Dear

**Freedom of Information: Right to know request**

Thank you for your request for information under the Freedom of Information Act 2000 (the Act), dated 19 September 2018, concerning the sales review of Interest Rate Hedging Products (IRHP). For ease of reference a copy of the full text of your request is enclosed in the below Annex A, and we will respond to each of the relevant questions (20-24) in turn.

Further, I would like to clarify that, in line with our policy and guidance produced by the Ministry of Justice, question 24 of your request will not be dealt with under the formal FoIA regime. This is because this part of your request is not for 'recorded information'; instead, you have asked us to provide answers or explanations to your question, which will therefore be treated as "routine correspondence".

Please see page 6 of the document available from the following link for further information on this:


**Question 20:** In March 2013, we published the findings of a pilot we had undertaken, which resulted in us making certain changes to the approach we had originally set out in 2012. This included some changes to the 'sophistication' test.

The report ([https://www.fca.org.uk/publication/archive/fsa-interest-rate-swaps-2013.pdf](https://www.fca.org.uk/publication/archive/fsa-interest-rate-swaps-2013.pdf)) makes clear that the changes were in response to the pilot findings, and we can confirm these were not introduced by HMT or persons representing HMT.

**Question 21:** As above.

**Question 22:** As above.

**Question 23:** We regularly collected data from firms to track progress with the review, which we published on our website. The figure quoted of 5,309 customers (as per this update: [https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf](https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf)) is based on firms providing us with the number of customers who had been objectively sophisticated because there was a notional value of over £10m.
However, the data we received for these public updates did not distinguish between:

a) A subsidiary of a large group whereby the large group itself was designated as 'sophisticated' as per the criteria that existed prior to January 2013? Or

b) SPV’s that formed part of a larger group, where the large group itself was designated as ‘sophisticated’ as per the criteria that existed prior to January 2013?

For this reason, I must advise that we do not hold the information you are seeking.

**Question 24:** Our view was that reviewing a sample of typically more complex cases would help to identify any issues, to help ensure the review would deliver fair and reasonable outcomes for customers.

We recognise that many people have views on how the review may have been designed differently, including the sophistication test. You may be aware that we have committed publicly to undertaking a 'lessons learned' review, once any relevant legal proceedings relating to the review have concluded.

Yours sincerely

**Information Disclosure Team**

Your right to complain under the FoI Act
If you are unhappy with the decision made in relation to your request, you have the right to request an internal review. If you wish to exercise this right you should contact us within three months of the date of this response.

If you are not content with the outcome of the internal review, you also have a right of appeal to the Information Commissioner at Information Commissioner’s Office, Wycliffe House, Water Lane, Wilmslow, Cheshire SK9 5AF. Telephone: 01625 545 700. Website: www.ico.org.uk

**Annex A:**

"**Background**

1. As you know, the FCA ordered the IRHP (Interest Rate Hedging Product) Review in June 2012.

2. Just over 30,000 customers/sales were deemed to have qualified for the IRHP Review, and all customers notified. (This includes clients of mine.)

3. Early on customers designated as 'sophisticated' as per the 'Small Companies Test' were excluded. This excluded 4,977

4. As you know, it is important to realise is that this sophistication test was always that which was used by banks when selling the products in the first place.

5. However, in early 2013 the FSA/FCA announced the retrospective introduction of an entirely new criteria for sophistication, namely that any customer that had IRHP's with
an aggregate notional value greater than £10mio, would now be classified as sophisticated and be excluded from the IRHP review.

6. Customers, including clients of mine, and who had originally been informed that they were included in the review, now received a letter in 2013 informing them that they had now been retrospectively classified as sophisticated and entirely as per this new criteria (IRHP Notional value of over £10mio) and would now be excluded from the review.

7. This had the effect of removing any opportunity for fair, free and objective redress under this review for all those effected, leaving them only the route of expensive civil litigation to achieve redress.

8. According to FCA website and data pursuant to the review, 5,309 customers were excluded entirely because of this retrospective introduced criteria.

9. Entirely unfair since all had been sold these products by the banks having been classified as non-sophisticated' at the point of sale and therefore the sales process should be judged against that standard. Such a retrospective move is akin to making it a criminal offence today punishable by 5 years in prison for speeding, and applying it to all offenders prior to the introduction of the new law.

10. My clients, like many, only had these IRHP's because the bank made them a condition of lending. No IRHP. No loan.

NOTE: The banks claim they were introduced to hedge risk. The reality is rather different. They were introduced to provide another revenue stream for the bank from lending, and a lucrative one at that. FOR EXAMPLE: One IRHP (A Cap) that a client of mine paid £145,000 for, earned the bank an instant £70,000 profit at the point of sale thanks to the 'mark up' they applied to the true market price.

As profit targets rose, so the banks made the IRHP's more complex, with more component parts. The bank could enjoy the same £70,000 profit on each component part, but by making some of the component parts a product whereby the bank would be paying the customer for it (A Floor), whilst still enjoying a similar level of profit on that part, they were able to make these products appear cheaper at point of sale.

A Collar, for example, would cost the customer less than a Cap, but generate almost twice the revenue for the bank at point of sale.

11. To date, the FCA review has seen £2.17bio paid in redress to 13,936 customers (This is out of 16,613 redress offers communicated to customers)
A good summary of the scheme stats can be found here: https://www.fca.org.uk/publication/data/aggregate-progress-final.pdf

12. A rudimentary estimate would be that this amount of redress was paid to customers based on an average IRHP notional value of £5mio. Whereas clients of mine all had IRHP's with a notional value of between £50mio - £70mio aggregated over a number of years.
13. We estimate that the introduction of this retrospective criteria saved the banks, and cost customers, approximately £15-18bio.

14. I have researched this new criteria and have serious concerns. It is claimed that the FCA/FSA introduced this new criteria following the findings of their 'Pilot Scheme'. (see link below)

15. Within the 'Pilot Scheme' report, the FCA cite reasons why they introduced this new criteria to exclude customers with IRHP's over £10mio in notional value. However, none of the reasons cited make sense. (I.E. The customer might have been a subsidiary of a much larger sophisticated business.)

FOR THE RECORD AND AVOIDANCE OF DOUBT, all of the reasons cited would have been determined on a case by case basis anyway as the sale of the products were reviewed in detail, and those cases would have been reasonably excluded as and when they were found. It simply does not justify a blanket 'catch all' criteria such as this.

16. During my research, I was introduced to someone that had been employed by KPMG as a 'Skilled Person' to work on the IRHP review on their behalf for Lloyds Bank. This person told me that during their time reviewing cases that they, or the team in which they worked, did not come across any that were sold correctly, and claimed that over 98% had been mis-sold. They further said it was clear very early on in the IRHP review process that the liability for the bank would be significantly greater than they had anticipated, and was clearly an evidence cause of concern for KPMG and Lloyds Bank.

17. Then in 2013, this new criteria was introduced. The 'Skilled Person' was in no doubt that this was as a result of the banks trying to minimise their liability.

18. I researched further and came across someone, with significant knowledge of the IRHP and the introduction of this criteria, that told me that the new criteria was not introduced by the FCA, or for the reasons given, but was actually introduced by, or on behalf of, HM Treasury, following 'lobbying' by the banks, at least two of which were 'State owned' at the time.

19. He went further and said that the criteria was forced upon the review by Sajid Javid (Former banker) on behalf of HMT, the department he was working for at the time, and specifically 'to reduce the impact / cost of the IRHP Review scheme for the banks.'

My formal Freedom of Information Request

20. Given the above background, can the FCA confirm or deny that the abovementioned criteria for evaluating client sophistication, that saw 5,309 customers now retrospectively classified as 'sophisticated' and therefore excluded from the IRHP review and therefore denied access to a free means of resolution and appropriate compensation, was introduced by Her Majestys Treasury (HMT) or persons representing HMT, particularly but not exclusively, Sajid David?

21. Given the above background, can the FCA confirm or deny that HMT or persons representing HMT, including but not exclusively Sajid David, played any part in the
introduction of, or suggestion of, or support of the introduction of the abovementioned criteria for evaluating client sophistication, that saw 5,309 customers now retrospectively classified as 'sophisticated' and therefore excluded from the IRHP review and therefore denied access to a free means of resolution and appropriate compensation?

22. Given the above background, can the FCA confirm or deny that HMT or persons representing HMT, including but not exclusively Sajid David, played any part or exerted any influence in respect to the introduction of the abovementioned criteria for evaluating client sophistication, that saw 5,309 customers now retrospectively classified as 'sophisticated’ and therefore excluded from the IRHP review and therefore denied access to a free means of resolution and appropriate compensation?

23. Finally, please provide details of precisely how many of the 5,309 customers that were retrospectively excluded from the IRHP Review as a result of this new criteria, were in fact any of the following:

   a) A subsidiary of a large group whereby the large group itself was designated as ‘sophisticated’ as per the criteria that existed prior to January 2013?

   b) SPV’s that formed part of a larger group, where the large group itself was designated as ‘sophisticated’ as per the criteria that existed prior to January 2013?

These being the particular client types that it is claimed by the FSA and by HMT, that this new retrospective criteria was introduced so as to exclude from the IRHP review.

For the record and avoidance of doubt:

- so rigorous and thorough was the IRHP review conducted by the banks and skilled persons, that the FCA and/or each bank MUST therefore be able to easily provide this information.

- Furthermore, the FSA report regarding the findings of the Pilot Scheme claims that the review process had been able to identify in each case whether each customer was or was not one of the abovementioned types that the FSA claimed it was seeking to exclude from the IRHP review, and therefore it stands to reason that it was equally easy to identify how many of the 5,309 customers that were retrospectively excluded were one of the above types.

- We know from information provided by the Skilled Person that by the time this new retrospective criteria was introduced, that a substantial number of cases had already been reviewed, so please do not claim that there is no data available because none of the sales to any of these 5,309 customers had been undertaken on account of them being excluded.

24. The report in to the findings of the FSA’s Pilot Scheme states that “We asked each bank to carry out a pilot of a small sample of typically more complex cases before beginning the full review.”
Is it not fair to say that focusing on more complex cases would have skewed any findings in terms of the customer sophistication within the sample? I.E. The more complex the case, the more likely it was a product sold to a customer meeting the original sophisticated criteria or being a subsidiary or SPV of a larger group or multinational.”