Association of Business Recovery Professionals

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Financial Conduct Authority
GC22/1: FCA's approach to compromises for regulated firms

Email only – gc22-01@fca.org.uk

23 February 2022

Dear Sir / Madam

FINANCIAL CONDUCT AUTHORITY ('FCA') – FCA'S APPROACH TO COMPROMISES FOR REGULATED FIRMS CONSULTATION RESPONSE FROM INSOLVENCY AND RESTRUCTURING TRADE BODY R3

1. INTRODUCTION

1.1 R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. We represent licensed insolvency practitioners, lawyers, turnaround and restructuring experts, students, and others in the profession. Our members work across the spectrum of the profession, from global legal and accountancy firms through to smaller, local practices.

1.2 The insolvency, restructuring and turnaround profession is a vital part of the UK economy. The profession rescues businesses and jobs, creates the confidence to trade and lend by returning money fairly to creditors after insolvencies, investigates and disrupts fraud, and helps indebted individuals get back on their feet. Our members have direct experience of restructuring and insolvencies and their impact on the UK economy and various stakeholders.

1.3 This response has been prepared by R3 in collaboration with members of its General Technical Committee and we thank them for their input. The committee deals with issues of general importance and significance to the profession in the United Kingdom, keeping under review all UK and EU legislation, prospective and other matters relating to insolvency law. The Committee is multi-disciplinary and is made up of representatives from across the insolvency and restructuring profession, including practising insolvency practitioners, lawyers (including those specialising in advising regulated entities), in addition to academics, and others.

2. GENERAL OBSERVATIONS

2.1 R3 welcomes the intention behind the FCA's proposed guidance in relation to compromises for regulated firms. The guidance will help R3 members to understand what information the FCA requires, and its general approach to such compromises.

2.2 However, while the proposed guidance is welcomed, we are disappointed by the lack of detail it contains in relation to how exactly the FCA will approach compromises, other than that it will consider each compromise on a case-by-case basis.

2.3 We also query whether the expectation of information to be provided to the FCA, in addition to the existing information and disclosure requirements under the companies and insolvency legislation, will result in a significant amount of duplication with the attendant time and costs that directors/managers of the distressed entity will have to assume. In addition, we set out below our concern regarding the guidance's juxtaposition with the legal duty of a director to *all* creditors where solvency is in doubt – not just consumers who may have redress claims.

2.4 We are further concerned that the FCA's approach may undermine the certainty that is provided by the formal compromise procedures, established under the auspices of the court's supervision. To date there is nothing to suggest that the court will not seek to ensure that all stakeholders are treated fairly before approving or rejecting a scheme/Restructuring Plan (RP). By way of example, in *Re ALL Scheme Limited[2021] EWHC 1401 (Ch*) the court rejected a scheme despite the fact that it had the requisite creditor support. It was made clear that the court expects companies promoting a compromise to have fairly allocated the benefits and loss in the restructuring. Another example of the court fully considering concerns regarding a compromise involving consumer redress claims was *Re Provident Financial*, where steps were taken to ensure proper disclosure and consumer advocate representation was provided, in order to ensure that the scheme

was fair and reasonable. The guidance may be perceived to be undermining creditor choice, preventing compromises from being considered at all and further has the potential to interfere with the court's role as ultimate arbiter of what is fair and reasonable, protecting all stakeholders (including consumers) in any given case for compromise.

2.5 We highlight these issues in the responses to the questions below.

3. CONSULTATION 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?

3.1 The proposed guidance includes an extensive list of information that the FCA will expect to receive when a firm is considering a compromise. As mentioned above, we think that there is considerable overlap with the information that is provided to creditors already as part of the formal compromise procedures (e.g. Practice Statement Letter, Explanatory Statement, the scheme/RP/CVA proposal.) We are concerned that this additional provision of very detailed information may result in additional costs and time for already distressed businesses and deter them from considering any compromise which could be in the best interest of their creditors. A company facing the prospect of insolvency needs to move quickly.

3.2 It would be useful to have an indication of the timeframes that the FCA has in mind for this pre-compromise disclosure and an indication of what the consequences of any failure to provide such information would entail.

3.3 The proposed guidance suggests that the FCA expects to be notified as soon as a company is 'considering proposing a compromise', which appears consistent with Principle 11 (the requirement that a firm must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice). However, the phrase 'considering proposing a compromise' is wide-ranging and the information for initial assessment of the proposed compromise requested may be too detailed at such an early stage and deter genuine attempts to deliver the best result for consumers by way of a compromise. In particular, it may duplicate the time and costs of what will already be set out in the considered compromise and notified to all stakeholders in accordance with existing legislation and court practice.

3.4 The extensive list of information that the FCA will expect to receive when a firm is considering a compromise contains some highly confidential information that may prejudice a compromise if it became public knowledge. There needs to be an express provision in the guidance that any confidentiality will be maintained.

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?

3.5 The guidance in many ways simply articulates the FCA's current approach to such compromises. It is perfectly understandable, given the FCA's regulatory remit, to expect firms to provide sufficient information and justification for such a course of action, but we query whether this is not already required as part of the established compromise procedures.

3.6 In practice, and as indicated in the guidance, it will make it very difficult for regulated firms to propose any compromise where consumer redress claims will not be paid in full but where it is envisaged that firms will continue to trade.

3.7 Even where a firm is winding down, the guidance seems to suggest that unless all stakeholders are 'affected' by the compromise (i.e. not just the redress creditors lose out), the FCA may take regulatory action and object to the scheme/RP. This potentially has the effect of treating consumers as a special category of creditors, which is not the case under current insolvency law. It fails to recognise that in formal insolvency cases, any special creditor protections are expressly provided for in the legislation. We understand that proposals to create a special category for consumers have been considered previously, but to date this has not been pursued in any legislation. We would suggest that any special treatment for consumers should be set out in legislation, if that is what the proposed guidance intends to achieve .

3.8 The danger in simply trying to enact such protection through guidance, with the uncertainties this entails, rather than through legislation, means that consumers are simply left to wait for the wind down to run its course, or for formal insolvencies to ensue. There is therefore a danger that, in the FCA seeking to set out its position in the new guidance, distressed entities are inadvertently deterred from seeking such compromises which would otherwise genuinely represent the best possible outcome for consumers.

3.9 The consultation specifies that the FCA's assessment of any given compromise is to be distinct from the court's assessment– it must be the best possible proposal for customers providing the maximum amount of funding so that they receive the greatest proportion of what is owed to them. By contrast, the court is not concerned with whether the proposed scheme/RP is the best scheme, the only fair scheme, or whether it could be improved upon, but rather whether the compromise has been approved by the requisite majority of creditors and is properly informed and acting in accordance with their class interests. The higher threshold imposed in the draft guidance ought to be set out within the legal framework, as it not only creates uncertainty in relation to such claims but may have the effect of deterring regulated entities from proposing any such compromises in the first place, which may not be the preferred route for consumers themselves.

3.10 We would also suggest that the FCA reconsiders its position on 'Letters of non-objection' as this would provide comfort to the directors and IPs when finalising a proposed compromise. In circumstances where the guidance is seeking advanced disclosure of information and details regarding the proposed compromise in advance, the FCA ought to be better informed so as to be able to provide such letters. It would also save time and costs for both parties, where the proponent of the scheme is already in a distressed financial position, and any costs savings would facilitate greater returns to creditors (including consumers).

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?

3.11 While we agree with the factors, we do not follow the rationale for charging a special fee for legal and advisory costs incurred in assessing schemes and RPs. Costs of CVAs are not included, as it is suggested that the FCA's ability to challenge CVAs is enshrined in Financial Services and Markets Act 2000 (FSMA) and therefore within its existing remit. It is difficult to distinguish this from the regulatory authorities' ability to participate in schemes and RPs. Ultimately the court will determine an appropriate costs order for any reasonable participation in such proceedings. Also, it is not clear why the FCA only may challenge a VA in "exceptional circumstances" which seems to be a different hurdle from Schemes and RPs

3.12 Furthermore, clarity on the FCA's Dispute Resolution: Complaints Sourcebook (DISP) and the role of the Financial Ombudsman Service (FOS) in a compromise would be helpful. It is not practical to suggest (para 21) that Firms "must comply with …DISP" at all times. Also we are not sure how a compromise can extinguish a right to raise a complaint (para 16 b i).

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?

3.13 Another consideration would be where there is deliberate and/or serious misconduct such claims in the form of regulatory action should be pursued by the regulator. If the misconduct relates to action or inaction by those seeking to compromise such claims, then the FCA ought to consider such factors as part of its case-by-case approach to any proposed compromise and object if it deems appropriate. Once the compromise of the redress claims has court approval, absent fraud/non-disclosure we do not consider that any compromise itself should be undermined/unwound, but we fully understand that separate regulatory sanctions may be imposed on those responsible for the misconduct.

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?

3.14 Yes.

4. CONCLUSION

4.1 While we have highlighted a number of issues, the proposed guidance is generally welcomed. However, we are disappointed with the lack of detail regarding how the FCA will approach compromises, other than that it will consider each compromise on a case-by-case basis. Furthermore, the proposed guidance appears to suggest that the FCA intends to take an increasingly interventionist approach to compromises for regulated firms.

4.2 Furthermore, the proposed guidance fails to recognise the conflict between the statutory objectives of the FCA and those imposed on directors and IPs. The FCA's statutory objectives are to protect consumers and the integrity of markets, which is aimed at one particular party: the consumer(s), whereas directors (and IPs in an advisory capacity) have a duty to act in the interest of a company's creditors as a whole in a financial distress situation. This conflict places unnecessary tension on directors (and IPs) at a point where time is of the essence in seeking to resolve issues of financial distress. We would encourage the FCA to acknowledge the conflicts in the proposed guidance.

4.3 Finally, we also query whether the proposed guidance should also cover Trust Deeds, a personal insolvency option in Scotland. We note that Trust Deeds are different from the other compromises under discussion in many ways but are generally regarded as the functional equivalent of Individual Voluntary Arrangements (IVAs) in Scotland, which are covered by the guidance. There might be some merit in considering whether it would be appropriate to expand the guidance to include them.

If you would like to virtually meet or if you have any other queries, please contact R3's Head of Technical, Ben Luxford, at ben.luxford@r3.org.uk or on 020 7566 4218.

Yours faithfully

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