Neutral Citation Number: [2025] EWHC 525 (Admin)

Case No: AC-2022-LON-001500

IN THE HIGH COURT OF JUSTICE
KING'S BENCH DIVISION
ADMINISTRATIVE COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 07/03/2025

Before :

MR JUSTICE FREEDMAN

- -

Between :

THE KING

on the application of

THE ALL-PARTY PARLIAMENTARY GROUP ON FAIR BANKING

Claimant

- and –

THE FINANCIAL CONDUCT AUTHORITY

Defendant

- -
- -

Mr Thomas Roe KC and Ms Anna Lintner (instructed by **Hausfeld & Co LLP**) for the **Claimant**
Mr Richard Coleman KC and Mr Christopher Knight (instructed by **Dentons UK and Middle East LLP**) for the **Defendant**

Hearing dates: 10 and 11 December 2024

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Approved Judgment

This judgment was handed down remotely at 2.30pm on Friday 7 March 2025 by circulation to the parties or their representatives by e-mail and by release to the National Archives.

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MR JUSTICE FREEDMAN:

I The nature of the application

1. This application for judicial review arises out of the sale of tens of thousands of Interest Rate Hedging Products alleged to be unsuitable that caused customers losses. The regulator, the Financial Services Authority ("FSA") agreed a redress scheme with various banks ("the Scheme"). The Scheme excluded various customers deemed to be too "sophisticated" in accordance with what has been called the Sophistication Test. Subsequently, the Financial Conduct Authority ("the FCA"), as successor to the FSA, committed to a review of the Scheme including the Sophistication Test. Mr John Swift KC (then QC, who is referred to in this judgment without discourtesy as Mr Swift), a leading authority on competition law and with an acknowledged expertise to report in this case, was appointed as an independent expert (also referred to in this judgment as "the Reviewer") with a view to examining the quality and effectiveness of the supervisory intervention. On 26 November 2021, and amended on 7 February 2022, Mr Swift issued a report on the Lessons Learned Review ("the Review"). The report made a number of recommendations including designing redress schemes to avoid unnecessary complexity, improving consultation with stakeholders and considering using statutory powers to obtain compensation and restitution.

2. On 14 December 2021 the FCA published its response to the Review ("the Response"). In a section of the Response headed 'next steps', the FCA explained that it had concluded that action should not be taken by way of using its powers to require any further redress to be paid to interest rate hedging product customers. The FCA did not agree that the FSA was wrong in limiting the scope of the Scheme to less sophisticated customers within the Private Customer/Retail client class. It decided that it was not appropriate or proportionate to take further action ("the Decision").

3. In this judicial review, the Claimant, an unincorporated association of Parliamentarians now known as the All-Party Parliamentary Group on Fair Banking, challenges that Decision as being unlawful, that is that it fell below the common law standards of reasonableness. It submits that it was an irrational decision to reject the findings of the Review concerning the Sophistication Test and to decide to do nothing further. It also submits that there was procedural unfairness in failing to consult stakeholders who were not consulted prior to announcing its decision about the response to the FCA's Response to the Review.

4. The FCA contends that it did not act irrationally and that there was no duty to consult. The FCA further contends that it is unlikely that the outcome would have been different. On 29 June 2023, permission to proceed by way of judicial review was granted by Fordham J: see [2023] EWHC 1616 (Admin). He summarised why the case was of general importance. He said that *"the case will determine this question: whether a maintained merits disagreement was a legally sufficient reason not to accept a key evaluative conclusion of an independent review. The case will determine this question: how the standards of reasonableness and legally adequate reasons operate in such a context."* As regards the procedural issue, he said that that was of general public importance because it would determine *"whether the authority - anticipating calls for action - could fairly organise the procedural sequence of events so as to exclude the informed opportunity for voices to be heard, in an attempt to persuade, while its mind is ajar"*.

II Legislative framework

5. It is necessary to consider the legislative framework. In the consideration of whether the Defendant acted rationally in the decisions which it took, it is necessary to have regard to its powers and duties drawn in general terms. It exercised discretions pursuant to those powers and duties, but subject to the usual checks of public law.

(i) The Consumer Protection Objective

6. S.1B of the Financial Services and Markets Act 2000 ("FSMA") provides that, in discharging its general functions, the FCA must (so far as is reasonably possible) act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, including the Consumer Protection Objective.

7. The Consumer Protection Objective is now defined in s.1C(1) FSMA (and was until 1 April 2023 defined in s.5 FSMA) as '*securing an appropriate degree of protection for consumers*' . '*Consumer*' has the wide definition given in s.1G FSMA which includes the customers who fell within and outside the Scheme created by the FSA.

8. Pursuant to s.1C(2) FSMA, in considering what degree of protection for consumers may be appropriate, the FCA must have regard to:

> "(a) the differing degrees of risk involved in different kinds of investment or other transaction;
>
> (b) the differing degrees of experience and expertise that different consumers may have;
>
> (c) the needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose;
>
> (d) the general principle that consumers should take responsibility for their decisions;
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> (e) the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question;
>
> (f) the differing expectations that consumers may have in relation to different kinds of investment or other transaction;
>
> …
>
> (h) any information which the scheme operator of the ombudsman scheme has provided to the FCA pursuant to section 232A."

(ii) Regulation of Interest Rate Hedging Products ("IRHPs") by the FCA

9. The sale of IRHPs falls within the FCA's regulatory remit.

10. FSMA confers on the FCA the power to make rules, which are published in the Handbook. The Handbook is divided into modules and contains, among other things, High-Level Standards, which include overarching requirements such as the Principles for Businesses (the 'Principles') that outline fundamental obligations of all regulated firms, and Business Standards, which outline the day-to-day conduct rules that apply to all regulated firms.

11. The key Principles relevant to the sale of IRHPs to Private Customers/Retail Clients (including the excluded customers) are Principles 6 to 9:

> "6. Customers' interests
>
> A firm must pay due regard to the interests of its customers and treat them fairly.
>
> 7. Communications with clients
>
> A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
>
> 8. Conflicts of interest
>
> A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
>
> 9. Customers: relationships of trust
>
> A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment."

12. The Business Standards module of the Handbook contains a section setting out the COB rules. The original rules were updated from time to time until 31 October 2007, when they were replaced with the COBS rules. The COB/COBS rules set out regulatory standards with which banks were required to comply when selling IRHPs to Private Customers / Retail Clients, including the excluded customers. The COB/COBS rules are delegated legislation which set out the determination of the FSA/FCA as to the levels of protection that are appropriate for different categories of persons receiving financial services.

(iii) Regulatory classification of customers

13. The COB and later COBS rules, drawn up by the FSA and later the FCA, expressly define different categories of customers, who are given different levels of regulatory protection. The COB/COBS rules prescribe the obligations owed by firms (in this case the banks) in respect of different customers depending on the customers' regulatory classification. The effect of this is that banks owe the same regulatory duties in respect of all customers within the same regulatory class.

14. Both COB and COBS set out three categories of customers. First, there was the most protected degree of regulatory protection afforded to private customers (COB classification) or retail clients (COBS classification) ("Private Customers/Retail Clients"). Second, there was a less protected degree of regulatory protection afforded to intermediate customers (COB classification) or professional clients (COBS classification). Third, there was the least protected degree of regulatory protection afforded to market counterparties (COB classification) or eligible counterparties (COBS classification). Certain types of customers were automatically designated in the second category where they met certain quantitative thresholds.

(iv) FCA's regulatory powers in relation to IRHPs mis-selling

15. The statutory powers to respond to mis-selling included:

(i) section 404 consumer redress schemes: the FCA may by rules require relevant firms including persons authorised by the FCA to establish a consumer redress scheme. This is where it appears to the FCA that there may have been a widespread or regular failure by those firms to comply with requirements applicable to the carrying on by them of any activity as a result of which consumers have suffered loss or damage. The onus is on the firm to review sales, identify any breaches and provide appropriate redress in accordance with the rules made by the FCA for the consumer redress Scheme. There were limitations in that the scheme was not actionable by many of the potential victims of the IRHPs during the relevant period. A scheme could not be imposed where the limitation periods for the schemes had expired and, in any event, it was time consuming to exercise such statutory powers.

(ii) section 382 (restitution orders): the FCA may apply to the court for a restitution order if it is satisfied that a person had contravened a relevant requirement occasioning loss to one or more persons. This requires the FCA to establish the breaches and quantify the loss. The power is subject to the six-year limitation period for actions for sums recoverable by statute (s.9 of the Limitation Act 1980).

(iii) section 384 (power of the FCA to require restitution): in the case of authorised firms, the FCA may itself make an order in essentially the same circumstances as apply to section 382 but without a formal limitation period. However, the lapse of time and delay since the grounds for exercising the relevant power first arose may be relevant to whether in the particular circumstances the FCA may lawfully exercise it and if so whether it should do so.

(iv) section 55L, since 1 April 2013 (and before that, a similar power of the FSA existed): the FCA may impose a requirement on an authorised person if it is desirable to exercise the power in order to advance one or more of the FCA's operational objectives. That could include a requirement on a particular firm to take remedial action in respect of past conduct or to establish and operate a redress scheme similar to a section 404 scheme. Here too there is no limitation period, but the discretionary matters set out in (iii) relating to lapse of time and delay would apply.

16. The Defendant draws attention to the following:

(i) whilst the regulatory scheme imposes the same duties to all customers in the same regulatory class, what has to be done to discharge the duties would depend on the particular circumstances of the sale and the customer (including the customer's relevant knowledge and experience).

(ii) breaches of the COB and COBS rules are actionable by individual consumers, but not by any other person acting in the course of their business. Most of the potential victims of mis-selling of IRHPs during the relevant period were companies or other types of business acting in the course of business who had no right of action to enforce these rules.

(iii) whilst the sale standards applied equally to all Private Customers/Retail Clients, the FCA had a discretion to determine its regulatory priorities including the particular areas of consumer harm that it wished to target. At all material times, in considering what degree of protection may be appropriate, the FCA was entitled to have regard to *"the differing degrees of experience and expertise that different consumers may have"* and *"the general principle that consumers should take responsibility for their decisions"*.

III Background

(a) The discovery of mis-selling

17. In 2010, the possibility of mis-selling of IRHPs was first brought to the attention of the FSA. These products were often offered on the basis that they would protect the SMEs' loans with the banks from interest rate changes – therefore known as 'interest rate hedging products' ("IRHPs"). In the next two years up to March 2012, it is apparent from the report of Mr Swift that there was disparate information from complaints made about the sales of IRHPs, from FSA employees and from a better understanding of the nature of products sold by banks, that there were a large number of complaints and concerns about the alleged mis-selling of IRHPs by banks. Very few of the complaints in the early stage were upheld. There were identified in particular failings in the way some banks had sold stand-alone collar, swap, and cap derivatives to small and medium sized enterprises ("SMEs").

18. The backdrop to the complaints arose when interest rates fell to historically low rates in the wake of the financial crisis. Many IRHPs in effect locked customers into paying interest on their loans above market rates, and liable to pay very significant "break costs" if they wished to terminate the product before its term had expired. Small businesses in particular were suffering financial distress as a result of having to meet substantial payments required under the IRHPs. The FSA had not conducted formal investigations to establish the validity or scale of complaints of mis-selling.

19. Such was the number of complaints that by March 2012, there was increasing public and political pressure on the FSA to intervene. In March 2012, the Daily Telegraph and the Sunday Telegraph published a series of articles detailing alleged incidents of IRHP mis-selling and profiling affected businesses. There was considerable public pressure to take steps which would provide the quickest possible form of practical benefit to the widest number of affected customers.

20. There was a time pressure driven by media coverage, ongoing political pressure (the formation of the All-Party Parliamentary Group of more than 40 MPs), and the wish to avoid delays which affected the PPI mis-selling investigation. There appeared to be many small businesses in distress who required an urgent response. This caused the FSA to review whether there had been mis-selling of products that were designed to allow small businesses borrowing funds to hedge against interest rate fluctuations. By the end of April 2012, the FSA was aware of possible mis-selling of certain IRHPs sold since December 2001 by certain banks to small and medium-sized business enterprises.

21. There was consideration by the FSA as to its powers identified above including a consumer redress scheme under section 404 FSMA, but a difficulty was identified of not having the sufficiently detailed evidence required. There was the possibility of enforcement action, but here too there were difficulties about the evidential hurdle and the expensive skilled resource required. It was also a slow route to redress.

(b) The voluntary redress scheme

22. It was this which led to the FSA in June 2012 encouraging the banks to participate in a voluntary redress scheme in relation to IRHPs instead of lengthy and uncertain statutory regulatory processes: see Steward witness statement paras. 28-31 and Swift Report at Chapter 3. The FSA opted for a voluntary redress scheme. This was with the following banks, namely HSBC, Lloyds, Barclays, RBS, AIB, Clydesdale, Co-op Bank, Santander and Bank of Ireland (collectively referred to as "the Redress Banks"). Key attractions about such a scheme included speed of redress, avoiding limitation points and avoiding the complications in respect of the calculation of damages in a court. Voluntary redress did not depend upon being able to prove legally actionable claims, which might be difficult whether due to insufficient evidence or legal barriers. Thus far, claims which had been brought and defended had largely been resolved in favour of banks.

23. The disadvantages of using available statutory powers included that (a) many businesses were in distress and could not await a more forensic process required in any exercise of the powers of the FSA, (b) without further investigations, the FSA had only limited proof of actual mis-selling which would involve time and resources to gather

the evidence and to establish which cases could be pursued, and (c) there were likely to be customers who did not have actionable claims.

24. By 19 May 2012, the FSA was contemplating the possibility of seeking voluntary redress for all structured collars and reviews of other IRHPs limited to *"sales to more vulnerable categories of consumers such as schools and charities"* (Swift Report at Chapter 3 paras. 35-37).

25. By 31 May 2012, the FSA decided to focus on reaching a voluntary agreement with banks in order to provide redress for customers. A paper before the Conduct Business Unite Supervision and Risk Committee ("the CSRC") said "*we believe we have evidence to suggest poor selling practices took place. However, we do not yet believe we have sufficient evidence to exercise our statutory powers to require firms to pay redress, due to the sample of files not being "statistically significant*". The Committee "*stressed the need to resolve this issue quickly as several SMEs were already in arrears, further increasing the potential detriment*".

(c) The differentiation between Private Customers/Retail Clients

26. The FSA's focus on the impact of mis-selling on less sophisticated customers in particular can be traced back to the early stages of the formulation of its policy, prior to the commencement of the discussions with the four first-tier banks on 9 June 2012. At that stage, the FSA in that draft redress agreement sought to make the Scheme available to all Private Customer/Retail Clients. However, as Mr Swift found, three of the four first-tier banks proposed that the Sophistication Test (as then formulated) apply to all IRHPs (Swift Report at Chapter 3 para. 69). There was concern within the FSA that at least two of the first-tier banks (HSBC and RBS) might not agree to the voluntary agreement (Swift Report Chapter 3 para. 74). The first draft of the redress scheme that the FSA sent to the banks on 25 June 2012 identified "customer sophistication" as a factor that could contribute to poor outcomes for customers.

27. In about June 2012, the FSA proceeded with establishing an initial agreement with the first-tier banks which would set out the terms of an initial voluntary redress scheme ("the Initial Agreement"). This would have the supervisory assistance of a section 166 skilled person. Upon the Initial Agreement being executed, the banks and the FSA would commence a pilot scheme through which a sample of IRHP sales for each bank would be reviewed in accordance with the Initial Agreement.

28. In the course of negotiations, the banks resisted attempts for compensation for all kinds of Private Customers/Retail Clients and sought to distinguish between those expected to look after themselves and those more vulnerable to mis-selling.

29. The Scheme involved the FSA making concessions by differentiating between Private Customers/Retail Clients who were less financially sophisticated than others in terms of their knowledge and experience of financial products, their financial resources and their ability to source independent professional advice.

(d) The Sophistication Test

30. The criteria for the Sophistication Test that were eventually included in the Initial Agreement (derived from ss.382 and 477 of the Companies Act 2006 and as suggested by the banks) were as follows:

> "'Sophisticated Customer Criteria' means:
>
> In the financial year during which the sale was concluded, a Customer who met at least two of the following:
>
> (i) a turnover of more that £6.5 million;
>
> (ii) a balance sheet total of more than £3.26 million; or
>
> (iii) more than 50 employees;" (the 'Companies Act Test')
>
> *or*
>
> (iv) The Firm (that is, the Bank) is able to demonstrate that, at the time of the sale, the Customer had the necessary experience and knowledge to understand the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved." (the 'Additional Test')."

31. A particular complaint of the Claimant is that the FSA capitulated in negotiation of the definition of the Sophistication Test. The original proposal made by the FSA on or around 11 June 2012 did not involve any numerical eligibility criteria for identifying customers to be offered redress or review. The FSA proposed that all Private Customers/Retail Clients who had been sold structured collars should receive proactive redress unless the banks could positively evidence on a case-by-case basis that the client truly understood the risks involved and that a business review would review all other Private Customers/Retail Clients who had been sold less complex IRHPs.

32. The Sophistication Test to subdivide Private Customers/Retail Clients on the basis of numerical criteria was introduced only following representations made by the banks for the purpose of identifying Private Customers/Retail Clients who had been sold structured collars but who would not be entitled to automatic redress. The first iteration of the Sophistication Test was formulated with reference to the Companies Act 2006 small companies criteria. Following a meeting of the CSRC on 26 June 2012, and discussions within the FSA that evening and on the morning 27 June 2012, the FSA decided in response to communications from the banks and HM Treasury that the Sophistication Test would (i) apply to all Private Customers/Retail Clients, regardless of what type of product they had been sold; (ii) exclude from the Scheme customers deemed to be sophisticated; and (iii) include, in addition to the Companies Act Test, a subjective Additional Test allowing the banks to designate customers as 'sophisticated' irrespective of whether they satisfied the Companies Act Test.

33. This has provided a focus within which to consider the finding of the Review that the FSA agreed to the Sophistication Test with only "*the briefest possible consideration*" (Swift Report at Chapter 7 Term of Reference 2 para. 13). The concern of the Claimant is that the FSA conceded this without any or any reasonable attempt to argue the contrary. The Defendant does not accept this. It says that its concern at the time was that the only offer on the table provided the possibility of redress for many of the more vulnerable customers who were facing financial melt-down. In those circumstances, there was a concern, which it says was a reasonably held concern, that not to take the offer (sometimes referred to as 'the bird in the hand') might lead to a significantly worse outcome for those vulnerable customers.

34. It is apparent from the documents and from the Swift Report that the FSA obtained what the Defendant says were significant concessions from the Redress Banks in respect of eligible complaints. In particular, the Scheme involved (i) disregard of limitation; (ii) in effect an irrebuttable presumption that all Category A IRHPs (structured collars) had been mis-sold; (iii) the application of sales standards going beyond the less-specific COB/COBS rules; (iv) detailed presumptions to be applied for the purposes of determining redress (e.g. the rebuttable presumption that a customer would not have purchased a product with break costs greater than 7.5% of the notional value of the IRHP); and (v) an independent oversight function at the expense of the Redress Banks through the role of the skilled persons appointed under FSMA s.166. Two elements of the Scheme benefited all Private Customers/Retail Clients: the Redress Banks agreed to stop marketing structured collars, and each Bank's CEO undertook that all complainants would be treated fairly, supported by obligations in the agreement that the Bank notify excluded customers of their right to complain (see clauses 3.2 and 3.8.1). The Redress Banks incurred costs of c.£920 million operating the Scheme: see para. 4.26 of the Board Paper (defined below at para.57(iv)).

35. As regards undertakings provided by the Redress Banks, these included:

(i) agreeing to provide redress to those customers with the most complex type of IRHPs, namely structured 'collars' where there would not be an analysis of whether the bank actually contravened any of the FCA's regulatory requirements (Category A products);

(ii) for category B products (all products other than Category A and Category C products), the Redress Banks agreed to review each sale (made since 1 December 2001 irrespective of limitation) in detail unless the customer opted out of the review and to provide redress for breaches of the relevant regulatory requirements. This was even though the Redress Banks may have had no legal liability for such breaches in relation to many small business customers e.g. where they are not private persons for the purposes of section 138D FSMA;

(iii) the Redress Banks also agreed to review Category C products (caps) on the same basis if the customer opted in to the scheme, following communication from the relevant bank;

(iv) in most circumstances, the Redress Banks agreed not to foreclose on or adversely vary existing lending facilities without prior notice or obtaining prior consent.

(e) Changes to the Sophistication Test

36. There was then a pilot scheme during the period between August 2012 and January 2013. This included a review by the FSA of 173 sales to non-sophisticated customers and a finding that over 90% did not comply with one or more of the FSA's regulatory requirements, and a further 133 sales were reviewed to check the application of the Sophistication Test. The banks also concluded their pilot reviews during November 2012.

37. There then occurred two further major changes to the Sophistication Test, namely (i) the numerical limits were to be applied to groups of companies rather than to individual customers, and (ii) all customers would be excluded whose aggregate notional value was over £10 million including those who had been deemed non-sophisticated by the Companies Act Test.

38. These changes followed concerns expressed by HM Treasury and banks in November 2012 to January 2013. Considerable pressure was brought to bear on the FSA especially in January 2013 by various banks and HM Treasury reflecting concerns of banks, especially government owned banks, and in a different direction, from the small business lobby trying to get the best outcome for them. This was described as "a narrow tight rope" in internal emails.

39. The Defendant stated in particular by Mr Clive Adamson (then the FSA's Director of Supervision) that the FSA was an independent regulator not a political body and as such was focused on achieving fair and reasonable outcomes for consumers. The Defendant stated that it found it inappropriate for HM Treasury to intervene in this matter. The engagement with HM Treasury and the resistance of the FSA were set out in the Review at Chapter 4 paras. 116 – 124.

40. On 29 January 2012, in an email from Ms Julia Dunn, Head of Retail Banking at the CSRC of the FSA, with regard to a call with Ms Gwyneth Nurse of HM Treasury, it was stated:

> "… We confirmed again that whilst we had moved substantially on sophistication to ensure that the right customers were involved in this exercise, we felt strongly that we should maintain our position on redress. Looking at this in the round, this presented a balanced approach which ensured fair and reasonable outcomes for the small and unsophisticated customers who had been mis-sold and was fair to banks."

41. The Claimant's case is to the effect that there was no testing to evaluate the effect of these changes on the numbers who would be excluded from the Scheme. As noted in greater detail below, at the first stage of the assessment, 10,577 sales of IRHPs out of a total of 30,784 IRHPs were excluded from the Scheme on the basis of the Sophistication Test, representing about 34.3% of the review population.

IV The Review

42. In June 2015, the FCA committed to a review of its supervisory intervention on IRHPs. The Review was commissioned by the FCA following a recommendation by the Treasury Select Committee to perform a lessons learned exercise with independent oversight. On 25 October 2018, at an FCA board meeting, the board agreed that it would commission an external reviewer to carry out an independent lessons learned review of the supervisory intervention of IRHPs. It approved the creation of a committee, that is the Board Sub-Committee, to oversee the conduct of the Review. The Review was announced in June 2019 to be conducted by Mr Swift. The Review was to be a non-statutory independent review of the supervisory intervention on IRHPs including an assessment of the actions of the FSA in relation to the Scheme. The decision to confine the IRHP Redress Scheme to non-sophisticated customers was particularly contentious.

43. The Review was intended to examine the *"quality and effectiveness of the supervisory intervention."* It covered the period between 1 March 2012 and 31 December 2018. The FCA stated that the purpose of the Review was to consider what lessons could be learned from its intervention, not to reopen the Scheme or individual cases. The most germane of the four topics covered by the Review's Terms of Reference was whether the eligibility criteria for the Scheme were appropriate, and the judicial review challenge is principally concerned with the impact of the Review's findings and conclusions as regards this topic and the decision taken in the light of those findings and conclusions.

44. The standard adopted in the Review was that of *"an experienced, skilled and efficient regulator acting in accordance with its statutory duties and taking full account of the evidence available to it at the time of the decisions"* (Swift Report at Chapter 1 para. 8). The Review expressly precluded using the benefit of hindsight in making evaluations.

45. The FCA made representations which *"involved seeking to persuade the Independent Reviewer that the eligibility criteria, and the sophistication test in particular, had been an appropriate and reasonable response, adopting a (familiar) type of 'proxy', in the context and circumstances."*

46. The Review concluded that reaching a voluntary agreement with the banks was an appropriate way for the FSA to respond to its concerns about the sale of IRHPs to those customers who are eligible under the terms of the Scheme. However, in respect of the excluded customers, the Review concluded that the Scheme was an inadequate response and that the FCA was wrong to confine the Scheme to a subset of Private Customers/Retail Clients designated as non-sophisticated.

47. The Re-amended Statement of Facts and Grounds stated at (para. 67) as follows:

> "The Review explained that all Private Customers / Retail Clients who fell within the remit of the FCA had the same rights and were owed the same obligations by the Banks, and the FCA had the same corresponding duty to protect those rights. While the FCA may have been able to treat some customers more advantageously than others, the Review concluded that the FCA's decision to restrict the scope of the whole Scheme to

> 'non sophisticated' customers was made '*after only the briefest consideration*' and without adequate consultation (Review: page 32, paras. 42-43). It found no evidence of any impact analysis being conducted nor evidence as to how the Sophistication Test was appropriate." (Review page 322 para. 17)

48. The 'main conclusion' was that the FSA had been wrong to confine eligibility to a subset of Private Customers/Retail Clients which it designated as "non-sophisticated", which avoided, without adequate justification, the FSA's *"wider responsibilities to secure redress for all Private Customer/Retail Clients who had been mis-sold IRHPs and to whom banks owed the same regulatory obligations as they owed to non-sophisticated customers"* falling within the Scheme's eligibility criteria (Review page 316 para. 1). The Review concluded that *'all Private Customers/Retail Clients were entitled to equal regulatory protection. There was no proper basis for differential treatment of different customers within that category'* (Review page 317 para. 4).

49. In Chapter 7 paras. 4-6 and 10 where Mr Swift considered the scope of the Scheme, he concluded as follows:

> "4.… all Private Customers/Retail Clients were entitled to equal regulatory protection. There was no proper basis for differential treatment of different customers within that category.
>
> 5. As other regulatory authorities, the FCA may use its judgement and discretion where appropriate. It is not necessarily inappropriate for the FSA/FCA to treat persons within the same client class/category differently. These categories do not operate as a straitjacket allowing no discretion on the part of the regulator, under which intervention for one must mean precisely the same kind of intervention for all. However, persons falling within the same category all have rights, which the regulator has a corresponding duty to protect. The FSA/FCA should not discriminate between them without an adequate and well evidenced objective justification for different treatment.
>
> 6. Where the FCA considers that there is an objective justification for limiting the scope of redress only to certain persons within a defined category, there should be proper consultation with stakeholders before any such action is taken. In that context, the FCA should explain its intended approach and the reasons for it (for instance that that sub-group alone has suffered detriment and/or that the wider scope would be disproportionate) and allow affected persons and other stakeholders a proper opportunity to make representations in respect to the proposed restriction of scope. None of this was done in relation to the exclusion of 'sophisticated' customers from the scope of the Scheme.

> 10.… it does not follow, however, that the FSA or the FCA was justified in further differentiating, by reference to the consumer protection objective or at all, as between consumers within the same category without adequate objective justification and without prior proper consultation with stakeholders. I have also seen no contemporaneous evidence to suggest that the FSA analysed or justified the concessions it made from time to time by reference to the consumer protection objective."

50. In relation to the specific limbs of the Sophistication Test, the Review found that:

(a) There was no clear evidence as to why the Companies Act Test had been identified as appropriate and there was no adequate explanation for why the customer's size meant it should not qualify for redress. There was no clear evidence of any impact analysis having been undertaken, no examination of whether the tests to be applied were the right ones, and the "*blunt tool*" appeared to have been adopted at the suggestion of one of the banks (Review page 322 para. 17].

(b) The Additional Test was not appropriate, namely for banks to assess whether a customer had sufficient knowledge and experience to understand the IRHP contract. It did not align with the FSA's regulatory remit, because some regulations could be breached in relation to an IRHP sale even if the customer was capable of understanding the contract [Review page 322 para. 18].

(c) The changes to the Sophistication Test following the Pilot Scheme "were all agreed 'behind closed doors'(Review page 326 para. 28), without consultation or explanation" and "(The FCA) sought to ensure that only the 'right' subset of Private Customers/Retail Clients would be eligible for the Scheme – without ever clearly articulating what that subset should be. Aided by this lack of specificity, the banks succeeded in getting the FSA to make several substantial concessions on the scope of the Sophisticated Customer Criteria. The position eventually arrived at – a mix of criteria of considerable complexity, as set out in the Supplemental Agreement – reflected the banks' very considerable success in further limiting their financial exposure to redress for Private Customers and Retail Clients" (Review page 327 para. 29).

(d) The Companies Act Group Test *"meant that, in effect, the FSA assumed knowledge and experience of IRHPs as a result of the group structure, even if none existed at the level of the subsidiary that had purchased the relevant IRHP"* (Review page 328 para. 31).

(e) The £10 million notional test threshold *"appears to have been an essentially arbitrary figure again with minimal underpinning analysis or impact assessment, albeit still significantly higher than the threshold suggested by the banks."*([Review page 329 para. 32).

(f) The final version of the Sophistication Test was an *"untested, unsampled mix of criteria so complex they had to be set out in a diagram resembling an intricate ancestry chart"* (Review page 332 para. 42).

51. The key recommendations made in the Review included that *"The FCA should aim to ensure that persons within the same category are treated consistently: where rules exist for the protection of all within a defined class, regulatory intervention should not be restricted to benefit only a subset of that class unless there is an objective justification founded on strong evidence and tested through consultation."* (Recommendation A2) .

52. The Review stated:

> "It was never clear, nor obvious, why customers who fell on the wrong side of the quantitative criteria (whether as set out in the Initial Agreement or as amended subsequently) should be excluded from the Scheme in the first place. The FSA appears to have proceeded on an impressionistic view that certain kinds of Private Customers/Retail Clients were deserving of regulatory protection, whereas others were not, without ever expressly articulating or testing that approach. On that basis, it adopted and varied the eligibility criteria (often at the instigation of the banks), with only a vague understanding of the real-world impact these changes would have on businesses that had been mis-sold IRHPs" (Review p.332 para. 41).

53. By contrast, there was no provision whereby customers could prove that despite the Sophistication Test, they did not in fact have sufficient knowledge and experience to understand the IRHP contract. *"The built-in asymmetry gave the banks 'two bites of the cherry'; whereas customers faced failing either the quantitative or qualitative test, without any adequate means of challenge."* (Review p.322 para. 41)

54. The Review concluded in relation to the Sophistication Test (the first draft report was provided to the FCA on 8 February 2021) that it was:

> "...clear that the FSA should never have agreed to limit eligibility for the Scheme, without adequate justification and consultation. Concluding the Initial Agreement on this basis (i.e. limiting eligibility within the category without such justification/consultation) was a serious regulatory error. This was exacerbated by the speed with which the relevant decisions were taken, the absence of any proportionality assessment weighing likely benefits and detriments, the lack of any meaningful involvement by the Board, and the failure to pause for proper consultation, formal or informal, with stakeholders." (Review p.324 para. 21).

V The Defendant's account of the Scheme

55. The Defendant regarded the voluntary Redress Scheme as a better means of securing an appropriate degree of protection for consumers than seeking to use the available statutory powers for the following reasons in summary.

(i) There was real urgency: as noted in the Swift Report at Chapter 3 para. 28, the FSA was conscious of the need to provide prompt assistance to small businesses in distress. There were consumers who were going bankrupt because of payments required to be paid under the IRHPs. This gave rise to acute and mounting financial difficulties for customers directly affected and due also to challenging economic circumstances during the global financial crisis. There was no time for many businesses to await a more forensic process which would be required in any exercise of statutory powers. A longer process would enable the FSA to interview employees at firms affected and to have inspected and analysed numerous sales files.

(ii) Whilst by 25 April 2012 there was prima facie evidence of inappropriate or unsuitable products, there was no evidence of how widespread the breaches were. The ESRC (the Executive Supervision and Risk Committee) found that at that time that the picture was not yet sufficiently clear and therefore proposed to undertake further work in order to make more detail preliminary findings and options for regulatory intervention.

(iii) There was consideration of the advantages and disadvantages of a voluntary industry wide scheme and the use of the FSA's statutory powers. In June 2012, the FSA sought to ensure that customers who had suffered or been exposed to financial detriment as a result of being mis-sold IRHPs should be swiftly and appropriately compensated. In the circumstances, the FSA found voluntary agreements to be the preferable approach, as it considered them likely to lead to fair and faster redress than consumers might otherwise receive, to be legally enforceable and robust, and not to place unsustainable burdens on its resources given its other priorities and commitments: see Chapter 7 of the Swift Report paras. 20 – 21 on pages 304-305.

(iv) As was recognised in the Swift Report at Chapter 8 para. 25, the FSA was aware of the various options available to it before it committed itself to the agreement and reasonably evaluated the relative advantages and disadvantages of these options. Mr Swift stated:

> "in my view, it was reasonable for the FSA to aim for a voluntary agreement with the first tier banks, rather than using any of its statutory powers. I am not convinced that delaying entering into the initial agreement in order to carry out further investigations pursuant to the FSA's powers under section 166 FSMA would have led to a preferable outcome. In principle, a voluntary agreement was a reasonable means by which to address concerns about the sale of IRHPs and, for the reasons explained above, was arguably preferable to the alternatives."

(v) Mr Swift (Chapter 1 para. 30, and Chapter 7 para. 23 on page 305) found that the voluntary agreements were an appropriate way to address the FSA's

concerns about the sale of IRHPs to those eligible under the Scheme. By locking the banks into a review by reference to an agreed and rigorous set of sales standards, the voluntary redress scheme was a "bird in the hand" which meant that eligible customers gained an advantage compared to the use of statutory powers with less certain and slower outcomes. The outcome of the exercise of statutory powers is never guaranteed and there is always the risk of losing if challenged or having the parameters of any redress scheme narrowed. The negotiation of a voluntary agreement also allowed the FSA greater scope in ensuring redress on the basis of the Principles for Businesses as well as the COB/COBS rules, which may otherwise have entailed lengthy and uncertain legal disputes. The use of a voluntary agreement allowed the FSA to obtain redress in relation to sales going back as far as 2001, avoiding limitation issues.

(vi) The Scheme delivered fair outcomes for those within its scope. The outcomes were likely to be preferable to that which would have been obtained through alternative options: see Swift Report (Chapter 7 page 364 paras. 29(a) and 30(a)).

56. At the heart of the criticisms of Mr Swift was his view that excluding customers from the scope of the Scheme was based on inappropriate concessions and without proper justification. It is accepted that there was opposition from first-tier banks as to the scope of the voluntary scheme and that there were intensive negotiations between the FSA and the banks. As is apparent from the above criticisms, Mr Swift fundamentally disagreed with the way in which the FSA entered into the agreements, excluding a large number of customers from the Scheme without proper impact assessments or objective justification for what was done.

57. The FCA considered draft criticisms of the FSA's conduct from Mr Swift. The nature of that consideration and the representations which it made have been set out in detailed evidence by the FCA. Without giving an exhaustive summary of the evidence, it has the following features.

(i) Mr Steward, who was the FCA's head of enforcement and market oversight, led a team which considered the appropriateness of the Scheme having regard to the criticisms of Mr Swift. He reported to the Board Sub-Committee which closely monitored the Review (which included the FCA chair and two non-executive directors), the Project Board (which was an internal working group considering issues of strategy in relation to the Review, consisting of 5 or 6 representatives chaired by Mr Steward) and the Risk and Compliance Oversight division (which liaised on the day-to-day conduct of the Review). Subject matter experts and persons who worked for the FSA in 2012/2013 were asked to consider extracts from the first draft report relevant to their areas of knowledge and expertise and to comment on areas for representations.

(ii) Representations were submitted on 30 March 2021 and a further set on 2 July 2021, and a further set on 11 August 2021. During the drafting process, there was input and direction from the Project Board and the Board Sub-Committee. Mr Steward set out in detail how the first representations came about (paras. 106-111). Likewise, he set out the same about the second representations

(paras. 120-121). The Defendant stated that it was reasonable for the FSA to aim for a voluntary agreement, rather than using statutory powers, and in doing so creating a "bird in the hand" advantage. There was no means of knowing what would have happened if the FSA had refused to restrict eligibility to non-sophisticated customers. In response to Mr Swift's professional position that there should have been prior consultation, the FCA noted that consultation would not be appropriate in all cases, in particular not where there was a need to act speedily.

(iii) In a witness statement of Mr Geale, the director responsible for the supervision of retail banking, he set out how he led the FCA's work relating to whether in the light of the Review, action should be taken against the Redress Banks for customers outside the Scheme. There were two broad lines of inquiry, namely (a) the potential legal power available and possible consequences, requiring the use of statutory powers, and (b) an understanding of how excluded customers had been treated by the Redress Banks. The large amount of work done especially between June 2021 and September 2021 is set out in detail at paras. 22 - 49 of Mr Geale's statement.

(iv) There is further evidence from Mr Lloyd, the senior independent director on the Board and a non-executive member since April 2013 and from Mr Watts, a technical specialist who was involved in the further redress question and in putting together of the board paper for the meeting of 30 September 2021 ("the Board Paper"). This decision is at the heart of the judicial review.

58. In its representations to the Review, the FCA submitted that whilst the ideal redress scheme would have included all customers who had suffered loss as a result of being miss-sold IRHPs, *"achieving the outcomes... through a voluntary agreement necessarily involved some trade-offs"*. Overall, the FCA considered that *"in the context of a tough negotiation in a short time, significant pushback from some of the banks and with a relatively weak bargaining position, the FSA achieved a very substantial result."*: see FCA representations para. 1.4 and 1.5 referred to in Mr Swift's report at Chapter 7 Terms of Reference 2 para. 8 (page 318).

59. The Defendant's response to the Reviews is that whilst it does not reject as irrational Mr Swift's criticisms, it says that there is a reasonably held disagreement between Mr Swift's findings and recommendations in this regard and those of the Defendant. Whilst the Defendant acknowledges that its record keeping was not as desired, such that its position is not well evidenced by contemporaneous documents, it is still able to respond. There are relevant documents referred to in the Swift Report by reference to the events at the time of the acceptance of the Sophistication Test by the FSA including especially in June 2012. There were representations made to Mr Swift, and the existence of significant contemporaneous documentary evidence is such that it is possible to ascertain the way in which the events occurred. Thus, it is possible even this far after the events in question to understand the chronology of what occurred in the run up to the Agreement, and much of it appears in the Swift Report.

60. The fundamental point is that the Defendant had to make an assessment with the limited evidence it had as to the scale of the mis-selling to negotiate a voluntary agreement or

to go for statutory remedies. There was nothing contended to be wrong about that until the banks insisted on the Sophistication Test. What then drove the Defendant to be prepared to enter into an agreement which made a distinction of sophistication among Private Customers/Retail Clients?

61. The Defendant took into account the following factors, namely:

(i) the factors which it had before the introduction of the Sophistication Test. This included especially that the negotiations with the banks and the concessions were in order to achieve swift redress for those most in need;

(ii) the distinction between those who were more likely as against those who were less likely to have been able to understand the risk of the IRHP was insisted upon by at least some of the banks. In these circumstances, the Defendant evaluated that it was better to make such a distinction than to walk away from a voluntary scheme completely.

(iii) the Defendant had a reasonably held belief that some customers were less sophisticated than others in terms of knowledge and experience of financial products, resources and access to professional advice;

(iv) the belief that whilst the test was imprecise or even blunt, there was some correlation between size and vulnerability, and that the smaller the entity, the more vulnerable and the less able to obtain advice about financial products it might be;

(v) the Defendant had concerns about the impact of such a test on customers who might be vulnerable despite their size, but had to do a balancing act between standing up for the principle of not making any distinction within the group of Private Customers/Retail Clients on the one hand and protecting the most vulnerable or a large part of them by making a quantitative distinction;

(vi) the Defendant took comfort from such a quantitative distinction being made in other contexts e.g. the Companies Acts, Ombudsman schemes, legislative protections for consumers. There was nothing wrong in principle about choosing to prioritise certain customers over others within the same class provided that it was rational to do so.

(vii) the Defendant believed that rights requiring proof through a statutory process would be more limited in that for many customers (a) there was only limited proof of actual mis-selling such that any attempt to exercise statutory powers would take time and resources, and (b) there would not be actionable claims or the scope of the claims would be substantially less than under the voluntary schemes (as regards the time periods of the sales or the customers included or the failings to be addressed);

(viii) there were undertakings provided by the Redress Banks to handle complaints fairly and in accordance with their handling procedures. Claims could be brought by excluded customers if they had actionable claims although two claims already brought had been successfully defended in court.

VI The performance of the Scheme in accordance with the agreements

62. The reviews were substantially carried out by the end of 2016. The Redress Banks paid about £2.2 billion of redress to customers in respect of 20,206 sales. It is estimated that the Redress Banks incurred costs of about £920 million in carrying out the exercise.

63. At the first stage of the assessment, 10,577 sales of IRHPs were excluded from the Scheme on the basis of the Sophistication Test, representing about 34.33% of the review population. 291 customers were excluded on the basis of the Redress Banks' assessment of their customers' sophistication. The FCA estimated that between 11% and 33% of IRHPs sold to the Sophisticated Customers in the period December 2001 to 2011 may have been mis-sold with potential uncompensated losses of anywhere between £200 million and £3 billion.

64. The FCA's analysis of the information which it had obtained about complaint outcomes for the excluded customers was contained in Annex 3 to the Board Paper of 30 September 2021. This showed that only 12% to 15% of the excluded customers had made complaints to the Redress Banks (a total of 668 complaints). The average rate of complaints upheld was 11%. The cash redress and other benefits paid totalled £20 million, comprising an average of £139,000 redress and £179,000 in other benefits, being slightly larger per claim than for upheld non-sophisticated cases in the Scheme.

65. The banks succeeded in 12 out of 14 cases that went to judgment. In particular on 21 December 2012, the High Court handed down judgment in *John Green and Paul Rowley v Royal Bank of Scotland PLC* [2012] EWHC 3661 (QB) dismissing a claim and finding that RBS had made adequate disclosure regarding break costs. The banks sought to say that this was an important ruling, but the FSA obtained advice to the effect that it was decided on its own facts.

66. Annex 3 also states that there were 193 litigation claims issued by excluded customers. Of the 193 claims, 63% resulted in payments being made by the relevant bank, mostly by way of settlement. The amount paid mostly in settlement totalled about £278 million, comprising an average of £1.1 million redress and £1.2 million in benefits, that is several times larger than the upheld complaints.

VII The FCA's decision in light of the Review not to seek to compel the Redress Banks to provide redress to the Sophisticated Customers

67. In view of the Review considering whether the findings that the FSA/FCA had been wrong and/or had made a serious regulatory error in agreeing to exclude customers from the Redress Scheme, the FCA considered whether the findings of the Review provided good reason for reopening decisions taken many years previously. The reasons why it decided not to compel redress from the Redress Banks for the Sophisticated Customers were summarised by the FCA (para. 32 of the Amended Detailed Grounds of Defence) as follows:

    (i) some of the causes of action were statute barred e.g. applications under ss. 382 and 404 FSMA;

(ii) the FCA disagreed with the Review's adverse findings about the scope of the Redress Scheme;

(iii) the Redress Banks had a strong argument that they could reasonably regard the matter of redress for Sophisticated Customers as closed;

(iv) the difficulty and complexity of any redress action;

(v) the burden on FCA resources; and

(vi) insofar as there were reasons for seeking redress, those arguments were outweighed by those in favour of not seeking redress.

VIII Reasons for disagreeing with the Review as regards the IRHP Scheme

68. The submission of FCA at the time of the Decision was that the Scheme was a workable tool to obtain speedy redress and bore in mind the following factors, namely:

(i) an early scheme would provide redress which could not be achieved through use of statutory mechanisms;

(ii) the FSA's position was weak at the time including having limited proof of mis-selling;

(iii) taking into account differing degrees of risk in different investments and differing degrees of experience and expertise of different consumers in relation to different kinds of regulated activity;

(iv) a range of conclusions was thus reasonably open to FSA when assessing what was an appropriate degree of protection for different customers in relation to IRHPs, including to conclude, as it did, that some customers within the very broad Retail Client category required a different level of protection from others;

(v) the Scheme may have been a blunt tool, but it provided a workable scheme to enable the Redress Banks to identify customers who should be in scope and to provide redress quickly;

(vi) there is no evidence that any of the Redress Banks would have agreed to a voluntary redress scheme if the FSA has insisted on it covering Sophisticated Customers too, nor is there evidence that a better outcome could have been provided without a scheme;

(vii) using statutory powers would have involved more time, resource and evidence against a backdrop of *"a significant prejudicial effect on customers, many of whom were facing financial hardship"*, as Silber J stated in refusing permission to apply for judicial review in *R (Jenkinson & ors) v Financial Conduct Authority* in August 2013 (CO/5140/2013).

69. There were serious concerns even in 2012-2013 about the evidential difficulties of bringing action to require redress. At the time of the Decision in 2021, it was considered that those problems were exacerbated with the passage of about eight years, such that further investigation would need realistically to be able to produce results which would justify action being taken. Just as there was concern about the limited resources of the FCA relative to the banks in 2012 and 2013, so those concerns remained at the time of the Decision both as regards taking action and making extensive further inquiries. The concern was that this would divert FCA resources which should be focussed on mitigating risk in other areas of the retail market and in assisting customers who were for the most part less sophisticated than the excluded customers. These were to be seen as additional points to the points made about the compelling reasons not to do so that are set out above: see paras. 4.40-4.45 of the Board Paper.

70. If it had been considered there was a sufficiently strong case to seek redress at this stage, then this factor might have prevailed over the other factors. The argument would be that the FCA is prepared to act to protect those who had been mis-sold products such as to show that the FCA would protect those who had been wronged: see paras. 4.46-4.48 of the Board Paper. Balancing any advantages against the reasons for not proceeding, the recommendation was not to seek to use any powers which the FCA had under s.55L or s. 384 to secure further redress for any of the Sophisticated Customers.

71. In short, the FCA response was that the FCA did not agree with Mr Swift that the Sophistication Test was wrong or had not provided appropriate protection to customers, bearing in mind the need for speedy and certain redress to the most vulnerable. In any event, it was stated that *"it would not now be appropriate or proportionate for us to take further action now".*

IX Response to recommendations

72. The FCA issued a Response in December 2021 in which it accepted most of the recommendations of Mr Swift. Most germane for the purpose of this action, whilst acknowledging that the FCA should aim to ensure that persons within the same category are treated consistently absent objective justification for treating a subset of persons differently (para. 3.20 of the Response), it considered that the decision to treat sophisticated and non-sophisticated customers differently in the case of IRHPs was justified (para. 3.21 of the Response).

73. It acknowledged that there were shortfalls in its processes, governance and record keeping when decisions about the Redress were made (para.3.21 of the Response). As for the future, it agreed that "regulatory judgements on any such differential treatment within a redress intervention should be reasoned, evidence based and objectively justified. We also agree that such potential differential treatment, if significant, may be a good reason to hold meaningful consultation on the intervention if doing so is possible and appropriate" (para. 3.30 of the Response).

74. The FCA's considered view, as set out in its representations, was that it did not agree with Mr Swift that it had been wrong to apply the Sophistication Test to the IRHP Scheme. It had held a relatively weak hand in the negotiations without sufficient evidence of mis-selling, and needed speedy action to provide redress to the

most vulnerable customers in real financial difficulty. Despite this background, it negotiated a voluntary scheme. It differentiated between customers by reference to differing degrees of risk and of experience and expertise (as well as the statutory principle of consumer responsibility for their own actions).

75. There was a range of conclusions available to FSA when assessing what was an appropriate degree of protection for different customers in relation to IRHPs, including to conclude, as it did, that some customers within the very broad Retail Client category required a different level of protection from others. This included that some customers were more sophisticated and would have likely appreciated the risks in purchasing an IRHP or have had access to relevant expertise and skills to help them to do so e.g., large property companies and special purpose vehicles. Any redress scheme should prioritise, and if necessary be limited to, non-sophisticated customers, so as to secure more timely redress for them given that they were more at risk. This was a consequence of having been mis-sold and facing more acute financial difficulties including from interest rates being paid as a consequence of the mis-selling. It believed that it did reasonably provide an appropriate degree of protection, notwithstanding that any criteria would operate as a blunt tool.

76. Mr Swift's recommendation was that the FCA should aim to ensure that persons within the same category are treated consistently, that is to say that *"where rules exist for the protection of all within a defined class, regulatory intervention should not be restricted to benefit only a subset of that class unless there is an objective justification founded on strong evidence and tested through consultation"*(page 372 recommendation A2). The effect was that different treatment of customers in the same category was exceptional. The FCA's position advanced in representations to Mr Swift was that there was no evidence that the Redress Banks would have agreed to a wider scheme, or that statutory powers could have been used to create one, or that without the voluntary agreement a better outcome would have been achieved. Taking the "bird in the hand" was a reasonable decision. It was agreed that differentiating within a consumer category should be reasoned, evidence-based and objectively justified, but that test was met in relation to the Scheme, and in any event, the Swift Report appeared to pose too high a threshold.

X Introduction to Ground 1

77. The argument of the Claimant as contained in the skeleton argument for the hearing summarised the first ground that it was irrational of the Defendant:

(i) to reject the findings of the Review (Mr Swift) concerning the Sophistication Test (paras.24 and following); and

(ii) to decide to do nothing further (paras. 28 and following).

78. This was then stated more specifically in the agreed list of issues about rationality into four issues, namely:

> "First Issue: Is it open to the Claimant to contend that the FSA acted unlawfully in 2012/2013 in agreeing to the Sophistication Test in support of its case that the decision under challenge (being the Decision taken by the FCA in 2021) was irrational?
>
> Second Issue: In so far as the Decision rested on the Defendant's disagreement with the Review's statement that that it had been "*wrong* [of the Defendant] *to confine* [the Scheme] *to a subset of Private Customers/Retail Clients designated as 'non-sophisticated'*", is the Claimant right to submit that such disagreement needed, in the circumstances, to be supported by cogent reasons if it was to be lawful? If so, was it?
>
> Third Issue: Was the Defendant entitled to take into account in making the Decision the considerations listed above at paragraph 15?"
>
> (Paragraph 15 was that the Banks may have had a strong argument that they could reasonably regard the matter of redress for IRHP mis-selling as closed on the grounds that (1) the Banks had a contractual right not to be required by the FCA to make further redress as regards the relevant mis-selling owing to the terms of the Scheme; and/or (2) by reason of the Agreements, their performance and the FCA's subsequent conduct and communications and the passage of time since the underlying events and the Scheme, the Banks have a legitimate expectation of not being required to do so; or alternatively that the FCA should not depart without good reason from its long-standing policy that the IRHP Redress Scheme was an appropriate response to the mis-selling of IRHPs; and/or (3) the passage of time meant that limitation periods for bringing claims and complaints against the Banks had long expired and evidence relating to the sales would have deteriorated over time.)
>
> "Fourth Issue: did the Decision of the Defendant to take no further steps to seek to secure redress for customers comply with common law standards of reasonableness?"

(a) The First Issue: the scope of the challenge

79. The Decision which is challenged is not the decision of the Defendant to enter into the Agreement in 2012/2013 and in particular to agree the Sophistication Test with the consequence that thousands of customers would fall outside the Scheme. The Decision which is challenged is the decision in 2021 to reject the findings of the Review (Mr Swift) concerning the Sophistication Test and to decide to do nothing further. It is too late to challenge the decision to enter into the Agreement. There was in fact an attempt to do in 2013. Permission was refused on paper in *R (Jenkinson & ors) v Financial Conduct Authority* (CO/5140/2013).

80. At the permission stage, there was an argument as to the case being an abuse of process because it was in effect a challenge on the lawfulness of the Sophistication Test: see para. 32 of the Summary Grounds of Defence and para. 6 of the Detailed Grounds of Defence. This was determined in the permission judgment of Fordham J in the instant case at para. 17 to the effect that the challenge was a decision to take no action in 2021 in the light of the changed circumstances of the Report and its reasoning.

81. Whilst it is true that the challenge is not therefore about the decision to enter into the Agreement in 2012/2013, the lawfulness or otherwise of what the FSA did in entering into the Scheme through the Agreement and agreeing the Sophistication Test is relevant to the Decision in 2021. This Court does not have to make a ruling as to whether the agreement in 2012/2013 was unlawful, but at the heart of the lawfulness or otherwise of the Decision in 2021 is an analysis of whether the FSA acted properly in 2012/2013.

82. I respectfully agree with Fordham J who rejected the argument that it was an abuse of process to bring the instant claim. That was predicated upon the premise that this was a challenge by another name today of the lawfulness of the decision in 2012/2013. Whilst it was related to that decision, the challenge is properly about the Decision in 2021. That was not time barred. The passage of time by itself between the decision in 2012/2013 and the Decision in 2021 does not give rise to an abuse of process.

83. It does not follow that the lawfulness or otherwise of the decision in 2012/2013 was irrelevant to the Decision in 2021. Insofar as the Defendant contended that it was irrelevant, that is not the case. The Review was critical of the agreement and the distinction among Private Customers/Retail Clients of clients deemed to have been sophisticated. The answer to the question *"Is it open to the Claimant to contend that the FSA acted unlawfully in 2012/2013 in agreeing to the Sophistication Test in support of its case that the decision under challenge (being the Decision taken by the FCA in 2021) was irrational"* is *"Yes"*. That does not mean that the Claimant has to prove that the FSA did act unlawfully in 2012/2013, but it is a relevant contention that it did or may have acted unlawfully. Nor is it the case even if it did act unlawfully in 2012/2013 that the challenge against the Decision of 2021 necessarily succeeds. The contention of unlawfulness in 2012/2013 is a relevant consideration to the challenge against the Decision of 2021.

(b) The second of the agreed list of issues: must the Defendant's disagreement with the Review be cogent?

84. The Review's statement was that it had been "*wrong* (of the Defendant) *to confine* [the Scheme] *to a subset of Private Customers/Retail Clients designated as 'non-sophisticated'*" (page 22 para. 6). The starting point for the Claimant is that permission was given by Fordham J on the basis that it was arguable that having set up an independent Review to report on the lessons to be learnt, and in circumstances where it was not contended that the decision of Mr Swift was unreasonable or unlawful, it was irrational to depart from the decision: see para. 21 of the judgment. In that context, and having spent £8.6 million on the Review, it did not satisfy the standards of common law reasonableness simply on the basis of a merits-based disagreement. Given the independence of the Reviewer (unlike the position of the Defendant which was considering its own conduct), the Claimant's submission was to the effect that it made

no sense to depart from the Review simply because of a merits-based disagreement. In context, the rhetorical question arose as to what was the point of investing all that time and expense in having a review if the Defendant could simply ignore it because of a reasonable disagreement.

85. The way in which the case is framed is set out in para. 11 of the Reply as follows:

> "It is common ground that the FSA was not bound to treat all members of a group equally in the event that rationally there could be a distinction between different members. It was agreed that differentiating within a consumer category should be reasoned, evidence based and objectively justified. However, the Swift Recommendation went further than that and stated that:
>
> > "The FCA should aim to ensure that persons within the same category are treated consistently: where rules exist for the protection of all within a defined class, regulatory intervention should not be restricted to benefit only a subset of that class unless there is an objective justification founded on strong evidence and tested through consultation."

86. The Claimant submits that the Defendant has departed from a duty to treat all persons within the same class equally unless there is very good reason or good reason or cogent reason to treat persons differently. The Sophistication Test was, as Mr Swift said, an arbitrary test. The size of the turnover of a customer or the value of the assets of the customer did not prove that the customer was or was not sophisticated, especially about a banking product such as a hedging product.

87. This second issue focuses on whether there was a particular threshold for departing from the recommendations of the Review, whether based on a very good reason or a good reason of or a cogent reason. The adjective "cogent" is defined in the Oxford English Dictionary among other meanings as "having power to compel assent or belief; argumentatively forcible, convincing." The argument of the Claimant in the context of commissioning an independent report from an acknowledged expert in the field who has undertaken a painstaking review is that it does not suffice for there to be reasonable merits-based disagreement. The particular disagreement has to be based on a good or very good reason for the disagreement or a cogent reason. If this is not established, it is said that it would be irrational to depart from the Review.

(i) Is a reasonable merits-based disagreement an answer to a challenge about irrationality?

88. At the permission stage at [2023] EWHC 1616 (Admin), Fordham J stated at [21] as follows in respect of the arguability of the claim:

> "These points arise in a particular context of having set up an Independent Review to report on the lessons to be learnt, with the value of the identified independence and expertise. The Independent Reviewer's decision is not said by the Authority to

> have been unreasonable or unlawful. One question is whether to 'depart' from it on the basis of a merits-disagreement is a course which satisfies contextually-applicable standards of common law reasonableness."

89. On this basis, the argument was that it did not suffice merely that there was a reasonable disagreement because of the context. It might negate the whole purpose of having an Independent Review which reached a not unreasonable or unlawful conclusion then to reject it simply on the basis of a reasonable disagreement.

90. The scope for reasonable disagreement was the subject of the decision in *Secretary of State for Justice v Sneddon* 2024 EWCA Civ 1258 at paras. 24, 29 - 31 per Lady Carr CJ:

> "29. If the SoS does seek advice from the Board, the Board provides just that: advice . The SoS is entitled to reject it if he (reasonably) concludes that the advice is not "wholly persuasive". The SoS is entitled to reject even a reasonable recommendation on the basis of his own (reasonable though different) assessment. The words used in the SoS's policy, at 5.8.3 of the GPPPF, underscore the fact that it is the SoS's view that matters: it is for the SoS to be "wholly persua[ded]" (or not). There is no presumption that the Board's views are correct, let alone the only possible (reasonable) views. As it was put in *R (on the application of Overton v. The Secretary of State for Justice* [2023] EWHC 3071 (Admin) (Overton) at [28], there may be issues arising as to which " *there will very rarely if ever be a single unquestionably correct answer* ". It is necessary to avoid being distracted by having regard to the rationality of the Board's recommendation (rather than the SoS's decision).
>
> 30. Thus, the SoS does not need to identify a deficiency in the Board's reasoning in order lawfully to reject the Board's recommendation. It is the decision of the SoS that is under scrutiny, not that of the Board."

91. In *Sneddon* at para.36, Lady Carr CJ recognised that *"attempts to draw together "key principles" on a concept as broad and elastic as reasonableness are unlikely to be helpful... In general, the weight that the Secretary of State ought reasonably to give to the findings or assessments of the Board is likely to vary according to whether or not the finding or assessment was one in respect of which the Board held a particular advantage over the SoS... the greater the advantage enjoyed by the Board over the SoS on any particular issue, the less likely a decision of the SoS to depart from that finding or assessment will be rational."*

92. At paras. 43-44 , Lady Carr CJ said:

> "43. Nothing in either of these judgments (cases of *Wilmot* [2012] EWHC 3139 (Admin) or *Gilbert* [2015] EWCA Civ 802) suggests that there is a requirement to show "very good" or "good" reason for departure from the Board's finding or recommendation in the sense advocated for by the prisoners.
>
> 44. Thus, to repeat, in assessing the lawfulness of the SoS's decision, the exercise is not to identify whether the SoS has relied on a "good" (or "very good") reason for departing from the Board's finding or assessment. Rather, the question is simply whether or not the SoS's decision was rational."

93. The importance of *Sneddon* in the current context is as follows:

(i) the scrutiny is not on whether the Reviewer (in the instant case) was correct or whether the recommendation of the Reviewer was rational, but on whether the view of the Defendant to depart from the recommendation was rational;

(ii) In *Sneddon*, the Court of Appeal reached that conclusion, departing from the reasoning of Fordham J which had been to the effect that the Secretary of State could not depart from a rational decision of the Parole Board: the rationality was about the decision of the Secretary of State, not that of the Board;

(iii) In *Sneddon*, despite the statutory context within which the Parole Board made its recommendation, the decision under review was that of the Secretary of State. *A fortiori* in the instant case where there was no statutory context, but an ad hoc appointment of an independent person to review without any agreement to be bound by the decision.

94. To the extent that an issue was raised at the permission stage that a reasonable merits-based disagreement may not suffice in the context of a reference to the Reviewer, the case of *Sneddon* has provided a different complexion. The Court must focus the light of *Sneddon* upon the rationality or otherwise of the 2021 Decision of the Defendant not to adopt the Recommendation of the Reviewer. Reference was made to the case of *R (A) v Newham LBC* [2008] EWHC 2640 (Admin), [2009] 1 FCR 545 to the effect that a higher test than the ordinary rationality test may apply: if and to the extent that that is suggested, it is not of application to the instant case, not least because it is inconsistent with the reasoning of *Sneddon*, which is to be applied. On that basis, there is no presumption that the Defendant should have followed the recommendation absent good reason or very good reason or a cogent reason. Nor does it suffice if the Court would prefer on balance the view of the Reviewer or if the Court disagrees with the view of the Defendant, unless there was irrationality or common law unreasonableness about the decision of the public authority.

95. It is not a point that if the FCA fails to accept and act upon the findings of the Review, then the public funds of £8.6 million spent on it will be seen as wasted. That is not the case in that most of the recommendations of the Review had been accepted. Whilst the

exclusion of customers was an important aspect of the Review, this consideration does not undermine the reasoning above that absent a statutory context to contrary effect, it was open to the Defendant to reject a recommendation or finding if it had a reasonably based disagreement.

(ii) The test for irrationality

96. In a public law challenge, the challenge is on the grounds of irrationality. To that end, the Defendant relies on the oft cited dictum of Lord Diplock in *Civil Service Unions v Minister for the Civil Service* ('*GCHQ*') [1985] AC 374. Lord Diplock characterised the ground of irrationality as *'a decision which is so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it'*.

97. The Claimant reminded the Court that whilst the bar is not always described in such colourful language, as was stated by Sedley J in *R v Parliamentary Commissioner for Administration ex parte Balchin* [1996] EWHC (Admin) 152 at para.27 as follows:

> "[the applicant] does not have to demonstrate, as respondents sometimes suggest is the case, a decision so bizarre that its author must be regarded as temporarily unhinged. What the not very apposite term 'irrationality' generally means in this branch of the law is a decision which does not add up - in which, in other words, there is an error of reasoning which robs the decision of logic."

98. Further, reference was made to cases about prosecutors where it is only in "highly exceptional" cases that the courts will disturb decisions by an independent prosecutor or investigator whether to investigate and prosecute (or to discontinue investigations and prosecutions) (see *R (Corner House Research) v Director of the Serious Fraud Office* [2008] UKHL 60, [2009] 1 AC 756 at para. 30). Such a limitation applies in the context of criminal prosecutions because of particular features relating to such cases including a particular public interest in avoiding satellite litigation which might have the effect of delaying a trial. It is also the fact that the powers in question are entrusted to the relevant authority and to no one else, and the fact that the authority is entrusted with a balance of policy and public interest considerations.

99. This does not apply in the instant decision which is not about criminal proceedings, where there is not a statutory framework and where the Review was to an independent and expert person to provide recommendations. If the decision was shown to be irrational, there is no reason in circumstances outside the context of criminal proceedings, or at least in the circumstances of this case, why there should be an additional hurdle of having to show "highly exceptional" circumstances or a presumption that the recommendation of the independent Reviewer will be followed.

100. Nevertheless, a regulatory authority's discretion is "not unfettered": the decision maker *"must seek to exercise his powers so as to promote the statutory purpose for which he is given them. He must direct himself correctly in law. He must act lawfully. He must do his best to exercise an objective judgment on the relevant material available to him. He must exercise his powers in good faith, uninfluenced by any ulterior motive, predilection or prejudice"* : see *Regina (Corner House Research)* para. 32.

101. The Court was referred to the case of *Julien Grout v Financial Conduct Authority* [2015] EWHC 596 (Admin) per Males J as he then was at para. 39:

> "39. One potential form of irrationality may arise where a public body accords differential treatment to persons who are in a materially similar position, without good reason. As Sedley J explained in *R v Ministry of Agriculture Fisheries & Food, ex parte Hamble (Off Shore) Fisheries Ltd* [1995] 2 All ER 714 at 722, "a discretionary public law power must not be exercised arbitrarily or with partiality as between individuals or classes potentially affected by it". The same point was made by Lord Donaldson MR in *R (Cheung) v Hertfordshire County Council*, (The Times, 4 April 1998) who referred to "a cardinal principle of public administration that all persons in a similar position should be treated similarly".

102. Despite this, there is a wide measure of subjective discretion afforded by Parliament to the Defendant, as the specialist and expert regulatory body, in seeking to apply powers and rules set in general terms. This has been referred to by Popplewell LJ recently in *Financial Conduct Authority v BlueCrest Capital Management (UK) LLP* [2024] EWCA Civ 1125 at para. 83:

> "First, it is commonplace in regulation of complex market activity to have rules and powers which are expressed in general terms and by reference to high level objectives, and to leave the discretion as to how they are to be fulfilled to the expertise of an experienced regulatory body of experts. That is especially necessary in the field of financial markets activity covered by the FCA's regulatory remit, which will potentially involve a myriad of different factual circumstances in a complex market with constantly evolving and novel products and services, something which is positively to be welcomed on a macro-economic level. The FCA is obliged by s. 1B(1)(a) to act compatibly with its strategic objective of ensuring that the relevant markets work well, and by s. 1B(4) to discharge its functions in a way which promotes competition on the interests of consumers. By s.1E(2)(e) the FCA must in pursuing its competition objective have regard to how far competition is encouraging innovation. The narrower and more prescriptive the terms in which its powers and rules are expressed, the less likely they are to provide an effective tool for regulating financial market activity to achieve these objectives. It is therefore neither

surprising nor objectionable that the FCA, as the specialist and expert regulatory body, should be afforded by Parliament a wide measure of subjective discretion in seeking to achieve the defined statutory objectives."

(iii) Conclusions in respect of the second issue

103. It follows from the above that the test to be applied in this case can be summarised as follows:

(i) the issue is not whether the Review was rational, but whether the decision to reject the findings of the Review concerning the Sophistication Test and/or to decide to do nothing further to follow the recommendation of the Review was rational;

(ii) there is no presumption against the Defendant that it would adopt the findings and recommendation of the Review and/or there was no onus on the Defendant to show that it had a very good reason or a good or cogent reason not to do so;

(iii) the ability to impugn the decision of the Defendant not to adopt the findings and recommendation of the Review is not limited to highly exceptional circumstances;

(iv) despite the colourful use of language about rationality, judicial intervention is not confined to a decision so bizarre that its author must be regarded as temporarily unhinged: it suffices if there is an error in reasoning which renders the decision lacking in logic;

(v) there are cases where the decision which is the subject of disagreement is the result of a body which has so many advantages over the regulatory authority or the Secretary of State as to make it difficult to justify the disagreement as rational or reasonable;

(vi) there is scope for a reasonable merits-based disagreement even in circumstances where there is a commissioned Review and a refusal to implement it, unless there is a binding agreement to adopt it;

(vii) the decision of the regulatory authority is not unfettered. It must exercise an objective judgement on the relevant material available to it, it must act in good faith and not for an ulterior motive and by reference to all the relevant circumstances of the case. It is in this context that the Court, knowing about the independence of the Reviewer relative to the Defendant, will scrutinise carefully whether disagreement is reasonable or in good faith;

(viii) a discretionary public law power must not be exercised arbitrarily or with partiality as between individuals or classes potentially affected by it, unless there is good reason to do so.

104. This last consideration may have resonance in the instant decision. Although it is not a challenge to the decision to enter into the Agreement in 2012/2013 or adopt the Sophistication Test in the Agreement, it is a challenge the decision to take no action following the Review which in turn had been critical of the Agreement and especially of the Sophistication Test. The question which then arises is whether there was an irrationality in maintaining a differential treatment of persons within and outside the Sophistication Test following the criticisms and recommendations of the Reviewer.

105. The nature of the controversy in respect of the second issue may have reduced by the submission of the Claimant that the need for cogency derives from the context. This submission is that the FCA was confronted with the detailed and authoritative report of Mr Swift. His authority was by virtue both of his credentials and the manner in which he carried out his report. Millions of pounds had been expended in producing the report over a period of years, and the same had been analysed extensively. On the facts, it did not suffice for the FCA to say that it disagreed unless there were clear and cogent reasons for doing so: see Mr Roe KC's submissions orally in opening at Transcript Day 1/122/1 to Day 1/125/19 and in reply at Transcript Day 2/142/4 – Day 2/144/21 . The point about needing clear and cogent reasons is said not to be a legal point, but practical reality in order to meet common law standards of reasonableness.

106. Whilst this clarification is welcome, the second issue is predicated upon something being added to the issue of whether the Decision in 2021 was irrational or failed to comply with the standards of common law reasonableness. If there is not a test in law to that effect, then it is important not to make that an additional test. It is something which the Claimant is able to pray in aid in the analysis of whether on the facts of the instant case, the FSA/FCA acted rationally/in accordance with common law reasonableness in the differentiation of parties on the ground of sophistication and in 2021 in the Decision that it then took.

107. On this basis, the second issue does not add to the analysis in the sense of providing a different hurdle, but it is a relevant consideration in the overall appraisal of rationality/common law reasonableness. To that extent, it will be considered as part of the analysis in respect of the fourth issue.

(c) The third of the agreed list of issues: was the Defendant entitled to take into account potential argument of the Redress Banks of a contractual right not to be required to make further redress and/or a legitimate expectation of not being required to do so or not to depart from the Scheme and/or the effect of the passage of time?

108. Various arguments have been identified by the Defendant that in the event that a claim had been brought following the Review that any further action of the Defendant would have led to a strong argument on the part of the Redress Banks to defeat the action. The first was about reliance on a contractual bar to action to be taken by the Defendant against them. The second was about a legitimate expectation caused by reason of the Agreements and their performance and subsequent conduct or by reason of the policy of the Scheme. The third was the effect of the lapse of time.

109. In oral argument, Mr Coleman KC wished to start his exposition of these points by reference to the effect of the passage of time: see T2/page 114/line 11 – page 115 line 12. He submitted that the effect of time was incontrovertible, which, in my judgment, it is. The consideration about passage of time is to be found in the Board Paper of 30 September 2021 at para.4.30 – 4.36. A particular feature at the time of the Scheme was that it was going to be very challenging to recover relevant documentation to show non-compliant behaviour of banks and to obtain details about the circumstances of the sales and the counterfactual choices absent mis-selling. For this to be done eight years later, as it was in 2021 (in addition to the number of years that had already elapsed at the time of the Scheme) was very difficult indeed. The deterioration of evidence over time was a real concern and a substantial factor in not taking further action.

110. In addition to the lapse of time, there was also the fact that limitation arguments might have affected the scope of what could be argued. Given the fact that limitation periods for complaints by customers may have been statute barred and time for complaints to the Financial Ombudsman may have expired, that might have been a factor weighing against action taken under ss.55L and 384. Further, and in any event, the benefit of agreement under the Scheme about limitation points not being taken and undertakings and presumptions to facilitate redress for non-sophisticated customers would not apply to the claims which were being brought.

111. As regards the contractual bar/legitimate expectation arguments, the Court does not have to determine them, but simply to appraise the factor referred to in the Board Paper that they were considered to be of "considerable force" against further action. One was the possibility that the Redress Banks would contend that the Agreement was a contractual bar to further action. Clause 6 of the Agreement referred to above stated that *"Nothing in this Agreement prevents or in any other way limits the FSA from taking disciplinary action or taking any other regulatory action in respect of any matter or business involving the Firm"*.

112. There may be an argument that the intention was to preclude further action, but it is difficult to see that it has 'considerable force' absent express words to bar such action. Clear words could have been drafted to prevent such further action, and there was expressly no such bar in respect of disciplinary or any other regulatory action. The FCA accepted that there were no clear express words barring such further actions and that it would be necessary to look to the tenor of the agreement in context or to import implied terms. The Court is very sparing about implying terms bearing in mind the narrow nature of the test for the implication of a term and the opportunity to set out an express term in a carefully prepared agreement: see *Marks & Spencer plc v Bank Paribas* [2015] UKSC 72, [2016] AC 742.

113. Likewise, if the contractual argument does not have 'considerable force', then it is difficult to see how a legitimate expectation has 'considerable force'. Any agreement or representation would have to be clear. In circumstances where the parties had reduced the agreement to writing, it is difficult to find that there was a legitimate expectation based on agreement or representation, and bearing in mind that Clause 12 of the agreement was an entire Agreement clause. Alternatively, paragraph 4.16 of the Board Paper refers to long-standing policy that the Scheme was an appropriate response not to be departed from without good reason. This might be an argument, but if there was no agreement or representation, it seems rather amorphous to call it a policy

(qualified by the ability to depart from it with good reason), let alone to be an argument of 'considerable force'.

114. Whilst the contractual bar and legitimate expectation arguments may not have had as much force as set out in the Board Paper, the concern about the passage of time since the underlying events and the Scheme are in my judgment arguments of considerable force in the round of everything else and support the reasonable basis for disagreement underlying the Decision of 2021. The decision making process of the Defendant is not invalidated by the fact that the Defendant may have placed more weight than was deserved on arguments about contractual bar and legitimate expectation. This was because of the considerable force of the effect of delay and the concomitant difficulty of erecting a case and then proving it in respect of the customers deemed to be sophisticated so many years after the Scheme and so many years more after such mis-selling as took place. It was also because of the many other reasons for its Decision.

115. The issue is whether the Defendant acted irrationally or contrary to common law standards of reasonableness in its rejection of the Review and its decision not to take further steps to secure redress for customers. It is to that to which this judgment turns by considering the reasons for not following the recommendation of the Review.

(d) The fourth of the agreed list of issues: did the Decision of the Defendant to take no further steps to seek to secure redress for customers comply with common law standards of reasonableness?

(i) The Claimant's position

116. It was acknowledged that the documentary records of the Defendant in order to justify the decision made in 2012/2013 were poor. That would have been the primary source of information about the quality of that decision. It is an inadequate substitute for documents to have to rely on witness statements. Those statements are by persons who were not with the FSA in 2011/2012, the relevant personnel having moved on by 2021. It is therefore submitted for the Claimant that the Defendant's case is a series of assertions.

117. Even without a starting point that the Review and the recommendations must be followed absent a good or a very good reason, the Claimant's case is that it was irrational/contrary to common law unreasonableness for the Defendant not to follow or to take no action following the findings of the Review as regards the agreement to the Sophistication Test and the effect of excluding customers from the Scheme. These include the following:

(i) The number of private client customers who found themselves deemed to be Sophisticated Customers was very large, comprising about 34% of the customers comprising many thousands of customers and products with allegations of having been affected by mis-selling. That was a large cohort, and far too large to be dismissed as an unfortunate effect of a necessarily imprecise form of categorisation. Even taking into account the fact that customers within

the Scheme received sums of £2.2 billion, there were so many excluded customers that, it is said, it was unreasonable to agree the Sophistication Test with so severe a consequence.

(ii) There was no consultation as to the effect of the Agreement. There was no statistical or other research to justify the position objectively. There was no detailed impact assessment, analysis or testing of the distinction between Private Customer/Retail Clients according to the Sophistication Test. Adopting a conclusion of Mr Swift at para.1 of his conclusions*: "... to the extent that the FSA's objective was to secure address only for customers who knew, or should have known, about the risks (of) IRHPs, it failed to find a mechanism appropriate to that objective: it relied on a complex mix of quantitative criteria, never properly tested for their suitability for that task, as well as an alternative qualitative test."* (Recommendation 2: Scope of the Scheme para. 1 page 316).

(iii) As regards the categorisation or definition of Sophisticated Customers, it did not follow from the size of a customer that they would have an understanding of a complicated financial product or even the opportunity to take advice in the context of their busy working lives. The fact that in other contexts, the Companies Act test of a small company was used did not justify deeming any customers as Sophisticated Customers. The exemption from publication of full accounts or Ombudsman schemes did not prove that a potential victim of mis-selling was able to look after themselves as regards remedy.

(iv) There was a stark contrast between being within and outside the Scheme. Those within were relieved of limitation barriers and had the advantage of undertakings provided by the Redress Banks. Those without would have to fend for themselves and with the disadvantages of having to prove very complicated cases against banks well versed in the products.

(v) The position was aggravated by the fact that where a customer qualified as a non-Sophisticated Customer, the Redress Banks could seek to exclude such a person on the basis that, in reality, such a person was a Sophisticated Customer. There was no converse ability of a person deemed to be a Sophisticated Customer to be able to submit that despite quantitative qualification, in reality, they were not a Sophisticated Customer.

(vi) The concession happened so quickly during the night of 26/27 June 2012 that it was submitted that there was no attempt to stand up to the banks and to ensure that customers were treated broadly equally. It is alleged that the Defendant simply keeled over to the banks. For example, they did not take offers off the table for so long as the banks insisted on the outcome which caused such detriment to such a large percentage of the customers who had been victims of mis-selling.

(vii) It followed that the FSA in 2012/2013 had failed in its duties in agreeing to treat the excluded customers differently from those within the Scheme and the FCA and likewise had acted irrationally and/or contrary to common law unreasonableness in rejecting the findings of the Review in this regard and

deciding to take no action thereafter.

118. The Claimant has submitted that it is not a part of the claim for judicial review that the Defendant must institute redress proceedings whether under section 384 or section 55L or otherwise. It is that there was not a basis for reasonable disagreement. The rational approach was for the FCA to consider the position again in the light of the findings and recommendations of the Review, to investigate the matter properly and to make the Decision again having investigated properly the practicality of pursuing the banks in accordance with its powers and duties (Transcript Day 1 page 32 line 22 – page 34 line 16).

(ii) Adequacy of contemporaneous records

119. As regards the criticism about the paucity of documents, these are significant criticisms: they go to the weight or otherwise of the Defendant's case. The Claimant submits that as there is a paucity of contemporaneous documents about how the Sophistication Test came to be discussed, analysed and accepted, is evidence of a lack of clear and cogent reasons for the decisions taken in 2012/2013 and in 2021. In the context of the second issue, as noted above, the Claimant submitted that it was a part of the practical reality that the decisions taken lack cogent and clear reasons, and that no amount of ex post facto reasoning then suffices to make them rational or satisfying common law reasonableness.

120. The Defendant accepts the criticism of its record keeping not being as desired: see para. 59 above. But this does not prove that the Defendant acted irrationally or unreasonably. This is not fatal to the Defendant's case. The Defendant was still able to make representations in 2021 to the Reviewer by reference to the events at the time of the acceptance of the Sophistication Test by the FSA. It is hardly surprising that relevant personnel, and that the witness statements which must have taken a vast amount of time to prepare, were largely those of employees who had joined the FCA since the events in question. They were the persons assisting in the response to the Review. As noted above, there was a significant amount of documentary evidence as to the way in which the events occurred. It was possible even that far after the events in question to understand the chronology of what occurred in the run up to the Agreement, and much of it appears in the Swift Report. There is a potentially more telling point to which this judgment will revert about the absence of contemporaneous records of the decision to apply the Sophistication Test and its likely effect.

121. Having found that the test is the rationality test to be applied without presumptions as referred to in the discussion about the second issue above, there are a number of contextual factors which are relevant to the Decision. I am satisfied that there is no test to the effect that the Defendant was bound to accept the findings of the Reviewer unless there was a good reason or a very good reason or cogent reason to depart from them. That was too rigid a position. If the findings were believed reasonably to be wrong, there would be an entitlement without more to reject them. In the instant case, it is not a part of the Defendant's case that the Reviewer's findings were irrational. They were said to be the subject of reasonable disagreement. The question is whether the Defendant had a reasonable basis for disagreement and whether it was entitled to prefer its view to the reasonable view of the independent Reviewer.

(iii) Reasons for caution in appraising the Defendant's case

122. That said, the Court should proceed with caution. There were reasons to be sceptical about a rejection of the conclusion of the independent Reviewer if his reasoning was wrong in law or believed to be wrong in law. This is for the following reasons, namely:

(i) if an independent reviewer had been appointed at great expense in order to learn lessons, the wider circumstances indicated at least a readiness to accept the findings;

(ii) the findings were clearly the product of considerable work and reflection from the Reviewer who was both independent and a distinguished expert in the field and indeed chosen because of his distinction;

(iii) the suspicion is that where the findings comprised criticism of the FSA, the natural self-defensive reaction would be to reject the same or to explain their own position in such a way as to escape the consequences of the criticism e.g. by relying on reasonable disagreement. In that regard, the suspicion would still remain even despite the replacement of the FSA by the FCA and even though the personnel changed to a great extent from 2012/2013 to 2021;

(iv) the scope for unconscious bias in their own favour was considerable in contrast to the independence of the Reviewer.

123. It follows that in the analysis of rationality as regards to the Decision in 2021, there needs to be a careful examination of the argument that this was a reasonable merits-based disagreement. Whilst there is no specific requirement for the Defendant to show a good reason or a very good reason or a cogent reason for not accepting the Review or a recommendation within the Review, there needs to be consideration of whether the Defendant acted rationally or in accordance with common law reasonableness in the Decision of the Defendant in 2021 not to follow the Recommendation and/or the Review. The rigour of that examination including detailed consideration of the differential treatment of customers in 2012/2013 is necessary and it is greater because of the matters referred to in the paragraph immediately above. It is that decision about differential treatment that this judgment now turns.

(iv) Differential treatment of customers

124. The Defendant's case as regards the Sophistication Test is that, contrary to the Reamended Statement of Facts and Grounds at paras. 67 and 92.2, there is no starting point that Private Customers/Retail Clients ranging from private individuals and small companies to very substantial private companies, in some cases part of an even larger group, should receive the same degree of regulatory protection. The regulatory scheme does not contemplate that all breaches of the COB/COBS rules or any other rules of the FCA will be remediated, or that the same options will be available to all Private Customers/Retail Clients.

125. The Defendant is afforded a wide measure of discretion as to the circumstances, manner and extent to which it will intervene in response to allegations of potential mis-selling. This is a matter for the Defendant as regulator, taking into account the broadly set statutory objectives, regulatory principles and its regulatory priorities, subject to the usual public law controls. There will be cases where different treatment of a subset of Private Customers/Retail Clients will be contrary to statutory objectives or regulatory principles, and that such conduct may be characterised as irrational or contrary to common law reasonableness.

126. It was rational of the FCA to disagree with the view of Mr Swift that differential treatment of customers within the Private Customer/Retail Client category had to be justified by reference to "strong evidence" and should be regarded as exceptional. It was also rational and a basis for reasonable disagreement for the consideration of the Defendant as to the breadth of its discretion to target intervention when most needed, without the luxury of the time required to research and prepare detailed evidence, it was entitled to act with greater urgency.

127. In my judgment, it was not irrational and/or it was in accordance with common law standards of reasonableness for the Defendant to disagree with the Review about the Agreement in 2012/2013 and the reasons for agreeing to the Sophistication Test. By 2021, the Defendant had the detailed analysis, conclusions and recommendations of the Review, which were critical of the FSA and the agreement to make a distinction among the Private Customers/Retail Clients without detailed stress testing or consultation.

(v) The December 2021 Response in respect of differentiation of customers

128. The Claimant relies on the Response of the FCA of December 2021 which acknowledged the need for objective justification for restricting a regulatory intervention to benefit only a subset of persons within a defined class. The need for an objective justification means that it is not sufficient for the case to be decided on a subjective belief of the authority.

129. In the instant case, there is a particular emphasis on the night of 26/27 June 2012 when the FSA appeared to concede the position by agreeing to the Sophistication Test. Mr Swift was critical about this concession being made "'*after only the briefest consideration*'" and without adequate consultation. There was no stress testing. There were not contemporaneous documents in 2012/2013 showing the pros and cons of the decision to make the differentiation.

130. In opening, Mr Roe KC said that the problem of the Defendant's case was that when one presses the FCA to explain why it was reasonable and appropriate to make the differentiation there is no coherent response. There are simply submissions which lack any objective justification for drawing lines which shut out thousands of people who had been sold IRHPs where a significant proportion of those people would have been mis-sold the products. It is said the failure to act on the Review by investigating the matter in the light of the criticisms made fails to meet common law standards of reasonableness.

131. An example of the need for objective justification is that without stress testing and research, there is not an objective justification for excluding thousands of customers who had acquired IRHPs, alleging mis-selling. The Claimant's cases is that it is irrelevant to those customers that other customers, deemed to be more deserving without such testing and research, have benefited from the Scheme. That is said to be an irrelevant consideration unless the objective justification for the differentiation between Private Customers/Retail Clients has been verified.

132. The Defendant submits that the need for objective justification does not mean that the justification must be based on detailed quantitative and qualitative research and consultation if, in reality, there was no or no adequate time for this or for any other reason there was a rational or reasonable basis for not undertaking this. It sufficed if in all the circumstances, at the time when the Decision under review was made, if the authority acted objectively speaking in a rational manner and in accordance with the common law standards of reasonableness. It is therefore important to consider the Response of the FCA.

133. The Court has considered carefully whether, based on the material before it, the disagreement with the Reviewer was reasonably based bearing in mind his independence against the factors requiring particular caution referred to in para. 122 above. There is nothing to indicate bad faith or some self-justifying charade in the detailed stages of the consideration of drafts of the Review. There was a scope for unconscious bias and the danger of ex post facto justification was significant. The Court must therefore examine the material before it with particular care before accepting that there was a reasonable basis for disagreement.

134. The Response was the culmination of the detailed consideration given in evidence as set out above. As was set out in the Response document (at paras. 3.22 – 3.28):

(i) a voluntary redress scheme would provide redress to customers in the most vulnerable circumstances more quickly and with greater certainty than a statutory approach;

(ii) if the FSA had sought to use its statutory powers to try to provide redress, this would have taken more time to achieve a result against a background of rapidly growing harm to many of the SMEs and could have led to redress being substantially less than under the voluntary scheme;

(iii) the Agreement necessarily involved some trade-offs and some of the delineation of the scope of the Scheme was in part a result of negotiations including a pilot review;

(iv) there is no evidence that the banks would have agreed to a voluntary redress scheme if the FSA had insisted that it cover the past sales to all Private Customers/Retail Clients;

(v) the FSA was obliged by FSMA to assess what it considered to be an appropriate degree of protection taking into account several factors including the differing degrees of experience and expertise that different consumers may have had;

(vi) There was a range of conclusions reasonably open to the FSA at the time and it was considered reasonable for the FSA to judge as it did that:

(a) some of the customers were more sophisticated and would have likely understood the key features of the IRHPs and all would have been able to access relevant expertise and skills to help them understand and appreciate those aspects;

(b) the redress scheme for IRHPs should prioritise and if appropriate be limited to less sophisticated customers so as to secure more timely redress for them in the context of acute financial difficulties;

(c) the Agreement provided certainty and swift redress for customers reasonably considered to be most at risk even though the dividing lines between those who should and should not have been included in the Scheme were difficult to draw and complex.

(vi) Basis for reasonable disagreement

135. In considering whether there was a reasonable basis for disagreement, the Court has far more than the Response. It has been able to appraise the matters considered at the time of the Decision in 2021 and reflecting back on the considerations in 2012/2013. The Court has factored in the scope for self-justification in the face of the criticisms of an independent and distinguished reviewer. Notwithstanding this, the Court considers that it was objectively rational for the Defendant to consider in 2021 that it had a reasonable basis for disagreement with the Review as follows.

(i) It was rational and a basis for reasonably held disagreement for the FCA to consider in 2021 that the reasons of FSA in 2012/2013 for regarding a voluntary agreement as being preferable to using statutory powers were still reasonably held. It was believed then, and it was proven right, that it achieved a favourable outcome for the many customers affected by the mis-selling who had acute financial difficulties. Such was the urgency that they could not wait for a medium to long term solution.

(ii) It was rational and a basis for reasonably held disagreement to take the view that the FSA had a stark choice in view of the fact that the banks or at least some of them were not prepared to make a deal of one size fits all. The banks had decided that there had to be a distinction along the lines of the Sophistication Test. The differentiation in order to get a voluntary agreement was considered in 2021 to be a rational response, and nothing that had happened including the Review undermined the belief of the Defendant that this was a reasonable course of action.

(iii) The FSA could have decided to bring the negotiations to an end. However, it believed that many of the cases at that stage would be difficult to prove and would have an uncertain outcome. I was also concerned that leaving the table would back-fire, as it would be forced back to the table with a worse position.

Considering the position in 2021, the Defendant was entitled to have a reasonable merits-based disagreement about the view that the FSA should have left the table.

(iv) It was rational and a basis for reasonably held disagreement to prioritise certain customers over others within the same class if it was reasonably perceived that this was the only way to obtain the voluntary agreement on the table. The distinction was between those who were more likely as against those who were less likely to have been able to understand, or to have had the opportunity to be advised about, the risk of the IRHPs. In 2021, the Defendant was entitled to have a reasonable merits-based disagreement that such prioritisation was justified as a proxy for sophistication even if there was not adequate time to do any meaningful stress testing or detailed research.

(v) Whilst laying itself open to a charge of having acted arbitrarily, the FCA was entitled rationally to consider in its Decision of 2021 that the FSA had acted in 2012/2013 urgently to protect the less sophisticated customers. Whilst the quantitative tests were imprecise and blunt tools, not least because deserving customers might be deemed to be sophisticated, there was not the time to do a more detailed impact assessment, analysis or testing of the distinction. It applied quantitative criteria which were well-established in the financial services regulatory scheme as a proxy for sophistication (that is a consumer's ability to understand the risks of a financial product, including by taking advice). Mr Steward's evidence at paras. 84-90 is that a variety of pieces of financial services legislation, both domestic and EU, use company size criteria as a proxy for sophistication and the need for protection, including the Financial Ombudsman Scheme.

(vi) There was a paucity of hard evidence to prove the difficulties of customers in 2012/2013. This was evident in cases brought which failed for want of such evidence. It would be an enormous exercise to obtain such evidence customer by customer or even on behalf of representative customers. This would be very costly and without knowledge of the benefits that would ensue from such research. The Defendant was entitled rationally to consider in 2021 that such an open ended investigation in circumstances where it was speculative at best what it would lead to was not a justified use of time and expense.

(vii) Even if any meaningful stress testing could have been done, there would still be a balancing exercise of whether the Defendant should enter into an agreement excluding customers or agree a test by reference to sophistication of customers. The insistence by at least some banks on a Sophistication Test meant that such a dilemma would still have to be confronted. The Defendant was entitled, even on limited information relative to that envisaged by Mr Swift, to form the view that the 'bird in the hand' of an agreement was better than the statutory route. The Defendant was entitled to take that view, based on its regulatory experience, that even without testing the distinctions by way of impact assessments, they were pursuing the objective of achieving the best outcomes which they believed to be available for consumers.

(viii) Against the background of urgent steps being required, it was not irrational in 2021 to consider that it adopted an imperfect solution rather than seeking a more

complete solution years later by which time it would be too late for many concerned.

(ix) When looking back at matters in 2021, the Defendant was entitled to reflect on the fact that the settlement achieved in the end a recovery of £2.2 billion which was believed to be a large recovery as to justify retrospectively the importance attached to taking this voluntary settlement on the basis of its being a 'bird in the hand'. The compensation was in respect of about 20,000 sales. As above noted, the Redress Banks incurred costs of c. £920 million operating the Scheme.

(vii) Accepting differential treatment in June 2012 and thereafter

136. Mr Swift considered that the FSA should have taken the potential agreement "off the table" if the banks were not prepared to include all Private Customers/Retail Clients within the Review. The Defendant was entitled to take the view that there was too much at risk to lose the "bird in hand" for the most vulnerable customers and therefore not to take the offer "off the table", even though it involved a differential treatment of customers within the Private Customer/Retail Client category. This would have involved putting at risk or even losing entirely the benefits that the FSA had achieved for the less sophisticated customers: see the Terms of Reference Question 1(d) at para. 23 page 305 of the Review.

137. Against the possible tactic of walking out of the negotiating room, it was not unreasonable for the Defendant to assess that this would have been too dangerous. The FCA made the point in its representations that if, having taken the agreement off the table, the FSA had been unable to achieve a satisfactory result by other means (which the FCA considered entirely possible because of the uncertainty regarding the availability of statutory powers and the extent of the redress that could be obtained if they were exercised), it would have had to return to the table with an even weaker negotiating position.

138. There is a serious danger in applying retrospective reasoning to a commercial negotiation. It is easy to apply the advantage of hindsight to such judgements. Sometimes it is the hunch that a person could have settled for better terms. It is the belief that at a certain point, the person should not have caved in so easily or quickly. There is scope for rational disagreement as to whether a termination of the negotiations would have involved an unacceptable risk of losing the opportunity of an early settlement. Ultimately, this is all part of a wider disagreement as to whether it was rational to enter into a settlement which favoured a cohort within the category of Private Customers/Retail Clients at the expense of others who would find themselves without compensation under the Scheme. For the reasons set out above, there was a rational basis for making a distinction within the group of Private Customer/Retail Clients in order to secure a deal for those who were within the scope of the Scheme.

139. The areas of reasonable disagreement have been set out above. Without in any way limiting that which has set out above, they include areas on which the FCA place more emphasis than the Claimant including:

(i) the FCA has placed more weight on the importance of obtaining a voluntary agreement to address the concerns about mis-selling, the importance of obtaining more certain and faster outcomes than would have been available by the use of statutory powers. There were also the advantages of obtaining the benefits of various undertakings and avoiding potential limitation issues;

(ii) the FCA's assessment of the appropriateness of the Scheme gives more weight to the weakness of the negotiating position of the FSA with the Redress Banks, and in particular the uncertainty of what could have been achieved through the exercise of the FSA/FCA's statutory powers. That was particularly because of the pessimism as to the prospects of enforcement action and the difficulties in obtaining evidence of mis-selling; and

(iii) there was a reasonable disagreement in negotiation tactics about whether to have taken the voluntary agreement off the table if the Redress Banks were not prepared to agree to admit all Private Customers/Retail Clients within the Scheme. The FCA considered that that would put at risk the benefits secured for the more vulnerable category it was seeking to prioritise described as the "bird in the hand."

140. A vital point of departure is the differentiation and the appropriateness of criteria based on the size of the business and transaction as broad markers of sophistication when seeking to deal in a proportionate way with tens of thousands of sales. In all the circumstances, the decision of the Defendant was rational and there was reasonable merits-based disagreement in respect of entering into the Scheme and making the differentiation.

141. Likewise, another vital point is the analysis of the benefits of the Scheme including the sum of £2.2 billion of redress to eligible customers in respect of sales. These have comprised fair outcomes for eligible customers and probably better than could have been achieved through the exercise of the FCA's statutory powers. The point of difference is that the Claimant submits that the satisfaction of the 66% does not justify the exclusion of the 34%, that is of thousands of customers and products.

142. For the reasons set out above, it was rational of the Defendant and it is a reasonable basis for disagreement for the FSA to have entered into the Scheme. This involved putting the emphasis on a voluntary agreement, the opposition of the banks to not making a differentiation, the absence of time for stress testing, detailed research and consultation, the quantitative formula being a proxy for sophistication however blunt it was and the fact that this was the offer on the table. Even with the benefit of the adverse analysis of the Review, it was rational and a reasonably held disagreement for the FCA not to accept the relevant recommendations and findings.

(viii) The discretion of FSA/FCA

143. Further, the FSA in 2012/2013, and the FCA in 2021, were entitled to take into account, among any other relevant matters, (i) its statutory consumer protection objective of

securing an appropriate degree of protection for consumers, and in doing so have regard to "the differing degrees of experience and expertise consumers may have" and "the general principles that consumers should take responsibility for their decision" (see now FSMA s.1C), and (ii) the statutory regulatory principles that it uses its resources in the most efficient and economic way and that a burden which is imposed be proportionate to its benefits, considered in general terms, which are expected to result from the imposition of that burden (see now FSMA s.3B(1)): see Amended Detailed Grounds of Defence at paras. 14-15. As noted above, there is a wide measure of subjective discretion afforded to the FCA in seeking to provide an appropriate degree of protection to consumers and to achieve the defined statutory objectives.

144. The questions as to the circumstances, the manner and extent to which the FSA/FCA should intervene in response to evidence of potential mis-selling is a question for the regulator, taking account of its statutory objectives, the regulatory principles and its regulatory priorities, and subject to the usual public law controls. Whether or not in any particular instance the FCA adopts the categories used in COBS, or any other differentiation, is to be assessed by reference to the rationality of that choice in the particular context, without any gloss on the scope of its discretion.

145. The Defendant's position was that whatever the limited private rights under COB/COBS rules as between the consumers and the banks/firms, the FSA's duties were regulatory and to the consumers as a whole. There was no presumption that all Private Customers/Retail Clients ranging from individuals and small companies to very substantial private companies (in some cases part of an even larger group) should receive the same degree of regulatory protection.

(ix) Further considerations

146. The Claimant has pointed to an internal document of the FCA's Risk and Compliance Oversight division in which the author stated that he had been unable to locate an analysis carried out at the time as to why sophistication test was required, and there were no analysis of the decision to apply the Sophistication Test to Category B & C products. The same document express the view that the author did *"not believe that there should have been a sophistication test at all and all sales to retail private customers should have been considered"*. That document has to be seen in context. It was in February 2021 at an early stage of a prolonged period of consideration before the FCA had formulated its position in response to Mr Swift's criticisms regarding the schedule of the Scheme.

147. The view reflected some diversity of document: it was exhibited to Mr Steward's statement. As the position evolved, and as explained in Mr Steward's witness statement at paras. 82-92, detailed consideration was given as regards distinguishing between customers in the same category. In 2012/2013, the FSA considered that the focus needed to be on the businesses that were most at risk. In the context of opposition from the banks to treating all Private Customers/Retail Clients in the same way, the FSA considered that some customers could be excluded because they were less vulnerable to mis-selling because of their resources, expertise and experience. The FCA conveyed its view to the Swift Review that the consumer protection objective did not impose a duty to protect all customers against all harm but empowered the FSA to assess what it

considered to be an appropriate degree of protection in furthering its consumer protection objective. It was therefore reasonable for the FCA to assess that some customers within the very broad group of Private Customers/Retail Clients would have likely appreciated the risks in purchasing an IRHP and that the protection did not need to be the same for everyone within the broad group.

148. As Mr Steward said, there was consideration of limitations on consumer protection within the Financial Services Compensation Scheme. There was consideration of European law using size as a proxy for sophistication particularly in respect to the Investor Compensation Scheme Directive. The FSA and the FCA considered that some customers could be excluded because they were less vulnerable to mis-selling for example because they had the resources to access expertise and experience when purchasing the products.

149. In the course of oral argument, the question arose as to whether the criticisms of the Claimant would carry more weight if the Defendant could have defined in a different way a category of excluded customers in way more likely to satisfy the banks and to enable a voluntary redress scheme to proceed. Understandably, the Claimant said that that was ultimately a matter for the Defendant as the regulator, but the FSA had agreed to the subset of customers excluded from the Agreement without proper research or consultation. The Claimant says that there was a failure to descend to the particulars of the criteria that were chosen and to explain why they were chosen and why they were the right criteria. In my judgment, this begged the problem for the FCA. In the view of the FSA at the time, there was no time for stress testing or for detailed quantitative or qualitative analysis to lead to a better outcome.

150. It is accepted that there is no case to the effect that more could or ought to have been achieved without this settlement in respect of those who were within the Scheme. There is no evidence as to what would have occurred if the Defendant had refused in June 2012 to enter into the Initial Agreement and/or if it had subsequently refused to agree the modifications thereafter of the Sophistication Test. In particular, there is no evidence as to what would have become of the customers within the Scheme or the overall position of the customers within and outside the Scheme in the event that there had been no Scheme.

151. It was submitted orally in argument that if there was no time for the FSA to consult with thousands of customers, there could have been consultation with the pressure group Bully-Banks or the Federation of Small Businesses, but it is not apparent that this would have been a substitute for a detailed statistical and evaluative analysis for which it was reasonably believed that there was no time. None of this has undermined the analysis that the FSA had a stark choice between a voluntary review or a much more medium to long term solution of statutory measures. For the reasons set out above, there was an objective reasoned basis for the determination to proceed with the voluntary review and the adoption of the Sophistication Test. It is not apparent that there was any real prospect within the very limited time framework and the need for urgent solutions for small to medium enterprises that the FSA could have found a different way of defining non-sophisticated customers that would have been more satisfactory, or that the banks would or might have entered into an agreement without a separation out of certain sophisticated customers.

152. The view of the FSA at the time of the agreement to the Sophistication Test and of the FCA in making representations to the Review and in the Response document of December 2021 was as stated above. As has been set out above, there was a belief, which was not irrationally held, that in the context of an urgent voluntary redress scheme, there was not time for the detailed research and consultation of the kind referred to by Mr Swift.

153. It is important to note the care with which the FCA approached the Review as is apparent from the evidence filed in these proceedings and referred to above. This is evidence of the rationality of the Response. Having considered the various factors, I am satisfied that the case of irrationality or a failure to act in accordance with the standards of common law reasonableness is not made out. This is a case where the totality of the points of the Defendant gave rise to objective justification for the exclusion of customers from the Scheme, and in turn to a reasonable merits-based disagreement. Whilst Mr Swift's conclusion was that this required detailed stress testing and research of customers and how they would be affected by the exclusion of a sub-set of customers, it was rational and reasonable in a public law sense for the FSA/FCA to take a different view both at the time of the Agreement in 2012/2013 and at the time of the Review in 2021.

(x) Conclusion on Ground 1

154. As the Claimant has emphasised, and as is common ground, this case is a challenge not to the decision in 2012/2013, but to the Decision reached in 2021. In view of the fact that the Review concerned the Agreement of 2012/2013 and the effect of the Sophistication Test, there is some overlap, but the challenge is not the same. The challenge to the Decision of 2021 is that it was said to be irrational to depart from the Review despite its authoritative source and the deep analysis of the Defendant's conduct. In my judgment, it was not necessary to find that the Review was irrational in order to depart from it. It sufficed that there was scope for reasonable disagreement with the Review of Mr Swift. The question was about the rational response of the Defendant, not whether the Review was rational.

155. In my judgment, it was rational to depart from the Review. This was not because the findings and recommendations of the Review were unreasonable or irrational. It was simply that there was scope for reasonable disagreement in the respects in which the Defendant disagreed with the findings and recommendations of the Review. The Defendant had agreed with most of the findings of the report, albeit that the criticisms regarding the Sophisticated Customer criteria were not accepted. The reasons why the Defendant believed that it was acceptable to agree to agreeing voluntary redress with a cohort excluded on the basis of the Sophistication Test has been set out above and was referred to in the Response to the Review summarised above.

(xi) Reasons for deciding to take no further action

156. In addition to these considerations, there were additional considerations by reference to the time of the report of Mr Swift and the Decision in 2021. Those included the following, namely:

(i) by 2021, it was the very long time after the events in question, which would make it especially difficult to prove any wrongdoing case by case on the part of the Redress Banks: this rests on the self-evident proposition that the more historic the allegations, the more difficult they would be to establish. The difficulties caused due to the passage of time from such mis-selling as there was to the time of the Review have been discussed in the section above about the third issue;

(ii) as stated in the Board Paper at para. 4.36, a challenge of Sophisticated Customers to try to recall a sales experience of one or two decades earlier and to consider the counterfactual choices which the customer might have made absent the mis-sale would have been challenging enough during the Scheme, but eight years on in 2021 would have been even harder;

(iii) the real difficulty so many years after the event of obtaining evidence to prove the matters case by case without the advantage of the undertakings obtained in the Scheme;

(iv) large amounts of money would have been required to prepare for and take action which would have an uncertain outcome not just due to litigation risks, but due to the difficulties of appraising any prospects of success until a vast amount of preparatory work had been undertaken;

(v) the need to dedicate resources to more immediate and less historic victims of mis-selling; and

(vi) the reasonable belief that it impeded chances of voluntary settlements in the future with banks in the event of such an action on the basis that even without a bar such as contractual discharge or legitimate expectation, banks may wonder what point making payments without finality.

157. The recognition that the claim, if successful, would require the FCA to reconsider or re-investigate the response of the FCA to the Review may be conventional, but it is still telling not simply about relief, but about the claim itself. It focuses on all the consideration that took place in 2021 referred to above, and how for the reasons above set out, there was a decision not to take any further steps. It is difficult to contemplate what would be entailed a decade or two decades after the sale of IRHPs to open up the extent to which excluded customers were the victims of mis-selling. This only again brings into focus the extent to which the matter has been considered carefully, the difficulties of detailed investigation so long after the events in question and how speculative it is that there will be viable claims so far removed from the events in question.

158. In all the circumstances, it was not irrational and not contrary to common law reasonableness to decide to take no further action.

159. For all these reasons, the claim on Ground One must be dismissed.

X Ground 2

160. The Second Ground has generated much less argument in the course of the hearing than the First Ground. The Second Ground is that the Decision under Review was unlawful was that it was unfair to time the announcement of the Decision in 2021 so as to present interested persons with a *fait accompli*, and therefore no opportunity to advance informed contentions that the FCA's response to the review ought to be a different one. Fordham J, in granting the Claimant's application for a cost capping order treated this second ground (as he did the first ground) as a matter of *'general public importance'*. That was *"whether the Authority - anticipating calls for action - could fairly organise the procedural sequence of events so as to exclude the informed opportunity for voices to be heard, in an attempt to persuade, whilst its mind is ajar."*

161. In giving permission on this second ground Fordham J observed [at para. 23] that it was *"arguable that standards of fairness (and reasonable sufficiency of inquiry) have not been met".* He said that the authority took a deliberate procedural decision to secure an alignment in time between the publication of the Report, the publication of the Response, and the publication of the decision on whether to take any further action. That was to eliminate the prospect of voices informed and empowered by the Review having the opportunity to persuade the decision-maker prior to the outcome and before minds were made up.

162. In its written submissions, the Claimant submits that the FCA was under a duty of sufficient inquiry which is an aspect both of procedural fairness and the doctrine of irrationality. As a public body, there was a duty to take reasonable steps to acquaint itself with material relevant to any decision it makes to enable it to make a properly informed decision. That may require the decision maker to take into account the affected person's views about the subject matter: see Laws LJ in *R (Khatun) v London Borough of Newham* [2004] EWCA Civ 55 [2005] QB 37 at para. 27. Public law requires that a consultation exercise will (1) be conducted at a time when the decision makers' thinking is at a formative stage; (2) afford adequate information and time to allow a proper and informative response; and (3) involve a conscientious and open minded consideration of relevant matters: see *R (Moseley) v Haringey LBC* [2014] UKSC 56, [2014] 1 WLR 3947 at para.25 per Lord Wilson endorsing the judgment of Hodgson J in *R v Brent London Borough Council, ex p Gunning*, (1985) 84 LGR 168.

163. An independent review had been highly critical of the basis on which the FSA denied the excluded customers access to the Scheme. It was critical of the FCA failing to take proper steps to ascertain the impact of the Sophistication Test for excluded customers. The FCA was aware that excluded customers were likely to take the view that the FCA should take steps to procure address in the light of the Review. The FCA knew that consultation would maximise its chances of gathering in and considering all relevant arguments for and against. In these circumstances it was submitted that it was in breach of these principles for the FCA to take the Decision behind closed doors and publish it at the same time as the review without listening to the voices of the relevant stakeholders informed by the findings of the Review. The FCA acknowledged that the Review would likely lead to public pressure for the FCA to take steps to ensure redress

was paid to customers not covered by the reviews, but they saw this as a reason not to consult and instead to publish the Review and Response simultaneously.

164. Ground 2 is a consultation challenge. Where Parliament intended to impose on the FCA a duty to consult, it has made provision to that effect in FSMA. Particular examples are contained in the general duty in section 1M and in sections 137J, 137K, 138I, 187B and 330. In the absence of a statutory duty to consult or a legitimate expectation of consultation arising from a promise or practice, such a duty will only be imposed at common law where it would be conspicuously unfair not to do so: see: *R (Plantagenet Alliance Ltd) v Secretary of State for Justice* [2014] EWHC 1662 (Admin), [2015] 3 All ER 261, para.98(2), approved in *R (MP) v Secretary of State for Health and Social Care* [2020] EWCA Civ 163, [2021] PTSR 1122, para.36 per Newey LJ. It is not an answer to this to rely upon authorities concerning the *Tameside* duty of inquiry which forms no part of pleaded Ground Two.

165. Applying the test of whether there was conspicuous unfairness in the FCA not carrying out a consultation exercise prior to reaching the Decision, I find for the reasons identified in paragraph 37 of the skeleton argument on behalf of the Defendant that no conspicuous unfairness has been shown nor has it been shown to be irrational or unreasonable at common law. This is for the following reasons, namely:

(i) the FCA was aware that the excluded customers were dissatisfied with the scope of the Scheme including customers who had suffered material financial loss and considered that the FCA should act in their cases;

(ii) the circumstances listed at para.36 of the skeleton argument of the Claimant containing criticisms about the nature and effect of the differentiation and the reasons why the FSA/FCA failed in its object to protect consumers appropriately all appear in the Review and did not require consultation to ascertain these criticisms;

(iii) the Board Paper noted all of this and it was a large part of the premise for the Review in any event, which recorded evidence of dissatisfaction of excluded customers, identifying loss suffered by excluded customers and evidence of recoveries of redress by excluded customers;

(iv) In June 2021 the FCA considered whether it should consult on the issue of taking further steps on redress, but formed the view that it was not necessary since it was already well aware of the nature of the issue and that doing so could provoke market speculation and uncertainty.

166. In the circumstances it was not conspicuously unfair or irrational or unreasonable at common law for the FCA not to seek more information before reaching the Decision. For the above reasons, Ground Two must also be dismissed.

XI Relief

167. It is argued in the alternative that section 31(2A) of the Senior Courts Act 1981 requires the Court to refuse to grant relief if it considers it highly likely that the outcome for the Claimant would not have been substantially different had the conduct complained of not occurred (the "Highly Likely" test). This is subject to an exception where the Court considers that it is appropriate to disregard this requirement for reasons of exceptional public interest in which case the Court must certify that the condition has been satisfied. This involves complicated counter factual matters in respect of the Highly Likely test, as well as questions of exceptional public interest. Having regard to the conclusions which I have reached to the effect that neither of the two Grounds is established, it is not necessary for the Court to reach a conclusion in respect of the alternative argument in respect of section 31(2A).

XII Concluding words

168. For all these reasons, the application for judicial review must be dismissed. The Court would be grateful for a draft order to reflect the matters set out herein and to the extent that there can be agreement about consequential matters.

169. It remains to thank the legal advisers for the expertise on both sides in the preparation and presentation of the case and for the assistance which they have given to the court. The quality of the advocacy on both sides was of the highest order.