Guidance consultation

FCA's approach to compromises for regulated firms

GC22/1

January 2022

1 Introduction

1.1 Compromises are arrangements that allow a firm to settle its liabilities with creditors and/or shareholders. We are seeing an increase in the number of regulated firms[1] proposing compromises to deal with significant liabilities to consumers, in particular redress liabilities. We are therefore consulting on guidance which sets out (i) how we consider compromises and the factors we consider when assessing them; and (ii) our role when a firm proposes a compromise.

1.2 With this guidance we aim to help firms understand what information we need and how we approach compromises in line with our statutory objectives to protect consumers and the integrity of markets, with a view to reducing the number of proposed compromises that we do not consider to be appropriate. We also remind firms of their regulatory obligations, in line with Principle 11, to notify us immediately and provide relevant information at an early stage if they are considering proposing a compromise. Where firms determine there is no better alternative outcome for consumers than to propose a compromise, the guidance will help firms to propose acceptable compromises that are compatible with our rules, including the Principles for Businesses, and statutory objectives. In particular, if firms do propose a compromise in respect of redress liabilities, they should ensure it is the best proposal that the firm can make, which includes the firm providing the maximum amount of funding for the compromise so that consumers receive the greatest proportion of what is owed to them.

[1] Firms authorised under the Financial Services and Markets Act 2000 (FSMA) and firms authorised or registered under the Payment Services Regulations 2017 (PSRs) or Electronic Money Regulations 2011 (EMRs)

1.3 The proposed guidance focuses on three types of compromise: schemes of arrangement (Schemes), restructuring plans (RPs) and voluntary arrangements (VAs). Firms should review the proposed guidance before considering such compromises to ensure that any compromise proposed will not be unacceptable to us.

1.4 The proposed guidance only relates to compromises in relation to liabilities and does not apply to Schemes or restructuring arrangements in other circumstances such as with-profits restructuring. Separate rules and guidance may apply to those types of restructurings and firms involved in such arrangements should consult their normal supervisory contact at the FCA and PRA as applicable.

2 The consultation

What we are consulting on

2.1 We set out the proposed guidance we are consulting on in the Annex.

2.2 Here, we summarise our consultation, together with the specific questions we would like views on:

- **Chapter 1 - Introduction** explains the scope of the guidance and our role in assessing compromises.
- **Chapter 2 - Engagement with the FCA** reminds firms that they are required to notify us if they propose a compromise and engage with us at an early stage. This chapter also outlines the minimum information that we expect to be provided by a firm, as part of their initial notification or at an early stage thereafter.
- **Chapter 3 - FCA's assessment of compromises** explains our approach to assessing a compromise proposed by a firm and the factors we will consider when deciding what action(s) to take.
- **Chapter 4 - FCA's participation in court process** explains the factors we will consider when deciding whether to participate in the court process.
- **Chapter 5 - Use of supervisory tools/regulatory action** explains when and how we may use our powers in relation to the conduct of a firm proposing a compromise.

2.3 We welcome views on the following questions:

Q1: Do you agree with our expectations on firms' engagement with the FCA in Chapter 2? If not, why not? Are there any other considerations that would be useful to consider?

Q2: Do you agree with our approach to assessing a compromise in Chapter 3 and the factors we will consider? If not, why not? Are there any other considerations that would be useful to consider?

Q3: Do you agree with the factors we will consider in deciding when to participate in court proceedings in Chapter 4? If not, why not? Are there any other considerations that would be useful to consider?

Q4: Do you have any comments on our use of supervisory tools/regulatory action in respect of compromises in Chapter 5? Are there any other considerations that would be useful to consider?

Q5: Do you agree with our proposal that we will consider using our regulatory powers where firms propose compromises in relation to redress liabilities and we are likely to find, or have found, the liabilities were caused by serious or deliberate misconduct by the firm? If not, why not?

Who does this consultation affect?

2.4 The proposed guidance is aimed at firms solely regulated by the FCA including those that are part of a dual regulated group, and firms that are dual regulated by the FCA and PRA from the perspective of conduct regulation. It is also relevant to advisers of regulated firms considering compromises (including insolvency practitioners and professional advisers), trade associations, consumers and consumer protection organisations.

2.5 The proposed guidance will not apply retrospectively to any compromise where the firm has issued a practice statement letter (in respect of Schemes and RPs) or proposal (in respect of VAs) to its creditors before the date that the proposed guidance comes into effect. For compromises where the firm has issued a practice statement letter or proposal to creditors before the effective date of the proposed guidance, we will review these on a case-by-case basis however the principles in the proposed guidance may be relevant.

Cost benefit analysis

2.6 FSMA does not require us to publish a cost benefit analysis (CBA) when proposing guidance. However, we state in our approach to CBA that we will 'produce a CBA if a high-level assessment of the impact of the proposal identifies an element of novelty which may be prescriptive or prohibitive such that significant costs may be incurred'.

2.7 We expect the costs of our proposed guidance will be minimal. This is because the guidance aims to clarify our expectations on compromises proposed by regulated firms and therefore there are no material new requirements on such firms.

Compatibility statement

2.8 Section 1B(1) of FSMA requires the FCA, when discharging its general functions, as far as is reasonably possible, to act in a way which is compatible with its strategic objective, and advances one or more of its operational objectives, and its general duty under section 1B(5)(a) of FSMA to have regard to the regulatory principles in section 3B of FSMA. The FCA also needs, so far as is compatible with acting in a way

that advances the consumer protection objective or the integrity objective, to carry out its general functions in a way that promotes effective competition in the interests of consumers.

2.9 We are satisfied that the proposed general guidance is compatible with our general duties under section 1B of FSMA, having regard to the matters set out in section 1C(2) of FSMA. We have also had regard to the regulatory principles in section 3B of FSMA, regulation 106 of PSRs and regulation 47 of EMRs.

2.10 The proposed guidance will help us advance our operational objectives of securing an appropriate degree of protection for consumers and protecting and enhancing market integrity by clarifying how we assess compromises and may intervene to achieve a fair outcome for consumers, and setting out practical considerations for firms when they are proposing a compromise.

2.11 In producing the proposed guidance, we have had due regard to the principles in the Legislative and Regulatory Reform Act 2006 (LRRA) and the provisions in the Regulators' Compliance Code for the parts of the proposals that consist of general policies, principles or giving guidance. We are satisfied that we have had regard to the principles in the LRRA and to the Regulators' Compliance Code to the extent that our proposals consist of guidance and we consider that our proposals are proportionate and will produce an appropriate level of consumer protection when balanced with their impact on firms.

2.12 We have also had due regard to the recommendations made by Her Majesty's Treasury under section 1JA of FSMA about aspects of the economic policy of Her Majesty's Government. The draft guidance takes into consideration the recommendations relating to better outcomes for consumers. The purpose of the guidance is to set out our general approach to compromises. When the guidance is final, firms should have due regard to it when proposing compromises, which will promote fair outcomes for consumers and help firms avoid proposing compromises which we find unacceptable and to which we are likely to object.

Equality and diversity

2.13 We are required under the Equality Act 2010 to have due regard to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Equality Act 2010, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, and to foster good relations between people who share a protected characteristic and those who do not.

2.14 As part of this, we consider the equality and diversity implications of any new policy proposals. We do not consider the proposed guidance will adversely affect any of the groups with protected characteristics.

2.15 We believe the proposed guidance may positively affect some groups with protected characteristics. For example, age, race and disability are protected characteristics, and having a lower income, physical or mental health condition is a driver of potential vulnerability. So, as the proposed guidance is aimed at ensuring a fair outcome for all consumers in a compromise, those with protected characteristics and that are likely to be potentially vulnerable may benefit from this guidance.

2.16 We will continue to consider the equality and diversity implications of this guidance during the consultation and revisit them when publishing the final guidance.

How to respond

2.17 We welcome comments on the proposed guidance by **1 March 2022**. Please send your comments using the online response form on our website or you can email your responses to gc22-01@fca.org.uk.

2.18 We will consider your feedback and publish our final guidance in due course.

Annex 1 – Draft guidance on the FCA's approach to compromises

Chapter 1: Introduction

1. This document provides guidance to UK based firms regulated by us on our general approach to compromises. This guidance is aimed at firms authorised or registered by us. This includes firms that are dual regulated by the FCA and PRA from the perspective of conduct regulation and those that are part of a group where a firm within that group is dual regulated by the FCA and PRA. The FCA is the competent authority for solo-regulated firms. The PRA is the competent authority for dual-regulated firms. The Bank of England is designated as the resolution authority for dual regulated firms and certain investment firms (ie solo-regulated firms that are part of a group subject to the Bank of England's resolution power under the Banking Act 2009).

2. Compromises allow a firm to reach a binding agreement with its creditors and/or shareholders in full and final settlement of their liabilities. This guidance focuses on three types of compromise: schemes of arrangement (Schemes), restructuring plans (RPs) and voluntary arrangements (VAs). VAs comprise company voluntary arrangements (CVAs), individual voluntary arrangements (IVAs) and partnership voluntary arrangements (PVAs)[2]. This guidance only relates to compromises in relation to liabilities and does not apply to the use of Schemes or restructuring arrangements in other circumstances such as with-profits restructuring.

3. Schemes and RPs are governed by the Companies Act 2006 (Part 26 and Part 26A respectively). They are court approved agreements guided by a vote of the creditors and/or shareholders. The court test for sanctioning schemes is 'fair and reasonable' and for RPs is 'just and equitable'. If sanctioned by the court, the terms of the Scheme or RP are binding on the firm and the creditors and/or shareholders subject to the arrangement, regardless of whether they voted for it. CVAs and IVAs are governed by the Insolvency Act 1986 (Parts I and VIII respectively) and PVAs are

[2] CVAs are available to companies registered in England, Wales, Northern Ireland and Scotland. IVAs are available in England, Wales and Northern Ireland but not Scotland. In Scotland, protected trust deeds are available (which are similar to IVAs). PVAs are available in England and Wales but not Scotland or Northern Ireland.

governed by the Insolvent Partnerships Order 1994 (Part II); the court is notified of the creditors decision and there is no court hearing unless the VA is challenged by a creditor or us.

4. This guidance clarifies our general approach to compromises, including the factors we will consider when deciding if and what actions we will take in line with our statutory objectives to protect consumers and markets. The guidance will help regulated firms understand our expectations and ultimately help firms to avoid proposing compromises that are unacceptable to us because they threaten or adversely affect our statutory objectives.

5. This guidance will not apply retrospectively to any compromise where the firm has issued a practice statement letter (for Schemes and RPs) or a proposal (for VAs) to its creditors before the date this guidance comes into effect. For compromises where the firm has issued a practice statement letter or a VA proposal to creditors before the effective date of this guidance, we will review these on a case-by-case basis however the principles in the guidance may be relevant.

6. This guidance is not exhaustive and should be read alongside the FCA's Handbook and other applicable legislative requirements and guidance.

The FCA's role in compromises

7. All regulated firms must comply with our rules, including the Threshold Conditions (or Conditions of Authorisation under the PSRs and EMRs for PIs and EMIs (Conditions of Authorisation)), and the Principles for Business, in particular treating customers fairly (Principle 6). If firms do not comply, we have statutory powers to take regulatory action. In Chapter 5, we set out when and how we might use our supervisory tools and take regulatory action where a compromise is proposed.

8. In addition, we have a statutory power to challenge CVAs and PVAs under section 356 of FSMA and IVAs under section 357 of FSMA. The circumstances in which we use this power are set out in section 13.10 of the Enforcement Guide (EG). We do not have a statutory role under the Companies Act 2006 in respect of Schemes and RPs, but the court will generally be interested in our view as regulator of firms proposing these arrangements.

9. We have an interest in compromises proposed by regulated firms because of our statutory objectives, in particular protecting consumers and the integrity of markets. Compromises that unfairly benefit a firm and its other stakeholders at the expense of consumers are unacceptable to us.

10. As part of our supervision, we will consider compromises proposed by regulated firms and firms that are appointed representatives or agents to determine whether the terms of the proposed compromise are compatible with our statutory objectives, Principles for Business and rules and/or whether the terms of the proposed compromise or the firm's conduct warrants us to take regulatory action. For firms that are appointed representatives or agents, we expect their principal firm to be responsible for compliance with relevant regulatory obligations and any crystallised or contingent exposures which were created by the appointed representative or agent. Our role in a compromise is not to negotiate or design the details of a firm's compromise. We assess a compromise on its individual characteristics and based on the facts of each proposal, taking into account all relevant circumstances, to consider

whether our participation in the court process and/or regulatory action would be appropriate.

11. Where redress is due to consumers, we expect firms to have made provision for the redress in line with our guidance in FG20/1 (Our framework: assessing adequate financial resources). In general, we would be concerned if a regulated firm proposes a compromise where customers are offered less than their full redress and the firm continues trading, where such redress liabilities were caused by serious and/or deliberate misconduct by the firm. If firms do propose a compromise in respect of redress liabilities, they should ensure it is the best proposal that the firm can make, which includes the firm providing the maximum amount of funding for the compromise so that consumers receive the greatest proportion of what is owed to them.

12. We will generally make a public comment in relation to proposals that have a significant impact on consumers or markets, including whether we consider they are consistent with the approach set out in this guidance.

Chapter 2: Engagement with the FCA

13. When a firm is considering proposing a compromise, in line with Principle 11 and relevant rules in SUP, PSRs and EMRs[3], the firm must notify us immediately and provide relevant information at an early stage to enable our assessment of the compromise. We consider proceeding with preparation for a compromise, without notifying us to be a significant breach of Principle 11 and the notification requirement in SUP 15. In such circumstances we will consider the appropriateness of conduct by the firm's senior management.

14. Firms should seek appropriate advice in order to ensure they fully understand the compromise process, statutory and regulatory requirements, and consider our expectations set out in this guidance before proposing a compromise. When proposing a compromise, a firm should ensure it will have appropriate resources to manage the compromise together with its business-as-usual activities, if relevant.

Information for initial assessment of the proposed compromise

15. For us to make an initial assessment of whether we are likely to consider the proposed compromise, a firm should provide the following minimum information as part of its initial notification to us.

    a) An explanation as to how the liabilities subject to the compromise arose. This includes the relevant period(s) of time, directors and senior management in place at that time, and any steps taken to mitigate the liabilities.

    b) Type of liabilities to be compromised and their value.

    c) Actions that the firm has taken or is taking to remedy the cause(s) that led to the liabilities, including any changes in business practices and/or management.

    d) Creditor cohorts or classes (and estimated number of creditors within each cohort or class) to which the compromise will apply, how they have been determined, as well as an explanation of why any creditor cohorts or classes have not been affected by the compromise and how they will be treated.

[3] SUP 15.3.21R(4) (for FSMA authorised firms) and regulation 37 of PSRs and regulation 37 of EMRs (for PIs and EMIs) as we consider a compromise to be a "substantial change in circumstance" for the purposes of those regulations.

e) Anticipated pence in the pound return to creditors or creditor cohorts or classes subject to the compromise with high level details as to how this has been estimated and clarification as to any other expected type of return to creditors (eg balance write-downs).

f) Intended trading activity (i) in advance of the compromise coming into effect, (ii) while the compromise is in effect, and (iii) after the compromise has come to an end, including business model, projections and material assumptions.

Further information for full assessment of compromise

16. In addition, to enable a full assessment of the proposed compromise, firms should provide the following information, where relevant, at an early stage and in any event as soon as it is available. These lists are not exhaustive.

a) Substance of the proposed compromise

i. Structure of the proposed compromise, including the parties/persons whose liabilities are to be compromised, and whether a special purpose vehicle (SPV) is to be used. Where an SPV assumes the liabilities of a firm subject to this guidance, the guidance will similarly apply to the firm using the SPV.

ii. Methodology and assumptions for calculating the gross liabilities to be compromised and any key factors that may affect this valuation.

iii. Granular methodology and assumptions for the assumed pence in pound return to creditors including the assumed claims rate, uphold rate and average redress award.

iv. Anticipated contribution to the compromise from the firm (or any other companies in its group such as parent company). This includes any initial sum and subsequent or contingent sum such as a profit share, and clarification as to how the costs of administering the compromise will be met.

v. A breakdown of the anticipated costs associated with the implementation of the proposed compromise.

vi. Details of other options considered, including other compromise proposals, with reasons why these were not taken forward.

vii. Alternative options available should the proposed compromise not come into effect. If insolvency is a likely outcome, details of the estimated outcome for creditors (secured and unsecured, including group or connected parties) and shareholders.

viii. Anticipated voting process (including how creditor cohorts / classes will be ascertained for voting purposes).

ix. Anticipated claims process (including the claims methodology, the calculation methodology, and any appeals or complaints procedure).

b) Practical effect of the proposed compromise on relevant creditors

i. Rights being extinguished (including ability to raise a complaint with Financial Ombudsman Service (Ombudsman Service)).

ii. Explanation of the effect of the proposed compromise on any compensation which may be available from the Financial Services Compensation Scheme (FSCS), should the firm be declared in default. Where appropriate, firms should engage with the FSCS as early as possible to discuss the proposed terms of the compromise and to discuss implications for the FSCS.

iii. Whether there are any set-off rights and, if so, how set-off rights will be dealt with in the proposed compromise.

iv. Any limitation periods for eligible claims to be compromised bearing in mind the time-limits set out in DISP 2.8.2R on how long customers have to complain to the Ombudsman Service.

v. If applicable, how the proposed compromise will apply to creditors who are now customers of a third party as a result of a sale of business and whether those creditors' claims will be treated in the same way as other creditors.

vi. Practical effect of the proposed compromise on the economic value/beneficial interest belonging to directors, shareholders, secured creditors, or other group/connected entities (as relevant).

c) Financial information

i. Financial forecasts for the next 6 months.

ii. Management accounts for the previous 3 months including the directors or partners' capital accounts showing their drawings, contributions and profit shares.

iii. Whether directors or partners were paid any bonuses or remuneration in addition to their salary over time, including, but not limited to, the period of liability or whether the firm intends to pay any bonuses or remuneration after the compromise.

iv. Any intercompany loan positions in the group, including any loans to or from directors or partners, and any plans to repay these loans.

v. Holders of security over the firm's assets (including where the firm is subject to a cross-guarantee) and the conditions under which security holders have the right to enforce.

vi. If the proposed compromise involves a sale of assets or equity of the firm, details of the proposed sale process, timeframe, and whether the sale will be to connected persons.

d) Other relevant information

i. An anticipated timeline the firm is working to, including critical path activities, key dates/deadlines and contingency arrangements.

ii. Plan for communicating and engaging with customers and all draft communications to customers (before sending to customers).

iii. Whether the firm will be setting up a creditors committee and how the committee will be set up and operate.

iv. External parties that will be engaged by the firm to advance the proposed compromise, the role and services provided by each party, and their main points of contacts.

v. Any tax implications for creditors.

vi. Explanation of how any existing complaints received by the firm will be dealt with, including any that have been referred to the Ombudsman Service.

vii. For Schemes, an explanation of how the Scheme meets the court's test of fairness and reasonableness[4].

viii. For RPs, an explanation of how the RP meets the court's test of just and equitable[5].

ix. Any other relevant formal or explanatory documents, including any reports prepared by the firm's advisers on the proposed compromise

17. If insufficient information is provided by a firm to enable us to assess the compromise, we will expect the firm to work with its advisers to provide the relevant information to us. Where necessary we will consider using our statutory powers to obtain such information (eg our powers under section 165 of FSMA to compel firms to provide information).

18. If aspects of the proposed compromise need further analysis (eg the methodology of the proposed compromise or where the proposed compromise is not straightforward and could impact retail and small commercial customers), we may require the firm to appoint a skilled person to provide a report under section 166 of FSMA. This would be with a view to assessing the possible impact and harm on consumers. We would expect to take the skilled person's report into account when assessing the proposed compromise against our statutory objectives. In line with SUP 5, we would expect a skilled persons' report to sufficiently identify and assess risks with supporting information and evidence.

Firms' engagement with the PRA

19. The PRA have an interest in compromises proposed by dual regulated firms, and we would expect to liaise with the PRA on any compromise proposed by a dual regulated firm. In addition to notifying us, dual regulated firms should also notify the PRA and we will work with the PRA to consider the proposal.

Firms' interaction with the Financial Ombudsman Service

20. The Ombudsman Service is an independent service for resolving disputes between consumers and firms, and with a minimum of formality on a fair and reasonable basis. The rules and guidance for firms relating to the Ombudsman Service are set out in the Dispute Resolution: Complaints (DISP) part of the Handbook.

21. Where firms propose to compromise redress liabilities, the liabilities may arise from awards by the Ombudsman Service. Firms must at all times comply with the complaint handling requirements in DISP (as applicable) and engage with the

[4] For an example of how the fair and reasonable test has been recently examined by the Court, please see the judgment in All Scheme Limited, Re [2021] EWHC 1401 (Ch)

[5] For an example of how the just and equitable test has been recently examined by the Court, please see the judgment in Virgin Active Holdings Ltd & Ors, Re [2021] EWHC 1246 (Ch)

Ombudsman Service where appropriate. Where a complaint has been referred to the Ombudsman Service, the firm must cooperate fully with the Ombudsman Service (DISP 1.4.4R).

Firms' interaction with the Financial Services Compensation Scheme

22. The FSCS is the UK's compensation scheme when a protected regulated firm is unable, or likely to be unable, to pay claims against it. The FSCS scheme is operated and administered by Financial Services Compensation Scheme Ltd under rules made by each of the FCA and PRA, and which set of rules apply is dependent on the nature of the act or omission giving rise to the claim for compensation. The PRA makes the rules governing the compensation scheme relating to claims for a deposit, dormant accounts, under a contract or insurance or in respect of Lloyd's managing agents. The PRA's rules are in the Depositor Protection and Policyholder Protection parts of its Rulebook. The FCA makes the rules where the claim in question is in connection with protected designated investment business, home finance mediation, non-investment insurance distribution and certain debt management business. The FCA's rules are in the COMP section of the Handbook (see COMP 5.2 for further details).

23. Firms should consider how the proposed compromise might impact any future claims to the FSCS, should the firm be declared in default. Where appropriate, firms should engage with the FSCS as early as possible to discuss the proposed terms of the compromise and to discuss implications for the FSCS.

Chapter 3: FCA's assessment of compromises

24. We will assess a compromise proposed by a regulated firm on a case-by-case basis, against our statutory objectives and consider whether the proposed compromise is compatible with our rules, including our Principles for Businesses. In particular, we assess the compatibility of compromises with Principle 6 (treating customers fairly), Principle 7 (customers' information needs) and Principle 8 (managing conflicts of interest). If the proposed compromise is not compatible with our statutory objectives, rules or Principles, we are likely to have significant concerns with it, which may lead to an objection in court. We may also use our regulatory powers in the circumstances described in Chapter 5 below.

25. In line with our consumer protection objective, treating customers fairly, including the outcome they would receive compared to other stakeholders, and whether the firm (and, where applicable, its Group) has put forward the best proposal possible for customers will be a central consideration when reviewing a compromise. This is also consistent with the court's test for sanctioning a Scheme or RP, although our assessment of a Scheme or RP is distinct from, and because of our statutory objectives necessarily broader than, the court's assessment of the Scheme or RP.

26. In line with our market integrity objective, the firm's plans after the proposed compromise will be a key part of our considerations when reviewing a compromise. We would be concerned if a firm proposes a compromise which pays customers less than their full redress entitlement but continues to trade, where such redress liabilities have been caused by serious and/or deliberate misconduct by the firm, because this undermines the integrity of firms and reduces confidence in the market.

27. Following a compromise, we would expect a firm to meet Threshold Conditions and to be compliant with our rules, including the Principles for Businesses.

28. When assessing a compromise proposed by a firm, we will take into account all of the information provided by the firm and consider a number of factors including but not limited to:

    a) whether the proposed compromise provides the best outcome possible for customers taking into account:

        i. how customers rights are affected eg rights of set-off

        ii. how compromise funds will be distributed and whether the proposed compromise provides a fair allocation of benefits and losses between all stakeholders of the firm

        iii. whether a better deal was available to customers

        iv. whether the firm proposes to undertake a fair process for creditors affected by the proposed compromise (eg whether customers have access to guidance/advice on the compromise (including alternative options to the compromise) and have had an opportunity to liaise with the firm on the proposed compromise)

    b) nature and scale of any misconduct that led to the liabilities subject to the proposed compromise

    c) number of, and impact on, any customers with characteristics of vulnerability

    d) whether the liabilities to be compromised involve redress, client assets or safeguarded funds

    e) effect of the proposed compromise on eligible customers' FSCS compensation rights

    f) how much is being put into the compromise fund by the firm (or wider group if applicable) how the firm will deal with claims and appeals

    g) what the firm intends to do following the compromise (eg continue to trade or wind-down)

29. Firms should be mindful of these factors when considering proposing a compromise. This will help to avoid proposing a compromise which we would be likely to object to in court.

30. We consider it unlikely that a compromise over client assets or safeguarded funds would be appropriate. For Schemes, this was confirmed in the judgment of Lehman Brothers [2009] EWCA Civ 1161, which established that a company cannot use a Scheme to alter or limit proprietary rights. For VAs, EG 13.10 states where a company, partnership or individual has control of consumer assets which might be affected by the VA, this will be a matter for the FCA to consider challenging a VA.

Letters of non-objection

31. Some regulated firms have requested a 'letter of non-objection' from us for any compromise they intend to propose. There is no statutory requirement on us to provide such letters and we do not consider that there are likely to be any circumstances in which we would issue such a letter for the compromises within

scope of this guidance. Instead, we focus our resources on assessing the proposed compromise and any connected supervisory and/or enforcement action, and communicating any concerns to the relevant firm and, where appropriate, the court.

Chapter 4: FCA's participation in court process

VAs

32. Our position on participating in proceedings for VAs is set out in section 13.10 of the EG. Section 13.10 of the EG provides that we will consider challenging an arrangement approved by a majority of creditors by using our powers in sections 356 or 357 of FSMA in exceptional circumstances and after considering the matters set out in EG 13.10.2.

Schemes and RPs

33. As a firm's regulator, the court will usually be interested in our views based on our wider knowledge of the firm and its business. We will consider whether to participate in the court process as part of our assessment of the proposed Scheme or RP.

34. In terms of our participation in the court process, where we object to the proposed compromise, we can make representations at either, or both, the hearing of an initial court application (to convene a meeting of creditors) and the hearing for application for court sanction. We would set out the reasons why we think the proposal should not be approved/sanctioned by the court and/or set out the concerns we have with the proposal. The court may then wish to consider our views as part of its assessment of whether to approve/sanction the Scheme or RP.

35. When deciding whether to participate in the court process, we will take into account a number of factors including but not limited to:

    a) whether the proposal fairly balances the interests of all creditors

    b) number and type of creditors subject to the compromise

    c) total amount of liabilities subject to the compromise

    d) average amount of liability being compromised

    e) whether the compromise gives rise to matters of public interest (eg is of interest to the wider public and other stakeholders from a consumer protection perspective)

    f) whether the firm has provided adequate information on the compromise in order for us to perform our assessment

36. The consideration of Schemes and RPs is not business as usual work for us. So, for Schemes, and in some circumstances RPs (eg where this involves a significant restructuring of the firm or the group to which it belongs) we may charge a Special Project Fee[6], for example for legal or advisory costs. We would not charge a Special Project Fee for VAs as these would be covered in our fees for business as usual work given our statutory powers to intervene in these arrangements.

[6] FEES 3, Annex 9 Special Project Fee for restructuring, see para. (2)R(b) and (c)

Chapter 5: Use of supervisory tools/regulatory action

37. As part of our assessment of a proposed compromise, we will consider whether it is appropriate to take regulatory action against the firm and/or its senior management and we will not hesitate to use our regulatory tools if it is appropriate to do so. This is most likely to be relevant in the context of a compromise involving redress liabilities. For example, we may consider enforcement action on past conduct that caused the liabilities giving rise to the compromise.

38. In determining the appropriate regulatory action, we will take account of any potential misconduct leading to the compromise (determined by supervisory review and any previous, current or proposed enforcement action) and/or the past behaviour of senior management of the firm). We also consider whether the firm complies with Threshold Conditions or Conditions of Authorisation at the time of the proposed compromise and is likely to in the future.

39. If a firm proposes a compromise to reduce or limit redress that we consider arose, or it is likely that has arisen, from serious and/or deliberate misconduct and the firm then continues to trade, we may use our regulatory powers to prevent the firm pursuing the compromise. It may not be compatible with our regulatory objectives to permit a firm to compromise its regulatory liabilities and continue to undertake regulated activities in such circumstances. We have a range of powers provided by FSMA, PSRs and EMRs which enables us to take action against a firm to protect consumers and markets. This can include, for example, imposing requirements on the firm to take specific actions (such as appointing new management), varying the firm's regulatory permissions to restrict business or imposing additional prudential requirements if appropriate.

40. When assessing the fitness and propriety of current or prospective Senior Management Function holders or approved person (as relevant) candidates, either at the time the compromise is proposed or in future, we will also take account of the proposed compromise and the circumstances relating to it. The Senior Managers and Certification Regime does not apply to PIs and EMIs.

41. Our assessment is independent to that of the compromise approval process, and irrespective of whether a compromise is approved by creditors and/or shareholders and the court (where appropriate), we will continue to assess the firm and its senior management, and we may consider further regulatory action where our assessment considers it appropriate.

Phoenixing

42. Phoenixing is a common term often used to describe the practice of closing a firm and that firm re-appearing under a new guise to avoid liabilities arising from the old firm. Each time this happens, the insolvent company's assets, but not its liabilities are transferred to a new, similar 'phoenix' company. The insolvent company then ceases to trade and might enter into formal insolvency proceedings (liquidation, administration or administrative receivership) or be dissolved. In the UK under the requisite laws directors of a company that has failed are not prevented from forming a new company, unless they are personally bankrupt or disqualified from acting in the management of a limited company. Furthermore, firms are not prevented from proposing a compromise. However, there is a risk that a company owing significant sums, often in the form of consumer redress awarded by the Ombudsman Service,

will be left unpaid. Directors, shareholders and senior staff who have engaged in financial misconduct may reappear, connected with a new firm of similar business or with the firm after the compromise takes effect. We consider this unacceptable practice. Where we find such individuals have deliberately avoided their responsibilities and not complied with previous redress awards made against their firms, we will question the fitness and propriety of these individuals and take necessary steps against them so that they do not cause further harm to consumers.

Chapter 6: Examples demonstrating the FCA's approach to compromises

The following examples are intended to illustrate how the FCA would consider compromises proposed by firms, in line with the guidance above. The FCA will assess proposed compromises on a case-by-case basis, taking into account the facts and matters specific to the compromise proposed to determine the appropriate regulatory action.

Firm A

Firm A is an insurance broker that provides card protection policies. Following identification of widespread mis-selling of the policies, Firm A proposes a Scheme to efficiently structure the redress claims process, allowing all customers to submit claims within the period of the Scheme and preventing the uncertainty of potential future claims arising. The Scheme provides a simple process for customers who were mis-sold to make a claim for redress. As claims are made, the firm will pay money into the Scheme to meet their outgoing redress payments. Firm A produces clear, fair and not misleading communications to policyholders by using language that is clearly understood (including translations for non-English speakers), using different mediums that meet accessibility needs for all policyholders, explaining the alternative options and providing contact details for policyholders to send any questions or concerns about the proposed Scheme. Once approved by creditors and sanctioned by the court, through the Scheme, policyholders will be able to claim compensation for mis-sold policies; successful claimants will be paid 100% of the redress owed to them. To make sure all policyholders come forward and future liabilities are made certain, Firm A would contact policyholders to make their claim three times using two different methods and provide a reasonable time period for making the claim.

We would consider this to be a fair compromise as policyholders will be able to claim 100% of the redress owed to them and no policyholders were unfairly treated or excluded from the process.

Firm B

Firm B is a financial adviser specialising in providing advice on pensions. Firm B has received a significant number of complaints from customers due to poor advice. Some customers have referred their complaint to the Ombudsman Service which has resulted in redress awards against the firm. The value of Firm B's liabilities to redress

creditors is over £200m in aggregate. Several complaints are still to be considered by the Ombudsman Service. A large proportion of the redress creditors are customers with characteristics of vulnerability. With mounting redress liabilities, the firm is in financial distress and proposes a Scheme to settle its liabilities to redress creditors to allow it to stay solvent. If the Scheme is sanctioned, redress creditors will receive 25 pence in the pound; secured creditors, shareholders and other unsecured creditors will be unaffected. Firm B's shareholders will also retain their full ownership stake despite not contributing any funds to be made available to meet the redress claims.

Firm B is intending to continue to trade despite being unable to meet its liabilities to customers created by the firm's misconduct. We do not consider this to be the best possible compromise that the firm can make as customers are not receiving the greatest proportion of what is owed to them. If it is unable to pay the full redress due to its customers, the firm should consider all options available to it, including a wind down scheme if appropriate. Whichever option the firm proceeds with, it should pay as much money as it can into the Scheme to ensure its customers get the best possible outcome. Furthermore, the firm is continuing to trade but economic returns are not being divided fairly between all stakeholders as only redress creditors will be affected in terms of the liabilities owed to them. Therefore, redress creditors would not receive a fair outcome in respect of the liabilities owed to them. We would take these factors into account along with the scale and nature of any misconduct which led to the redress liabilities when deciding whether to use our regulatory powers and/or whether to object to the Scheme in court.

Firm C

Firm C is a consumer credit firm. Firm C has received a significant number of mis-selling complaints from customers due to its unaffordable lending practices. Some customers have referred their complaint to the Ombudsman Service which has resulted in redress awards against the firm. The value of Firm C's liabilities to redress creditors is over £100m in aggregate. Several complaints are still to be considered by the Ombudsman Service. A large proportion of the redress creditors are customers with characteristics of vulnerability. Firm C proposes a Scheme to settle its liabilities to redress creditors. If the Scheme is sanctioned, redress creditors will receive 50 pence in the pound. The only likely alternative to the Scheme is insolvency. Firm C has ceased its lending activities and the firm will wind down following the implementation of the Scheme, meaning that it will no longer continue in business. Due to the wind down, it is likely that other creditors will incur losses and shareholders will lose the value of their investment in the firm. Therefore, other creditors and shareholders of the firm will also be affected by Firm C's proposals.

We have significant concerns about the Scheme being proposed and used by Firm C to limit the amount of redress paid to customers. However, we are conscious that the only likely alternative to the Scheme is the insolvency of Firm C and that the Scheme is proposed as part of a wind down whereby all stakeholders of the firm will be affected. We would take these factors into account along with the scale and nature of any misconduct which led to the redress liabilities when deciding whether to use our regulatory powers and/or whether to object to the Scheme in court.

Annex 2 – Abbreviations used in this paper

CBA	Cost benefit analysis
COMP	Compensation Sourcebook
CVA	Company voluntary arrangement
DISP	Disputes Resolution Complaints Sourcebook
EG	Enforcement Guide
EMI	Electronic Money Institution
EMR	Electronic Money Regulations 2011
FCA	Financial Conduct Authority
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
IVA	Individual voluntary arrangement
LRRA	Legislative and Regulatory Reform Act 2006
PI	Payment Institution
PRA	Prudential Regulation Authority
PVA	Partnership voluntary arrangement
PSR	Payment Services Regulations 2017
RP	Restructuring Plan
SPV	Special purpose vehicle
SUP	Supervision Manual
VA	Voluntary arrangement