Cf. FCA GOR ¶123.

[94] FCA GOR ¶114.2.

[95] [2023] UKSC 34, [2024] AC 955.

[96] Or, as the FCA puts it in GOR ¶120, "*the essence of the court's task in a s.140A claim is to identify the unfairness and order a remedy which removes it.*"

[97] At [257ff], in particular at [265], [295]-[296], [305]-[307].

(if so) whether this would have affected the overall package including the vehicle price ([271]).

(4) In requiring firms to presume that loss or damage was caused, the FCA has gone beyond what a court would do on a claim under s.140A-B CCA.[98] The existence (or not) and quantum of any financial loss or damage caused by unfairness is important when it comes to determining what (if any) remedy should be awarded. The no better deal rebuttal does not fully capture the circumstances in which a court would find no loss or damage was caused.

(5) Johnson was a case that turned on its own extreme facts. It contains no reasoned analysis of the principles that a court should apply in other cases to decide what remedy to award under s.140B CCA. The question of remedy is addressed at [338] in a single conclusory paragraph. The court may have been influenced by its assumption that the cost of commission had no impact on the vehicle price, but had been passed on to the customer through credit charges ([328]).

77. The Schemes are therefore *ultra vires* because (even taking into account the no deal rebuttal) it is not within the limits of the FCA's powers[99] to specify that firms are required to presume loss or damage (and the Tribunal has primary jurisdiction to decide this for itself under s.404D(7) FSMA).

78. In any event, even if this aspect of the Schemes is not *ultra vires*, the FCA's exercise of its discretion was unlawful because it was irrational (in particular, because it was not properly based on the available evidence establishing the existence of loss or damage caused by inadequate disclosure of any of the Relevant Arrangements) or, alternatively, it was exercised in a manner that frustrated, rather than promoted, the statutory purpose (as to which see paragraphs 111 to 115 below) or that gives rise to a disproportionate interference with CAAF's A1P1 rights (see paragraphs 116 to **Error! Reference source not found.** below) and/or infringes Article 6.

[98] The FCA is also wrong to suggest at e.g. GOR ¶¶118, 136, that s.404A(3) FSMA required it to replicate any wider enquiry that a court might undertake under s.140A-B CCA beyond determining whether the consumer has suffered loss or damage as a result of the relevant failure. FSMA, s.404A(3) applies only to matters that a court would (or would not) take into account "*for the purpose mentioned [in s.404A(1)(c)]*". So far as material, that purpose is only the determination of whether the failure caused loss or damage (and not any wider enquiry).

[99] Under ss.404(4)-(7), 404A(1)(c) and 404A(3) FSMA.

STAGE 4: REDRESS

The fundamental flaw in the FCA's approach

79. The fundamental flaw in the FCA's approach to redress is that it does not even seek to award redress based on either the loss caused by any unfairness or the financial award that a court would actually make as redress for that unfairness. Instead it systematically and by design (via the hybrid remedy) affords consumers financial redress that is substantially in excess of the amount necessary to reverse the adverse consequences of any unfairness.

80. It also fails to take any account of the fact that not all consumers will have been adversely affected by the non-disclosure of the Relevant Arrangements either at all or to the same extent. The FCA has not even attempted to distinguish between consumers on the basis of the extent to which they have been harmed and ends up treating very different cases alike.

81. The consequence of this is that the Schemes impose liabilities on firms that are vastly in excess of any sensible assessment of loss or the size of existing civil liabilities. This is contrary to the FCA's duty to have regard to the nature and extent of the loss or damage in question and the statutory purpose of the FCA's powers to impose a CRS, and, in any event, it constitutes an irrational exercise of the FCA's CRS powers.

The statutory framework

82. Section 404A(1)(d) FSMA contains the FCA's power to make rules in respect of redress. It provides that rules may be made "*as to the kinds of redress that are, or are not, to be made to consumers in specified descriptions of case and the way in which redress is to be determined in specified descriptions of case.*"

83. However, there are two express limits on this power:

    (1) **First**, it must, by s.404A(4) FSMA, be exercised "*so as to secure that, in relation to any description of case, the* <u>*only*</u> *kinds of redress to be made are those which [the FCA] considers to be* <u>*just*</u> *in relation to that description of case*." (emphasis added).

    (2) **Second**, this constraint is itself subject to the further limit in s.404A(5) FSMA, which expressly requires that: "*the FCA must have regard (among other things) to* <u>*the nature and extent of the losses or damage*</u> *in question*." (emphasis added).

84. The FCA contends that its rule-making power in relation to redress is "*particularly wide*"[100] and that its assessment of what is "*just*" permits it to carry out "*an exercise of evaluative, inherently multi-factorial judgement, in particular, having regard to the interests of all affected parties including procedural considerations such as speed, cost-effectiveness, clarity and accessibility*".[101] The FCA also argues that this power can be exercised without being constrained by the redress that a court would award in a civil claim and that it is not required to seek to achieve any degree of correspondence between redress and loss or damage or the financial award that consumers would receive from a court.[102] On this basis, the FCA has taken the APR adjustment figure (itself a purported measure of the impact of discretion, not non-disclosure, in DCAs only), applied that figure to all Relevant Arrangements (even though there is no coherent basis for doing so in the case of HCAs and tied arrangements), and then averaged it with the amount of commission in each case. This results in a so-called "hybrid" remedy that is divorced from, and systematically inflated above, any evidenced assessment of actual loss or any court-ordered financial award.

85. This approach is wrong. Section 404A(5) FSMA imposes a duty on the FCA to have regard to the nature and extent of the loss or damage suffered, on the basis of proper evidence, both in individual cases where there has been inadequate disclosure of the Relevant Arrangements and on a global level across the consumer body as a whole.

86. Further, in concluding that it has the power to specify monetary redress that is divorced from actual loss or damage, the FCA has also misdirected itself as to the purpose of the statutory regime and the scope of its powers to impose a CRS.

87. The purpose of a CRS is to provide a procedure by which firms make redress to consumers in respect of pre-existing civil liabilities that corresponds to actual loss or damage, thereby avoiding the need for consumers to take court action. The FCA is not empowered to conjure into existence a fresh and free-standing legal basis for monetary redress that is more generous than a court is likely ever to award in respect of the same alleged failure.

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[100] FCA GOR ¶154.

[101] FCA GOR ¶155.8.

[102] FCA GOR ¶155.

Nor is it empowered to award redress on the basis of a "*policy assessment*" as to "*the need for a re-allocation of resources*" from the motor finance industry to consumers.[103]

88. This statutory purpose is apparent from the following matters:

(1) The 'gateway' requirements in s.404(1) FSMA. In particular, the FCA may only make a CRS where it appears to it that consumers have suffered or may suffer loss or damage as a result of a widespread or regular failure by firms to comply with requirements in respect of which relief would be available in legal proceedings.

(2) Section 404(1)(c) states that CRS rules must be made "*<u>for the purpose</u> of securing that redress is made to the consumers in respect of the failure*" (emphasis added). In the context of s.404(1)(a)-(b), this must be read as referring to appropriate redress to compensate consumers for the actionable loss or damage that they have suffered.

(3) The link between the redress and actionable loss or damage resulting from failures by firms to comply with requirements is reinforced by the steps which the FCA can require firms to take under s.404(4)-(7) which include: *first*, investigation by the firm of whether there has been a failure to comply with requirements; *second*, determination by the firm of whether that failure has caused or may cause loss to consumers; and *third*, <u>but only if</u> a failure is found to have caused loss or damage, determination by the firm of what the redress should be <u>in respect of</u> that failure.

(4) CONRED 1.5.12G provides that "*the FCA cannot disregard the normal legal rules on causation or remoteness of loss*", reinforcing the central importance of actionable loss or damage in informing the proper scope of any CRS.

(5) As already noted, the FCA must exercise its redress power to secure that the only kinds of redress available are those it considers to be "*just*", having regard, among other things, to the nature and extent of the loss or damage suffered by the consumer: ss.404A(4)–(5). This confirms that the purpose of the FCA's power to require firms to pay redress in respect of failures is to compensate consumers for loss or damage.

[103] FCA GOR ¶258.

(6) This is also supported by the following *dictum* of Ouseley J in R (British Bankers Association) v Financial Services Authority [2011] EWHC 999 (Admin) at [232] – [233]:

> "The purpose of the statutory scheme is to provide a remedy for widespread mis-selling which has caused loss, that is in the circumstances required by section 404(1). That remedy is provided by the combination of a review of past business and the payment of compensation. The statutory nature of a scheme is contained in section 404(2). It has to determine the nature and extent of the widespread failure to comply with rules; then it establishes the liability of individual firms and finally it determines how much the individual firms must pay to each of its affected customers. As Mr Fordham put it: failure, liability and compensation. … I accept Mr Brindle's description of it as a compulsory, proactive industry or sector wide vehicle for a review of past breaches of rules and the provision of redress for actionable complaints, in circumstances where there was widespread concern about mis-selling and where private persons had suffered or would suffer loss."[104] (emphasis added)

89. There is nothing surprising about this. Not only does the requirement for actual (and actionable) loss or damage run through every aspect of the statutory framework; but, fundamentally, the object of compensation for loss is inherent in the very concept of "*redress*".[105] The fact that Parliament chose the word "*redress*" is significant. If it is not redress to compensate for actual loss and damage, for what is the redress being provided?

90. It is no answer for the FCA to point to the fact that s.404F(1) FSMA permits redress which includes "*a remedy or relief which could not be awarded in legal proceedings*". Even if the forms of relief within a particular CRS might include those which a court is not empowered to require (such as an unwinding of an agreement, a replacement contract on different terms, or an apology) this subsection cannot sensibly be read as permitting the systematic overcompensation of consumers in light of the clear and limited statutory purpose of the FCA's powers under s.404 and s.404A FSMA.

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[104] This decision was primarily concerned with the old version of s.404 that was in force until 2010, but it was also said at [194] that the now current CRS regime applied "*in essentially similar circumstances and with essentially the same aims*"; and "[j]*ust as section 404(1)(b) only applied where the loss suffered is actionable loss, so too does the new provision*". There is no material distinction therefore between the pre- and post-2010 regimes.

[105] FSMA, s.404F(1), states that "*redress*" includes "*a remedy or relief which could not be awarded in legal proceedings*". This addresses a situation where the FCA considers that an alternative to cash that a court could not award may better achieve the object of compensating consumers – see e.g. CONRED 1.5.18G ("*For example, instead of providing cash compensation, the FCA could require firms to top up pensions or offer to alter the terms of a contract.*" (emphasis added).) It does not change the purpose at which an award of redress is to be targeted.

91. The FCA's errors at the redress stage exacerbate its earlier errors in making rules that pre-determine liability and causation of loss or damage, in circumstances where neither criterion is in fact satisfied. The FCA's rules in relation to redress are unlawful because:

(1) The FCA did not comply with its duty under s.404A(5) FSMA to have regard to the nature and extent of loss or damage both at the level of individual consumers and at a global level and/or to obtain the evidence necessary for it to do so. Against the relevant statutory background, it was irrational for the FCA to provide for redress that was structurally divorced from, and systematically inflated above, any assessment of actual loss or damage;

(2) The FCA breached its Padfield[106] duty; and/or

(3) The divergence between the redress payable and the quantum of existing civil liabilities constitutes a disproportionate interference with lenders' A1P1 rights.

Failure to comply with the duty in s404A(5) FSMA and/or irrationality

Lack of evidence of loss

92. It is inherent in the duty in s.404A(5) that the FCA must take reasonable steps to obtain the evidence and information, and carry out the analysis, to enable it to comply with that duty on an informed basis.[107]

93. The FCA was required to evaluate conscientiously and rigorously, on the basis of the evidence and analysis that was reasonably available, whether and to what extent loss or damage was actually suffered by consumers as a result of inadequate disclosure of Relevant Arrangements, both at a global level across the whole market and by individual consumers. Otherwise the redress awarded could be both excessive overall and poorly targeted.

[106] See Padfield v Minister of Agriculture, Fisheries and Food [1968] AC 997.

[107] This follows from Secretary of State for Employment v Tameside Metropolitan BC [1977] AC 1014.

94. Put shortly, the FCA obtained no evidence to support the conclusion that consumers suffered any loss at all from inadequate disclosure of Relevant Arrangements, still less to quantify that loss either on a global basis or at an individual level.

95. The Schemes also fail to take account of subvention and subsidisation in motor finance contracts whereby consumers obtain a variety of different types of benefits such as discounted APRs, deposit contributions, discounts to the vehicle price and service packages.[108] This involves a further significant failure by the FCA to have regard to the extent of the loss or damage in question for those cases where subvention or subsidies occurred.[109]

The APR adjustment is a hopelessly flawed proxy for loss

96. Faced with root-and-branch challenges to its methodology from the lenders, the FCA now says that it was "*neither the FCA's duty nor its objective, nor was it the FCA's intention in selecting the APR adjustments either in principle or at the levels set*" to ensure an outcome in each case that approximates actual financial loss as closely as possible and that the Applicants "*misstate the purpose of the APR adjustment as a 'proxy' for loss*".[110]

97. This is an extraordinary position for the FCA to take. The APR adjustment is the <u>only</u> element of the redress that can even arguably be regarded as an attempt to approximate any loss or damage suffered by consumers. If the FCA did not consider even this aspect of the redress as a proxy for loss then it has clearly failed in its duty under s404A(5) to have regard to the nature and extent of the losses or damage in question; effectively it has ignored them since no element of the redress assessment would take account of loss.

98. In fact the FCA is here re-writing history again, since it did originally intend the APR adjustment to reflect quantifiable financial loss:

    (1) As set out in paragraph 5(5) above, the FCA expressly stated in an ExCo paper that the APR adjustment was intended to focus directly on the quantifiable financial loss experienced by consumers.

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[108] Hughes 2 [54] – [61]. Approximately 83% of CAAF's financing of new cars during the period covered by the Schemes involved one or more of the forms of subvention outlined at Hughes 2 [57].

[109] CAAF's Grounds, ¶61.

[110] FCA GOR ¶161.

(2) The FCA had also presented the APR Adjustment remedy in the Consultation Paper as "*based explicitly on financial loss*"[111], and maintained its position in the Policy Statement that the APR Adjustment was intended to reflect "*estimated loss*".[112]

99. However, the APR adjustment is hopelessly flawed as a proxy for loss:

(1) For DCAs:

(a) It purports to measure the impact of discretion not non-disclosure. The impact of discretion cannot be a proxy for the impact of non-disclosure. On any view, the effect of inadequate disclosure of DCAs on APRs must be less than the effect of discretion itself. The FCA has made no attempt to reflect this in its methodology for calculating redress, instead attributing the entirety of the impact of discretion measured to its non-disclosure.

(b) In any event the calculation of the APR-17% figure was flawed (see paragraph 52(2) above) and the APR-21% adjustment was even less satisfactory for the reasons set out in CAAF's Grounds ¶133-135.

(2) For HCAs and tied arrangements:

(a) There is no rational basis for the FCA to treat a figure calculated by comparing APRs between DCA and non-DCA arrangements as a measure of loss caused by HCAs and tied arrangements, still less non-disclosure of them.

(b) The FCA internally recognised that the application of the APR adjustment, being "*a proxy metric derived from the analysis of one type of conflict of interest* [i.e., DCAs] *to two other types of conflict of interest* [i.e. HCAs and tied arrangements]", presented "*certain risks*" including that it "*may not accurately reflect consumer loss.*"[113] The FCA recorded that it could be criticised "*for not doing what we have done with DCAs to find a best proxy for harm by, for example, gathering more data to determine any gap between*

[111] Consultation Paper, paragraph 8.28.

[112] Policy Statement, paragraphs 1.27 and 11.2.

[113] FCA1/704.

outcomes provided by tied arrangements versus the best outcome that could have been obtained if the broker had gone to the market."[114]

(c) The FCA nevertheless sought to justify the application of the APR adjustment to HCAs and tied arrangements on the purported basis that "*it offers a reasonable proxy metric, within the same market context, for assessing the extent of opportunistic behaviour brokers might display under alternative commission arrangements if they do not recognise an obligation to disclose a conflict of interest.*"[115] This is no more than a bare assertion. There is no logical or coherent basis for the FCA to make this assumption.

(d) The FCA also acknowledged the lack of relevant evidence to enable it to assess what (if any) loss had been caused by HCAs and tied arrangements. However, the FCA suggested that it would be complex to take further steps to obtain such evidence and that "*the impact of using a proxy metric that may not accurately reflect consumer loss would be limited at a market level*"[116] because of the "*small proportion of non-DCA agreements.*"[117] These reasons cannot justify the FCA's approach:

(i) As set out above, the FCA was obliged to obtain the evidence and information necessary to assess whether loss or damage was actually suffered by consumers as a result of inadequate disclosure of each of the Relevant Arrangements individually, rather than treating them (without evidence) as a monolith with precisely the same impact on consumers.

(ii) Further, even if HCAs and tied arrangements are less common than DCAs, this could not justify an approach which (contrary to s.404(6) and (7) and s.404A(5) FSMA) does not determine redress having regard to the nature and extent of any loss caused specifically by the non-disclosure of those different types of arrangements.

[114] FCA1/748.

[115] FCA1/702. See also FCA1/748.

[116] FCA1/704

[117] FCA1/1696.

(e) The FCA's reliance on its contention that applying a single adjustment rate across all of the Relevant Arrangements "*would enhance simplicity, cost-effectiveness, transparency, and timeliness*"[118] is flawed for the same reasons. These concerns cannot justify the FCA adopting an approach which fails to determine redress based on whether, in a particular case, a consumer had suffered loss as a result of the Relevant Arrangement(s) in question going beyond any remedy that a court might award in the vast majority of cases, particularly in view of the fact that CAAF's A1P1 and Article 6 rights are engaged.

100. Insofar as the FCA seeks to defend its position by saying that no better analysis of loss could reasonably have been done with available data, that is wrong.

(1) The FCA now apparently accepts[119] that other methodologies or approaches existed that would better approximate the actual financial loss suffered by consumers.

(2) The FCA was provided with further evidence and analysis regarding consumer harm by consultees during the consultation process, but rejected this without adequate basis, and decided not to seek further evidence or carry out further analysis.[120]

(3) As identified above, in order to assess whether non-disclosure of the Relevant Arrangements caused loss, the FCA could have undertaken analysis on APRs pre- and post- the decision of the Court of Appeal in Johnson in October 2024 (after which disclosure practices improved) and pre- and post- the ban on DCAs in 2021.

(4) The FCA's Tameside duty required it to obtain this information/analysis. Having not done so, the FCA was not in a position to comply with its duty under s.404A(5).

The Hybrid Remedy systematically inflates redress above actual loss

101. Further, even if the APR adjustment were a suitable proxy for loss caused by inadequate disclosure of any of the Relevant Arrangements (which it is not), the Schemes are designed systematically to over-compensate consumers by averaging the APR adjustment with the

118 FCA1/704. See also Policy Statement, paragraph 1.31.

119 FCA GOR ¶¶161-162.

120 FCA00000525, page 3; FCA00000530, in particular at pages 6 and 7; FCA00000531, page 2 and 13-14; FCA00000517, in particular at page 3.

Commission Repayment Remedy. This divorces redress from any evidence-based estimate of actual loss. It also creates a remedy that will inevitably be far in excess of what a court would ever have awarded in the vast majority of cases. A court would only be likely to award the Commission Repayment Remedy in an extreme case on egregious facts like Johnson, yet the FCA's approach means all consumers will receive redress that is determined in part (and increased) by the size of commission. The FCA internally recognised this as a "*key risk*" because "*fundamentally, the midpoint is arbitrary in the sense that it doesn't derive from a quantitative assessment of harm or a judicial formula and assumes equal weighting between the minimum and maximum remedies. This means it may not reflect the distribution of case severity or consumer detriment.*"[121]

102. The FCA's disclosure reveals that, shortly before issuing the Consultation Paper, it estimated the total redress amount under its hybrid remedy (based on the then-current CRS proposal) to be c.£9.5 bn, as compared with c.£6bn for a 'loss-based' remedy (i.e. the APR adjustment). The FCA nevertheless decided not to "*reconsider*" its redress proposals. This was said to be justified on the basis that:

> "The rationale for the hybrid remedy continues to hold that the 'just' redress amount in the scheme is pulled in two directions between the loss-based approach and the Johnson remedy. Therefore, in our opinion, the hybrid remedy continues to be the approach that we will consult on. A further rationale that we have set out in the CP is that applying a purely loss-based remedy to all cases risks under compensating consumers and would not deliver the fair and comprehensiveness [sic] redress required for a market-wide scheme. This is because the loss-based remedy only accounts for econometric loss and does not account for other forms of detriment or unfairness, such as distress or inconvenience, or the erosion of an individual's trust and confidence in providers."[122]

103. This shows that the FCA has effectively disregarded its own estimate of the nature and extent of the loss and damage, contrary to s.404A(5) FSMA, in favour of requiring almost 60% more redress to be paid to consumers. The stated reason for doing so was that a loss-based redress scheme (i.e. one where the quantum of redress reflects that which a court would award for the same failure by a firm) would somehow "*under compensate*" consumers.

104. The FCA's purported justifications for this approach are incoherent:

[121] FCA1/759.

[122] FCA00000003, page 2

(1) **First**, the uncertainty as to when (if ever) a court might order full repayment of commission on less extreme facts than Johnson cannot sensibly justify 'splitting the difference' in every case so as to systematically inflate redress far above actual loss.

(2) **Second**, there is no basis for the makeweight suggestion that this huge uplift in the total amount of redress payable by firms could be justified on the ground that it captures consumers' non-pecuniary losses, such as distress or inconvenience or the erosion of trust and confidence, which would not be compensatable in civil proceedings, even if there were evidence supporting the existence of such harm.

105. What is conspicuously absent from the FCA's analysis is any consideration (or concern) that its approach is systematically more generous to consumers than courts were ever likely to be and that it was therefore imposing large new redress liabilities on firms.

106. The FCA also now seeks to justify this approach[123] on the basis that it was necessary for the Schemes to pay redress in excess of consumers' actual losses in order to incentivise consumers to participate in the Schemes. However, that is not a legitimate consideration for the FCA to take into account in determining what constitutes "*just*" redress, having regard to the nature and extent of the loss or damage. The point is not improved by the FCA's attempts to dress it up as a concern that the Schemes might otherwise appear inaccessible, unduly burdensome or time-consuming for consumers. There is no basis for the FCA's suggestion that different models of redress that more accurately reflected actual loss would make it more difficult for consumers (or lenders) to participate in the Schemes. In any event, practical considerations of this type cannot justify deliberately inflating redress above the level that can properly be justified by reference to any actual loss.

107. The FCA has also acknowledged that its powers under ss.404-404A are subject to "*safeguards provided for by Parliament*" and that these include that "*the CRS framework under FSMA only aggregates existing liabilities*."[124] CAAF agrees that the FCA's powers are constrained in this way. But, without carrying out analysis to identify and quantify "*existing liabilities*", the FCA was not in a position to comply with its duty in s.404A(5) since it was required to have regard to whether the total redress liabilities on the Schemes exceeded the level of firms' existing loss-based liabilities and, if so, to what extent.

[123] FCA GOR ¶162.

[124] FCA GOR ¶63.

108. The FCA's statutory duty to consult before making rules requires the publication of a cost benefit analysis: FSMA, s.138I. However, the cost benefit analysis published with the Consultation Paper and the Policy Statements does not even attempt to compare the estimated quantum of redress liabilities under the Schemes with any estimate of the existing liabilities of firms absent the Schemes.[125] The FCA offered two purported justifications for this approach. Neither of them withstands scrutiny:

(1) **First**, the FCA stated that the Schemes do not create the underlying liability as it arises from historic non-compliance, not the introduction of new rules. However, this assumes that the quantum of redress under the Schemes is co-extensive with and no greater than existing civil liabilities. Given the FCA's approach of systematically inflating redress above any estimate of actual loss or damage and any award that a court would be likely to award, that assumption was manifestly without reasonable foundation.

(2) **Second**, the FCA stated that there was significant uncertainty about the level of redress that would be payable absent the Schemes and that attempting to assign a monetary value would require broad assumptions. However, that does not release the FCA from the obligation to comply with its duty under s.404A(5).[126] Moreover, as explained above, there were alternative methodologies available that would enable a better estimate to be made.

109. For these reasons, the FCA failed to comply with its duty under s.404A(5) when making rules in relation to redress.

110. Further or alternatively, the FCA's approach of systematically inflating redress far above consumers' actual losses involved an irrational exercise of discretion (bearing in mind the centrality of actionable loss or damage within the statutory scheme and the fact that the nature and extent of such loss or damage is singled out in s.404A(5) FSMA as a mandatory consideration to which the FCA is required always to have regard).

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[125] See e.g. Annex 1 to Policy Statement ¶5, ¶¶42-44.

[126] The FCA suggested in the Consultation Paper at ¶8.20 that this comparison "*could lead to undue focus being placed on what might be a relatively small difference, rather than larger differences in non-redress costs firms, the redress system and market face between the counterfactual and our proposed intervention.*" However, to the extent this can be understood, it again assumes no material difference between the quantum of redress liabilities and existing liabilities. The FCA had no evidential basis on which to make that critical assumption.

Breach of *Padfield* duty

111. The FCA is required to determine what constitutes "*just*" redress consistently with the statutory purpose set out in paragraphs 87 to 89 above, namely to provide a scheme by which firms make redress to consumers in respect of pre-existing civil liabilities that corresponds to actual loss or damage.

112. The Padfield duty also requires the FCA to exercise its statutory powers in a manner that promotes, and does not frustrate, this purpose. Any inquiry as to frustration of purpose must consider whether there is a rational connection between the rules and the statutory purpose.[127] Here the redress rules must have a rational connection to providing compensation for actual loss or damage.

113. Thus, while the FCA has the other high-level strategic and operational objectives in s.1B FSMA (including the consumer protection and integrity objectives), any balancing of these general objectives is necessarily constrained by the need to give effect to the specific statutory purpose of s.404 and s.404A (as explained above) when designing any CRS.

114. For the reasons set out above, the FCA has singularly failed to do this.

115. Furthermore, the FCA has plainly misdirected itself as to the relevant statutory purpose, claiming in GoR ¶258 that: "[T]*he very purpose of a CRS is a policy assessment by the expert regulator of the need for a re-allocation of resources to provide redress to consumers who have been the subjects of wrongdoing, and from the industry which engaged in that wrongdoing*." This wrongly treats the FCA's exercise of its CRS powers as a high-level societal tool of redistribution rather than a genuine attempt to aggregate existing loss-based liabilities of individual firms to individual consumers. It is therefore unsurprising that the FCA has exceeded its statutory powers in this regard.

A1P1

116. Section 6 of the HRA makes it unlawful for a public authority like the FCA to act in a way "*which is incompatible with a Convention right*".

117. A1P1 ECHR provides that:

[127] R (Rights of Women) v Lord Chancellor [2016] 1 WLR 2543 at [42], per Longmore LJ.

"*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.*"

118. Interference by a public authority with A1P1 rights must comply with the principle of lawfulness and pursue a legitimate aim by means reasonably proportionate to the aim sought to be realised. The analysis "*focuses upon the question whether a fair balance has been struck between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights*"[128].

119. The significance of a challenge based on A1P1 is to import the different, and stricter, standards imposed under the ECHR analysis. In particular, where there is an interference with possessions (as plainly there would be in the present context in which a CRS imposes liabilities on firms which exceed the existing level of liabilities that could be imposed in claims brought against firms in court proceedings), it is necessary for the public authority to establish that its interference is proportionate. That includes satisfying the well-established four stage test in <u>Bank Mellat v HM Treasury (No 2)</u> [2013] UKSC 39, [2014] AC 700 per Lord Sumption at [20]:

"*(i) whether [the measure's] objective is sufficiently important to justify the limitation of a fundamental right; (ii) whether [the measure] is rationally connected to the objective; (iii) whether a less intrusive measure could have been used; and (iv) whether, having regard to these matters and to the severity of the consequences, a fair balance has been struck between the rights of the individual and the interests of the community. These four requirements are logically separate, but in practice they inevitably overlap because the same facts are likely to be relevant to more than one of them.*"

120. As the Supreme Court recognised in <u>Shvidler v Secretary of State for Foreign, Commonwealth and Development Affairs</u> [2025] UKSC 30, [2026] AC 607 at [120], "*the question whether an act is incompatible with a Convention right is a question of substance for the court itself to decide; the court's function is not the conventional one in public law of reviewing the process by which a public authority reached its decision*".

121. The Schemes constitute an unlawful infringement of CAAF's rights under A1P1 including for the reasons set out below.

[128] <u>AXA General Insurance v Lord Advocate</u> [2012] 1 AC 868 per Lord Reed at §108.

122. **Interference with CAAF's possessions:** as Lord Reed recognised in AXA General Insurance Ltd v Lord Advocate [2011] UKSC 46 at [114]: *"The concept of "possessions" has been interpreted by that court* [the European Court of Human Rights] *as including a wide range of economic interests and assets, but one paradigm example of a possession is a person's financial resources*." A provision which has the effect of a requiring a party to make redress payments out of their financial resources will therefore constitute an interference with a person's possessions for the purposes of A1P1 to the extent that the amount of redress exceeds the quantum of existing civil liabilities.[129] The Schemes constitute an interference with CAAF's financial resources by imposing obligations on lenders to pay redress which does not correspond to liabilities which could be found by a court under ss.140A-B CCA. As set out above, the Schemes impose liability (i) where no unfair relationship would be found by a court under s.140A CCA and (ii) to pay redress in amounts which go beyond any award which a court would be likely to award under s.140B CCA. This is an interference with CAAF's possessions for the purposes of A1P1.

123. **Apparent pursuit of an illegitimate aim:** in seeking to defend the proportionality of the Schemes the FCA argues that its statutory powers to make a CRS can be exercised in order to advance its "*policy assessment*" in "*a highly sensitive economic and moral policy area*". In particular, the FCA asserts that: "*The very purpose of a CRS is a policy assessment by the expert regulator of the need for a re-allocation of resources to provide redress to consumers who have been the subjects of wrongdoing, and from the industry which engaged in that wrongdoing*."[130] This is not a legitimate aim for the FCA to pursue in exercising its powers to make a CRS. It provides no proper basis on which to defend the proportionality of the Schemes. As set out above, the purpose of the powers in ss.404 and 404A is to enable the FCA to establish a CRS that provides an efficient mechanism for consumers to secure compensation for wrongs done to them. It is illegitimate for the FCA to pursue the aim of making redress available to consumers that is determined in a manner insufficiently connected to their actual loss. The CRS power is not a policy tool that can

[129] For example, in AXA General Insurance Ltd, Lord Hope and Lord Reed clearly recognised that funds which insurers would be required to use to satisfy their obligations under insurance policies would be a possession for the purposes of A1P1 and that legislation which had the effect of establishing a new basis of liability (and which in consequence diminished the insurers' funds) would be an interference with that possession: at [28] per Lord Hope and [114] per Lord Reed.

[130] FCA GOR, ¶258.

be used by the FCA to strike what it perceives to be a fairer balance between the interests of consumers and firms than might be struck by the existing law.

124. **Disproportionate interference**: even if and to the extent that the Schemes can properly be said to pursue a legitimate aim, they are a disproportionate interference with CAAF's rights under A1P1. As set out above, the Schemes impose new liabilities substantially greater than those which a court would find in claims under ss.140A-B. Other less intrusive measures could have been used to achieve any legitimate aim of the FCA. The approach to causation and redress could have been more appropriately scaled overall and also better targeted to compensate consumers by reference to the actual loss incurred (if any) in each case (see paragraph 52(4) above). This would have ensured that the impact of the Schemes corresponded more closely with lenders' existing liabilities, while better advancing the objective of providing compensation to consumers that reflected their existing entitlement under the general law.

125. For all of the reasons set out above, including in particular the because the CRS does not in numerous respects correspond closely or at all to actual unfairness or actual loss or damage suffered by consumers, the FCA's exercise of power was disproportionate.

SIR JAMES EADIE KC

ROSALIND PHELPS KC

RUPERT ALLEN KC

GILLIAN HUGHES