Interest rate hedging products

1. About this helpsheet

This helpsheet is for insolvency practitioners.

In 2012, the Financial Conduct Authority (FCA) identified failings in the way that some banks sold interest rate hedging products (IRHPs). The banks involved agreed to review their sales of IRHPs made to unsophisticated customers since 2001. The full review started in May 2013.

The FCA has designed the review process so that, if a business is insolvent it does not affect its eligibility to participate in the review and does not change how redress will be determined. This means that insolvency practitioners may become involved in the review process, if an insolvent company was sold an IRHP which is subject to the review.

Under the IRHP review customers who have been mis-sold an IRHP can expect to be offered fair and reasonable redress. The objective is to put customers back in the position that they would have been in, had it not been for the mis-sale. This is the same approach used by the Financial Ombudsman Service.

The FCA's principles of fair and reasonable redress require a bespoke assessment of all relevant evidence to determine what the customer would likely have done had the sales process been conducted compliantly.

As each review will be driven by the facts of the case, it is very difficult to give any definitive guidance on how an insolvency practitioner should act when faced with an offer of redress. This guidance, therefore, seeks to alert insolvency practitioners to the high level issues associated with the review process. If insolvency practitioners have any queries about a particular review in the first instance, the most productive way for the insolvency practitioners to take forward queries and concerns will be to discuss these directly with the bank in question.

2. The independent review process

The review has been set up such that a customer can have their case reviewed and can receive fair and reasonable redress without needing professional advice. To ensure that outcomes are fair and reasonable every case, from start to finish, is overseen by an independent reviewer. Using their powers under the Financial Services and Markets Act, FCA required the banks to appoint independent reviewers.

FCA oversaw the appointment of the independent reviewer at each bank. During the selection process, a number of factors were considered and a robust approval process was conducted to ensure the reviewers had the necessary skills, expertise and independence to understand both the complex aspects of IRHPs and the specific needs of small businesses. When selecting the independent reviewer for FCA approval, each bank also had to identify any potential conflicts of interest. FCA considered the nature and value of previous work undertaken by the independent reviewer, including involvement in (a) the design of the products and sales processes being reviewed, (b) winding up of IRHP customers, and

(c) the provision of auditing services to the bank. Where FCA identified the potential for a conflict of interest between individual customers and the first independent reviewer appointed by the bank (or a perception that there could be a conflict), the banks were required to appoint another independent reviewer to review those cases.

Now that cases are being reviewed, FCA are continuing to provide close oversight of the independent reviewers. The independent reviewers report regularly to the FCA, both on the judgments they are making and how the banks are performing and the independent reviewers meet regularly together to ensure a consistent approach to assessing claims and determining redress. For transparency, FCA publish on a monthly basis the results of the banks' reviews. The latest figures published (as at September 2014) show that more than 90% of sales have been assessed as non-compliant and around 80% of redress offers involve a full, or near full, refund of all IRHP payments.

3. Set-off

Set-off is self-executing in liquidation however it does not take effect in administration until the administrator gives notice under Rule 2.95.

The FCA is clear that the application of insolvency set-off is a matter that sits outside of the IRHP review. The bank will need to deal with the payment of redress in a way that is consistent with its legal rights and obligations. As would be the case for any payment being treated in this way, if there is disagreement as to whether set-off is valid, this should be dealt with between the interested parties in line with usual practice for dealing with such insolvency disputes.

Set-off does not necessarily negate the benefit of fair and reasonable redress offered under the IRHP review. Fair and reasonable redress, including potentially consequential losses, introduces additional funds into the insolvency process that is likely to be relevant to the objectives of the insolvency practitioner and could have a positive impact in reducing or extinguishing liabilities.

4. Consequential loss

As part of the IRHP review, the banks have agreed to pay 8% simple interest per year on any redress payments to reflect lost opportunities. For most customers, this has represented a straightforward and fair proxy for a consequential loss claim.

The amounts awarded so far are not insignificant. The typical customer receives up to 40% in interest, which means that average pay out includes around £45,000 to reflect consequential losses. In total, of the £1.2bn paid out so far, around £300m has been automatically added to address customers' lost opportunities.

If customers believe their lost opportunity costs amount to more than the 8% simple interest, they are able to put together a claim for consequential loss. Businesses that can demonstrate that the mis-sale of an IHRP caused the insolvency are able to claim consequential losses for the losses suffered. Of course, many businesses will have got into financial distress for a variety of other reasons. In this regard, the FCA has suggested that that a helpful first step might be to construct a timeline to understand whether the company's financial difficulties coincided with the IRHP payments. In a number of cases the FCA has seen so far, businesses were already showing signs of distress before having made any significant payments on their IRHPs. There's more information on claiming for consequential loss on the FCA's website.

For the customers who believe they have a claim for consequential loss, the banks are offering a good amount of support with their claims. All claims are being assessed by independent reviewers. If claims are rejected, banks are providing constructive feedback so that customers may be able to provide additional information to support their claims.

If an insolvency practitioner is concerned about the costs involved in pursuing a consequential loss claim, the banks have put in place a process whereby basic redress money can be paid ahead of submitting claims for consequential losses.

HM Revenue and Customs has issued advice on the tax treatment of the redress payments.

5. Insolvency Practitioner decision making and potential litigation

Insolvency practitioners may need to make important decisions in relation to redress offers (for example, whether to accept 8% simple interest or pursue a consequential loss claim). In that regard, IRHP claims are no different to other decisions an insolvency practitioner may need to take– weighing up the potential benefit of pursuing certain actions against the cost of doing so and the risk of the claim being unsuccessful.

In some cases the company's former directors may be pressing the insolvency practitioner to reject the bank's offer of redress and pursue litigation. Again, this falls within the normal course of decision making when deciding whether to commence legal action. As yet, no cases have come to court so any legal arguments are as yet untested, so the success or otherwise of any legal action cannot be predicted.

It's worth noting however, that in the recent case of Hockin and others v Marsden and others [2014] EWHC 763 (Ch) the High Court ordered a company in administration to assign its claim for the mis-selling of an interest rate swap agreement to a creditor under paragraph 74 of Schedule B1. The judge did not criticise the administrators for declining to pursue the claims themselves, but he felt that, as the terms of the proposed assignment included that the estate would share the benefit from any success, it would unfairly harm the creditors if the claims were simply lost and thus he felt that there was a basis to the creditor's paragraph 74 claim.

6. Dissolved businesses

The banks have agreed that, so far as possible, they will treat companies that have been dissolved consistently with all other customers.

- The banks will automatically review files of a dissolved **category A** company (i.e. where the IRHP purchased was a structured collar) and will make a reasonable effort to identify and contact the interested parties from the dissolved company, which is likely to include former directors and secured creditors, with the details of any redress offer. The interested parties can then decide whether they wish to restore the company to the Companies Register.
- The banks will make a reasonable effort to identify and contact the interested parties from a dissolved **category B** company (i.e. where the IRHP purchased was a swap or simple collar), which is likely to include former directors and secured creditors, to see if they want the dissolved company's sales file reviewed. If they do, the bank will conduct the review and then inform the interested parties of any redress offer. The interested parties can then decide whether they wish to restore the company to the Register.
- If any interested parties from a dissolved **category C** company (i.e. where the IRHP purchased was a cap) contact the banks and request a review, the banks will review the case, and follow the same process as with dissolved category A and B customers (set out above).