Helpline: 020 7066 9870
Email: complaints@fca.gov.uk
Website: www.fca.org.uk/about/governance/complaining-about-us

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28 November 2013

Our Ref: 3302

Dear Mr Thomas

Thank you for your email of 14 November 2013.

We note that we responded to you about this matter in our letter of 6 March 2013 and email of 12 March 2013. However we have liaised with the area of the FCA most closely connected to your complaint in order to provide you with a response to the matters raised. We have provided what we hope will be useful information below.

You raise two points concerning the scope of the review agreed by the FCA and the banks into the sale of Interest Rate Hedging Products (IRHPs) since 2001 ("the IRHP Review"). We have addressed each of these points below.

Legal Definitions

You propose that "*the legal definitions accepted by the FSA to exclude our product from Statutory Protection are wrong. The argument that our product is not covered by MIFID is not based on the facts but on erroneous nomenclature*."

In order to address this element of your argument we have set out below the basis on which the scope of the IRHP review was determined.

The IRHP review covers sales of those IRHPs that are classified as "derivatives" for the purposes of the FCA rules and which were sold separately to a lending arrangement for the purpose of managing interest rate fluctuations (i.e. standalone IRHPs). The FCA position is that standalone IRHPs are Contracts For Difference (CFDs) for the purposes of article 85 of the Regulated Activities Order (RAO). A CFD includes rights under a contract "the purpose of which is to secure a profit or avoid a loss by reference to fluctuations in ... an index or other factor designated for that purpose in the contract". Where interest rate contracts are purchased separately to a loan which a client wishes to hedge, they are a form of CFD as the purpose, from the customer's viewpoint, is to avoid a loss by reference to interest rate fluctuations. Where such terms are included in a loan agreement, it does not have the effect of turning the loan into a contract 'the purpose of which is to obtain a profit or avoid a loss' – the contract remains a contract, the purpose of which is to lend money on specified terms. Sales of such commercial loans are not regulated by the FCA.

We would further note that in a recent judicial review of the IRHP review it was claimed that the exclusion of Tailored Business Loans was irrational. However, in the Permission Decision the Court agreed with the FCA that it did not regulate such products and that it was not irrational for the FCA to limit the exercise of its powers to matters that are within its regulatory ambit.

You have also made a number of references to the scope of the Markets in Financial Instruments Directive (MIFID). In our view the interpretation of Article 85 of the RAO set out above is consistent with the scope of MiFID and in particular the definition of "financial instrument" in article 4(1)(17). The Commission's answer to the question submitted by Arlene McCarthy appears to confirm this, as does Question ID 289 in the Commission's Question and Answers on MiFID (see http://ec.europa.eu/yqol/index.cfm?fuseaction=question.show&questionId=289).

Regulatory intent

You propose that "*the regulations are clear that it is the product's characteristics,* ***not the product's name,*** *which determines its regulatory status. To continue to allow the banks to evade their responsibilities simply by ignoring the overriding importance (in Regulatory terms) of product characteristics is not consistent with the FSA's own interpretations of its own objectives and regulatory intent".*

In considering whether an activity is regulated by the FCA it is necessary to look at the legal structure of the arrangements against the drafting of the RAO. Irrespective of the name given by a provider to a product or activity, if the legal arrangements are such that it falls within the RAO, the FCA's view is that it would amount to a regulated activity.

As set out above, it is the FCA's view that in order to determine whether a contract falls within Article 85 of the RAO it is necessary to look at the purpose of the contract. If the purpose is to lend money on specified terms, then it would not amount to a CFD.

You further propose that the FCA's approach with regards to the IRHP review is contrary to its more "principles based regulatory regime", on the basis that you believe the banks are guilty of many of the same failings in respect of the sale of tailored business loans and fixed rate loans as for standalone IRHPs. You refer in this regard to Principles 6 to 10 of the FCA's principles for business.

However, the regulatory requirements to which you refer apply to firms where they are carrying on regulated activities. To the extent that a firm is not carrying on such activities, it is not open to the FCA to apply those standards.

For these reasons we believe we have acted in accordance with the scope of the UK and EU legislation which regulates financial services and therefore do not consider that your arguments justified.

If you are dissatisfied with the outcome of this investigation, you may refer your complaint to the Complaints Commissioner who may decide to carry out his own investigation. A referral to the Complaints Commissioner should usually be made within three months of the date of this letter, although a referral outside the three months' time limit may, where there are adequate reasons for the delay, still be considered by the Complaints Commissioner. If you decide to contact him, please write to:

Office of the Complaints Commissioner
48-54 Moorgate
London
EC2R 6EJ
Telephone: 020 7562 5530
Email: ComplaintsCommissioner@fscc.gov.uk

Yours sincerely

Emma Wotton
Complaints Investigator
FCA Complaints Team
Corporate Services