HOUSE OF COMMONS

Treasury Committee

Oral evidence: The Swift Review, HC 1166

Wednesday 16 March 2022

Ordered by the House of Commons to be published on 16 March 2022.

Watch the meeting

Members present: Dame Angela Eagle (Chair); Rushanara Ali; Harriett Baldwin; Kevin Hollinrake; Siobhain McDonagh; Alison Thewliss.

Questions 1 - 57

Witnesses

I: John Swift QC, Independent Reviewer of the FCA's supervisory intervention on IRHPs; David Capps, Partner, Ashurst LLP; and Nikolaus Grubeck, Monckton Chambers.

Examination of Witnesses

Witnesses: John Swift QC, David Capps and Nikolaus Grubeck.

Q1 **Chair:** Welcome to the Treasury Committee's evidence session on the Swift review. Could I invite the witnesses to introduce themselves?

John Swift: Good afternoon. I am John Swift. I am the independent reviewer.

David Capps: I am David Capps; I am a partner at Ashurst.

Nikolaus Grubeck: I am Nikolaus Grubeck of Monckton Chambers.

Q2 **Chair:** I would like to thank you very much for coming to give evidence to us on this particular issue. Mr Swift, your report was both large and very complex. How difficult was it for you to reach your conclusions?

John Swift: It was a long inquiry. We had to cover about 20 separate questions set for us by the FCA. It was a testing inquiry, not least because we were dealing with a very complex investigation by the FCA and the FSA before it. Many difficult questions of judgment had to be exercised by the FSA and the FCA. I and my team gave very serious consideration to each of those issues. We had a lot of documentary evidence to look at. The FCA gave us over 1 million documents and we interviewed many witnesses.

You asked me how difficult the issues were. In my conclusions, I said I am satisfied that we have arrived at very clear conclusions on the evidence. I do not resile from any of them. When I have differed from the FCA and its judgment, it has been after very serious consideration of its reasons. I am confident that the recommendations we have made to the FCA, most of which it has accepted, will produce an FCA in the future with far better corporate governance, much better direction towards the protection of those customers who look to the FCA for protection and, more generally, a much better process in the manner in which it arrives at its decisions. On each of those matters, I reached those conclusions without much difficulty.

Q3 **Chair:** In your review you state that you found "no explanation" as to why sophisticated customers were excluded by the FSA from the compensation process. You say it was done with a "stroke of the pen". Why do you suspect that the FSA took the initial decision to make this division between unsophisticated and sophisticated customers, and then exclude sophisticated customers from the compensation scheme?

John Swift: I am going to find myself talking about the FSA and the FCA, but it was definitely the FSA back in 2012. Having realised there was a serious problem and having been alerted to that by MPs and the press, they started off in what I would regard as the right way. They recognised that the banks should carry out a past business review into the sale of derivatives, interest rate hedging products, to all those customers who fell within the classification known as private customers until November 2007 and retail clients thereafter. That was a class to whom firms such the banks owed specified duties known as the regulatory requirements, which are a set of principles and conduct rules. That was how they started off.

Why was that right? It was right, because it recognised the very important principle of equality of treatment. No doubt there are customers with different characteristics, but one characteristic that they shared in common was that they were members of that class. That was the proposal put to the banks in June 2012, quite apart from the separate proposal that they should provide immediate redress to certain customers called non-sophisticated customers to whom a particularly complex derivative had been sold, namely a structured collar.

I am concentrating now on the main aspect of that proposal, which was a past business review. That would have involved a case-by-case assessment under the supervision of skilled persons as to whether a hedging product, an IRHP, had been mis-sold. Only if it had been mis-sold would the bank then be under an obligation to provide redress.

Two of the banks made representations to the FSA asking why, since there was a provision in the proposal that non-sophisticated customers should get immediate redress if they had been sold structured collars, the whole scheme should not apply to non-sophisticated customers. In my

report I have said that, within about 24 hours of that consideration, among others, the FSA did a U-turn and therefore went back on it.

Q4 **Chair:** Why do you think they did that? You have had a look at a million documents. You have been involved in considering these things for a long time. Why do you think that happened?

John Swift: Exactly, Dame Angela. There was no contemporary record explaining why that U-turn had been undertaken. Not surprisingly, we put that question to every former member of the FSA who was prepared to give evidence to us. "Why did you do it?" Answer was there none. We could not arrive at any explanation. Since then, in the course of my review, which, as the Committee will know, did not start until 2019, the FCA has made representations to us as to why the decision had been taken. As the Committee will probably have seen in the FCA's published response to my report, it was a combination of reasons: they were emphasising support for vulnerable people; it was a trade-off; and there were other reasons. As to contemporary evidence, there was none.

Q5 **Chair:** There was no contemporary evidence, but the FCA has stated that there is no evidence that the banks would have agreed to a voluntary redress scheme if it had covered all customers. That is a hint of what might have been going on here, even if there is no contemporary evidence. The banks said that they would undertake a voluntary scheme, but they did not want all the 30,000 people who had been sold these products to be included in it. In fact, this definition of sophisticated and non-sophisticated customer excluded about a third of those who had bought these products.

John Swift: I will answer that in two ways. First, the FCA was very clear in its statement. What it said was that there is no evidence that the banks would have agreed to the enlarged scheme, if the FSA had insisted. There is a premise there. If the FSA had insisted, it says, there is no evidence that the banks would have agreed. When there was no insistence, there can be no evidence as to what the banks would have done.

Q6 **Chair:** Perhaps there is a lot of nodding and winking in meetings between the FSA and the banks about what they would agree to, which is not written down. I know it is conjecture, but there are ways that these things can be communicated in meetings. The line of least resistance, surely, for the FSA was to get the banks to agree to a voluntary scheme. The quid pro quo may well have been that the banks agreed to a voluntary scheme so long as it did not include everybody.

John Swift: In my opinion and in my conclusion, the line the FSA should have taken was to recognise the principle of equality of treatment. If it was going to depart from that principle, it should have had adequate justification. Merely drawing a line and saying, "Those we deem to be non-sophisticated will be eligible for relief, but those we deem to be sophisticated will not," was not, in our view, an adequate justification.

One can only speculate as to what would have happened if the FSA had said to those banks, "I am sorry. This is the proposal we have put to you. We think it is a sensible proposal that you should carry out this past business review. What we are going to do now is look at each of the banks separately". I am now speculating as to what could have should reasonably been undertaken. If this policy was the correct one, the FSA should have gone to each of those four major banks and said, "I would like you to enter into an agreement in respect of which you will undertake a review of all your sales to all those customers." They should have gone around the floor.

We know that only two of the banks made those representations. In the meantime, the FSA could have said, "If there is a problem with vulnerable customers, we will go for triage. We will ask the banks to provide the evidence on who the most vulnerable are, and we will use our powers to protect them." It did neither of those things. It did a U-turn without adequate justification.

I was not impressed by the representations made during the review; I have not been impressed by the representations made in the FCA's response published on the same day as my report that this was the best deal that it could make, because it was not sure as to what the banks would do. However, that is the case that is being put by the FCA. In my judgment, I am not convinced by it.

Q7 **Chair:** Are they being too soft as a regulator?

John Swift: That is a very big question.

Chair: Are they being too soft? Are they taking the line of least resistance to make it easier for them to carry on?

John Swift: Dame Angela, we are back to the first question you put to me. Why did they do it? That is the question that I find extremely difficult to answer. Having done it—I am sure we will come on to this later on—and having adopted the new policy, they then went further and moved the dividing line further towards the banks and away from the customers. No doubt we can come to that in due course.

I hope that is not too long an answer, but that is one of our critical findings. Going back to your first question to me, that was a conclusion that we reached without much difficulty. They had the right idea; they had the might of a regulator to take it forward; they did not.

Q8 **Chair:** What should be the best way forward now to ensure fairness for those who were left out?

John Swift: My remit is limited to making a report to the FCA. This is a lessons learned review. I concluded that it would be well beyond my remit to make any recommendation to the FCA as to what action it might take. It is quite clear from the terms of my review that its purpose was

not to reopen the scheme. That is why I have gone as far as I can and should go in this report.

Q9 **Chair:** Is there evidence that the Treasury appeared to be putting pressure on the FCA to reduce costs to banks, especially given that two of them were in public ownership at the time?

John Swift: I would say to this Committee that the evidence I have included in my review would support that conclusion.

Q10 **Chair:** What evidence is there on how this pressure influenced the FCA's decision-making?

John Swift: This was a matter to which we had to give the most serious consideration. Had I found that the regulator had surrendered its independence to the Treasury and was merely complying with what the Treasury wished to see as an outcome, it would have been a most grievous adverse finding about the regulator. That would have been a betrayal of everything that Parliament expects of an independent regulator.

Why did I come to the conclusion that the FCA acted independently? By the time the Treasury made those representations to the FSA at the end of 2012 and the beginning of 2013, the FSA was already well on the way to accepting the banks' arguments that there should be a further movement of the dividing line between the so-called sophisticated and so-called non-sophisticated customers. It had already been developing a policy.

At one of the critical meetings when one of the senior directors of the FCA was present, the director in question took a most unusual step of making sure that he made his own minute of that meeting. This was not the minute agreed between the Treasury and the FSA; it was a minute taken by the FSA director in question. If the Committee has seen that minute, it is clear to me that the director in question and his team left that meeting determined to make their own independent decision.

That was a critically important finding in my report. I based it on the contemporary evidence that I had and on the fact that I believed the man in question when I interviewed him. As the Committee will be aware, so much of the conclusions and recommendations in my report has come from witness evidence, by talking to people, throughout the pandemic, across the table with the documents in front of us and forming a view as to whether I believed that person.

I was getting very honest answers from those senior executives within the FCA and from those where the protocol requires me to anonymise them. They were not in any way falling over as a result of the Treasury pressure and doing what the Treasury wanted. They knew what their duties were as a statutory body and they complied with them. The fact I disagreed with their conclusions is a different matter.

Q11 **Chair:** A team of FSA staff met with HMT officials on 24 January 2013. There are minutes of this meeting, with official H stating that "the Treasury had been lobbied hard by the CEOs of the banks, particularly the two state-owned institutions" and that "the purpose of the meeting was for HMT"—the Treasury—"to understand the FSA's proposals in order to find ways to cut the cost". HMT official H is recorded as acknowledging that this may be seen as a "volte face" given the Treasury's previously adopted position.

He goes on to talk about a meeting between Sajid Javid, who was then Financial Secretary to the Treasury, Martin Wheatley, head of the FSA, and Treasury officials on 24 January 2013, when Sajid Javid explained his concern about where to "draw the line" in respect of sophistication. When that line in respect of sophistication changes, we know you get a whole load more people excluded from the scheme, which saves money.

It would look to an average observer, would it not, that that was Treasury pressure that excluded people from the scope of the scheme because the CEOs of the major banks had been putting pressure on the Treasury to do so?

John Swift: It would have been very easy for me to have concluded, given the coincidence of timing of the pressure and the further movement of the dividing line, that it was as a result of that pressure. I had to form a view as to whether there was that causal connection. I formed the view that, even if there had been those changes, they were the ones that the FCA regarded as appropriate to make in order to arrive at an agreement by 31 January.

If I may just expand on this, there were two critical dates in the development of this scheme. The first was the end of July 2012 when the then chairman of the FSA had committed his own organisation to arrive at a decision by the end of June. That was the rush that brought about that agreement, which turned out to be an agreement with so many holes in it that it had go through a pilot review that was not completed until the end of January or even May. That is the first point.

Secondly, the FSA—and then FCA—was under pressure from stakeholders and MPs, among others, to do something. It had been sitting on this and doing a pilot review since June 2012. It was then moving into 2013. When are these customers going to get the redress that the FSA promised them would be done swiftly? The next deadline was 31 January 2013. When, as a regulator, you put yourself into that position, you do not enhance your negotiating position. In my view, those final concessions were made because they had to make that 31 January deadline. It was much more that than it was the—

Q12 **Chair:** The banks are a bit obdurate; you are coming up against a deadline as the regulator, so you compromise by excusing more people from the scheme to make it cheaper for the banks. That is essentially what you think happened.

John Swift: I am saying that is what happened, but I am also saying the FCA regarded those further concessions as entirely appropriate, recognising the boundary between what it called the non-sophisticated and the sophisticated customers. Otherwise, the FCA would not be saying now that it thought that decision was absolutely right and reasonable.

Q13 **Chair:** Do you have any reflections on the behaviours of the banks when they were implementing the voluntary redress scheme in terms of the pressure they imposed on the FCA, it seems, via the Treasury as well as in their own other ways?

John Swift: Dame Angela, your question refers to when they were implementing this scheme, which started in May 2013. We saw all the first-tier banks; we saw most of the skilled persons. The clear impression we formed was that the banks and the skilled persons were working to the management of that scheme as they had agreed. We did not see any backsliding from the banks. Moreover, that is why the skilled persons were there and why the FCA still had a supervisory role. The banks did comply with the agreement under the scheme. They were under considerable pressure from skilled persons to do so.

The Committee may want to get into this on another question, but the fact is that back in January 2013 the FSA—or maybe the FCA; whatever it was—published the findings from the pilot review. They said, "It is going to take six months to get the redress and 12 months for the more complex cases". When I started my review in 2019, one of the witnesses was a skilled person. They were still working on some of the consequential loss cases in 2020. However, having said that, that was an extreme case. Most of the cases had been resolved by the autumn of 2015. In 2016, the FCA produced the results. But 20,000 individual cases had to be looked at. The notion that they could have been resolved within six or 12 months was artificial.

Q14 **Harriett Baldwin:** As constituency MPs, most of us have come across cases that your review would have touched on. I should also say for the record that from May 2015 until mid-2016 I was Economic Secretary to the Treasury. One of my strategic objectives at the time was that the UK financial system should resolve and move on from all of the legacy of the financial crash. I do not recognise the comment about differentiating between state-owned and non-state-owned banks, but I certainly remember that, in my regular meetings with the banks involved, I would always ask for an update on this subject, because it was important to try to find a resolution for it. I just wanted to state that for the record.

I wanted to ask specifically about skilled persons. I was fascinated by one of the sentences in your report: "I have reservations as to whether the scheme delivered consistent outcomes across customers of different banks". That is a very subdued but worrying statement, in my opinion. Can you point to specific examples where you saw that the skilled persons regime that was set up delivered different outcomes for exactly the same situation?

John Swift: Yes, that is absolutely right. This is a very serious point in my conclusions. The Committee will recall that within the terms of reference—this is ToR 3—I was asked whether, overall, the scheme had produced fair and consistent outcomes. I will move on to consistent outcomes, but, as to fair outcomes, when each of the skilled persons reported back to the FCA, they reported that in their view the banks had complied with their obligations under the scheme and that fair outcomes had been realised.

The problem within the scheme was that there was no overarching responsibility on the FCA to carry through on a systemic basis a comparison of outcomes as between the banks. I must not overexaggerate this, but there were forums in which skilled persons would talk together with the FCA. There were analyses of different results. There were also objective reasons why you could never get precise consistency through quantitative analysis, because the mix of customers within the banks would be different.

Nevertheless, for the first time—it had not been done before—we looked at all the skilled persons reports and we compared the quantitative results. It did seem that, in the case of some banks, there had been a higher incidence of full tear-up and interest than in others. Because we could not ourselves carry through a case-by-case analysis, we had to conclude that the quantitative evidence did not allow me to give the FCA the assurance it wanted that there had been consistency of outcome as between the banks. Having said that, as you will see in my report, I did say that we concluded that, in respect of the customers for each bank, without going into specific cases, the skilled persons said there had been fair outcomes.

In a sense, it is left a bit at large. The main point I was making here is more in the sense of the recommendation that, when you have a scheme of this complexity, if you are seeking to go for consistent outcomes as well as fair outcomes, you have to have some form of mechanism to enable you to measure it. That was another aspect of our concern. I hope I have answered that question.

Q15 **Harriett Baldwin:** I think so. I am hoping I have understood your point of view correctly. You would have preferred skilled persons to be the decision makers and for the FCA to have done some sort of quality control around consistency. I asked that question, because, if this gets used again in the future, I am interested to know what would have been a better approach, in your opinion.

John Swift: Certainly, in the past, the fact was that the scheme was there. The FCA could not unilaterally substitute a skilled person for a bank, because that was what the agreement provided for: the banks would be the primary decision makers. It has been said, absolutely correctly, that there was so much obvious inherent bias in the scheme that the banks were judges in their own cause. It was not just a question of finding money for people to whom the products had been sold. There

was a basic finding about whether the banks were in breach at all. There had to be skilled persons involved in checking the banks on that primary decision.

The skilled persons were inevitably limited in what they could do. It was a review process. We have said to the FCA, "Going ahead, you should be really considering the skilled persons as the decision makers", because then you do two things. First of all, you remove bias completely. Secondly, if you add to that an appeal mechanism, you can give an assurance to customers that there is fairness in the system and that all the decision-makers are going to be subject to review if necessary.

The FCA says, "We do not like that. It is going to add to delays". We do not see why switching decision making from a bank to a skilled person is going to cause delay at all. Nevertheless, that is part of its response. I should say that this is one of the very few of my recommendations where the FCA has said, "We do not like this."

If you have to go through something like this again—something complex, novel and difficult, involving serious suggestions that the banks have been in breach of their regulatory requirements—you should not make the banks the primary decision makers. It is as simple as that.

Q16 **Harriett Baldwin:** In terms of the skilled persons themselves, there was some overlap. For example, KPMG worked for Barclays and RBS; and Deloitte worked for Barclays, HSBC and AIB. There was some overlap, but there was no consistency in terms of the decision makers. Is that something that could have been better set up?

John Swift: First of all, that is inevitable. There are also elements of subjectivity in terms of whether there was a breach of the regulatory requirements at all. There are going to be elements of subjectivity whatever happens. There is some cost that has to be accepted. There is a cost of initial inconsistency, and then you try to control that as it develops.

If a regulator wants to have complete consistency and goes for one skilled person, in this case looking at 20,000 cases, first of all I doubt whether any skilled person would have the capacity to do it. Secondly, there would almost certainly be inconsistencies as between the managers responsible for doing it. Above all, my experience is that you do not put decision making in the hands of one person, if you can possibly help it. The notion of a monopoly skilled person looking at 20,000 contracts is one that I would not regard as efficient or fair regulation.

Q17 **Harriett Baldwin:** You are confident that all the skilled persons who were involved were appropriate in terms of their skills and their independence.

John Swift: I am. I am absolutely confident of that. I am also confident that the FCA did a good job. The FCA at that time did not have the power to appoint the skilled persons. The banks had to appoint the skilled

persons, but the FCA had to approve them. One of the reasons why the pilot review took from July 2012 to April 2013 was that there were nine banks involved and more skilled persons had to be appointed. The FCA was so reliant on the skilled persons. For its own credibility, it had to ensure they had competence, independence, resources and commitment. In my view, it did that.

Q18 **Harriett Baldwin:** If the recommendation you have made about primary decision makers had occurred, would it have made any difference to, for example, the sophisticated customers? Could it have been a decision that might have benefited them?

John Swift: No. It would have had no effect, because they could not be brought back within the scheme. Only if they had been eligible within the scheme could there have been any difference. That difference would then have applied to all eligible customers, not just the sophisticated ones. That is a very difficult question to answer. Would the outcome have been different had the roles been reversed? I cannot give a sensible answer. It is a hypothesis that is almost impossible to test in terms of probabilities.

Had they been there, there is no doubt in my mind that the scheme would have been seen by all customers to have had that degree of fairness that it lacked. The perception of fairness is not helped when the banks are primary decision makers. Whether the offer by a bank is accepted or not, in the absence of any appeal mechanism there is always a residual doubt among customers that they had to accept grudgingly. I am not saying that is a general reaction, but it is inevitable when you create a scheme that has this imbalance of decision making and you add to that imbalance an asymmetry of knowledge about what was in the scheme.

Not until this Committee banged a gavel on the table and said, "Why is it that you are continuing to withhold from the public this agreement?" did the FCA finally get the banks to agree to disclose it.

Q19 **Harriett Baldwin:** That is interesting because the reasons the FCA gives for not accepting your recommendation that skilled persons should be the primary decision makers is that it could have potentially delayed the delivery of redress. What is your reaction to its concerns?

John Swift: That is more a question about my recommendation as to the future. I am not sure whether they are saying that, within the scheme itself, had the skilled persons been the decision makers, it would have caused delay. If I may use the vernacular, I do not buy the argument. I do not believe it is backed up by any strong evidence at all.

Q20 **Rushanara Ali:** Good afternoon. I just wanted to get a bit more of a sense of the scale of the problem. Nine banks contributed, and their contribution was £2.2 billion, according to your report, on a voluntary redress basis. You have talked a lot already about the sophisticated group. What would have been the overall amount the banks would have

had to pay, if we started afresh and included equal treatment across the board? Just to get a sense of the scale of what has been missed, do you have that number?

John Swift: Ms Ali, you really are asking me to put a crystal ball on the table. It is not in my report. I am not being defensive, but what is not in my report I cannot speak to.

The Committee may have seen some figures that have been suggested by some people about what the likely total cost of the redress would have been. Effectively, what would have to be done—I have not done this exercise, and therefore I am not going to put a figure on it—is to ask, "What would have happened if the 10,000 customer contracts that had been excluded from the scheme had been subject to a past business review to determine, first, whether there had been a breach of the regulatory requirements, including the sales standards, and, if so, what redress would there have been?" I do not believe that the £2 billion could be taken as a reliable denominator by reference to which one could apply a percentage.

Q21 **Rushanara Ali:** Is that £2 billion speculated by others?

John Swift: The £2 billion is what the banks paid back to the eligible customers. Before the £2.2 billion or whatever it was, all those costs and all the risks of those customer contracts had laid with the eligible customers. With that £2.2 billion, all the costs and risks had been transferred to the banks as a direct result of the scheme. That was a major significant effect of the scheme. I have not attempted in my report—

Q22 **Rushanara Ali:** Should the FCA be answering that question, then? Should somebody be answering the question about the gap for those who were in the category that did not qualify?

John Swift: The FCA, with respect to it, is not going to provide that figure. The FCA says, "We were right to exclude them anyway." I do not know how it could be done other than prospectively through some form of sampling of the 10,000 contracts and forming a view. It is not something we felt was within our capability.

Q23 **Rushanara Ali:** The reason why I ask is because some of the things you have described echo some of the evidence we received on the impact on small businesses during the Global Restructuring Group scandal, which made lives a misery. Some of those SMEs might have been considered sophisticated customers, but it caused ruin. They described the way in which they were treated. It was really bad. They were up against, as per your description, this asymmetry of information and these powerful banks. This is the legacy of what we are dealing with. The sophisticated customers in this category are lives and businesses.

John Swift: The only people who could possibly answer that question are those who would have done the calculation, if they ever did the

calculation. That would have to be the banks. I found nothing in the million or so documents that would enable me to give you an honest figure as to what that sum might be. What I can say is that we have found nothing to indicate that the FCA knew what that figure was before it agreed those major changes to eligibility.

Q24 **Rushanara Ali:** You argued that the FSA/FCA should have carried out a more intensive investigation of the root causes of the mis-selling before concluding not to pursue enforcement action. Why did they not do this? Is it because they just wanted a quick and easy way through this? Were there deeper reasons for it?

John Swift: I think you have got it right.

Q25 **Rushanara Ali:** It was a shortcut, and shortcuts mean consequences.

John Swift: Yes. We picked this up pretty early on when we got the documentary evidence. The FCA was saying, "We have to get to the root cause of this". Of course you have to get to the root cause. If you are a regulator, you do not want to know just that there has been mis-selling; you want to know why there has been mis-selling. What is driving it? What is driving that surge in supply between 2005 and 2008?

Was it to repair lost profits as a result of increased competition in some other part of the market, or was it a lack of controls? What was driving it? As the Committee will be aware, that is one of the matters on which we drew the conclusion: why was there no enforcement action?

Q26 **Rushanara Ali:** In your view, would such an investigation have led to quite different outcomes for customers?

John Swift: I do not think it would have led to a different outcome for customers because the customers wanted a redress scheme. Although I am now speculating and talking about something that did not happen, had there been enforcement and the sanctions that follow on enforcement, there would have been a very clearer message to the banks from the FCA that the regulator was not simply concerned with moving costs and risks from one sector of the economy to the other. It was there to demand improved behaviour from the banks in the future and to sanction previous past behaviour. That is why a regulator with these massive powers has the powers of enforcement.

Q27 **Rushanara Ali:** There is a failure by the regulator to really get under the skin of what happened and to learn the lessons. You observed that a redress scheme on its own is unlikely to remedy relevant failures and address any wrongdoing. In your experience of what you have done and those observations, what elements of misconduct of banks in this instance have escaped action? Is it hard to say?

John Swift: Again, it is difficult because the question does require a view as to what evidence would have been produced by an investigation into the root causes. Had it, for example, shown a lack of effective controls

from the centre to those who had negotiated the contracts, had there been improper incentives, had there been a blatant wilful disregard of the rules that applied in relation to those contracts, you can see how enforcement could have escalated as each element of the misconduct was revealed. That is simply me speculating on what might have happened, but this is why people must investigate root causes, because the extent of misconduct is precisely what is going to be revealed by that. In my report, I can go no further.

Q28 **Rushanara Ali:** We have seen numerous reports and issues that have come up over the years since this case. We have had the LCF case and others. There is a question niggling in the background: if those lessons had been learned and that deeper set of investigations had happened, could the FCA have taken more pre-emptive action to improve the climate in which banks operate and prevent other bad behaviours from taking place?

John Swift: Let me say that I agree. Of course, Dame Elizabeth, whom you saw last year, was dealing with a pretty egregious example. I think I can fairly use that expression. It was a fairly recent occurrence. I was dealing with conduct by the banks that went back to 2001, and conduct by the FCA that started in 2012 and finished in 2016. It was quite a big gap and, as you will have seen in the response from the FCA, the FCA is saying, and I do not dispute this, it is now a different animal. I am paraphrasing; that is not the expression, I suppose, I should use about a regulatory body. Anyway, it is different from its predecessor, which took all these decisions.

Q29 **Rushanara Ali:** The review states that, if section 404 of FSMA were amended to remove limitations to remedies and the relief available to customers in civil proceedings, it would be a much more effective tool in the FCA's armoury. Can you explain why it would be a more effective tool, and would there be any adverse consequences for amending it, from the Government or FCA's perspective?

John Swift: The principal reason is that, if Parliament were to change the law so that a breach of the regulatory requirements by the bank would create a breach of statutory duty, that would enable the FCA to use section 404 more effectively. I am saying this not looking to my left, but he knows that if section 404 comes up I might get it slightly wrong. Nik, do you have anything to add?

Q30 **Rushanara Ali:** He has nothing further. I have one very minor point, and feel free to write to us about it, as to what the reasons were for you not being able to accept or review any IRHP evidence of serious wrongdoing that is the subject of NDAs. Were there legal or technical reasons for that, or did you feel that that was out of scope? Were there specific reasons?

John Swift: I am not quite sure I have understood that question. Could you take me through it again?

Q31 **Rushanara Ali:** Our understanding, which has come through from a colleague who has constituency issues that have come up in relation to this case, is that those who had signed NDAs were not covered, as part of the review that you did, with banks that were affected by this issue.

John Swift: I may just consult with my colleagues on this. First, as the Committee will know, it is impossible for me to answer questions about individual cases.

Rushanara Ali: It was a general point about those who were affected by NDAs, but feel free to write to us if there is anything specific you want to come back to us on.

John Swift: We did not receive any material evidence in my review that the total population of the customer contracts was in some way reduced below what it should have been. It was quite clear that the FCA was certainly looking to the banks to make sure that the derivatives, the IRHPs, were included within the scheme. As we know, the FCA, and it might have been correct, had excluded the loans. We did not find it very possible, in the exercise of our review, to check out on whether some customers who had derivatives had been wrongly excluded. In those circumstances, I would have expected the customer would have made representations to the FCA and/or the skilled person, and it would have been resolved in that way. It was not a significant aspect of our investigation.

Q32 **Alison Thewliss:** I would like to touch on the absence of Martin Wheatley in your report. Despite multiple attempts, your review was unable to secure the co-operation of Martin Wheatley, CEO of the FSA and the FCA during the time of the scheme. You have said that his account of events would have been quite valuable evidence for your review. Is there particular evidence that you feel you are missing due to that lack of co-operation?

John Swift: I am not sure I really understand this particular question about the lack of co-operation.

Alison Thewliss: At the start of this afternoon you had said that you had asked all who were prepared to answer various questions about what had happened at the time, but without Martin Wheatley you had not managed to get any answers on that.

John Swift: Is this on Martin Wheatley?

Alison Thewliss: Yes.

John Swift: Sorry, I had misunderstood.

Alison Thewliss: Apologies.

John Swift: If the Committee would put itself in my position, here I am, asked by the FCA, in 2019, to conduct a review into a complex, novel supervisory conduct by the FSA and FCA, I would have expected co-operation from all those who were responsible for decision-making. I do

not know why Martin Wheatley decided that he would not co-operate. My report indicates the number of occasions on which we tried to contact him. We did contact him at a time when we were in Maxwellisation because we thought there was potential criticism of the CEO. We got acknowledgment of that, which showed that Mr Wheatley was indeed receiving, but he was not in submitting mode. We have all given a lot of thought to this. In particular, could it be said that my conclusions and recommendations are in some way weakened or vitiated by the fact that I was not able to talk to the CEO?

I have thought about that, and it goes back to the very first question from Dame Angela, about how easy or difficult it was to arrive at conclusions. Fortunately, even though the FCA now admits that its recordkeeping left a lot to be desired, I had the benefit of massive contemporary documentation. I had the benefit of those who were willing to talk to me and who were closely involved in a committee mode in taking those actions through. Of course, I would have liked to have asked Mr Wheatley lots of questions on each of those questions in the terms of reference. Indeed, I would have been failing in my duties had he turned up and offered to co-operate, but there it is. I cannot command witnesses to appear before me. I am fortunate that he was the only one who refused. There it is. Whatever his reasons were, they were not disclosed to me, and I do not know them now.

Chair: Of course, we can command witnesses to appear before us, so we will give that some thought.

Alison Thewliss: Yes, we will do, certainly.

John Swift: It is not for me to make any further comment on that.

Q33 **Alison Thewliss:** Would you have expected him, for example, to shed light on the decision to exclude sophisticated customers?

John Swift: Yes, on all of them. The line on sophistication/non-sophistication was one of them, but why no enforcement and why no examination of root causes? Why reduce the resources that you had available in the FCA, in May 2013? Why did you think you could do it in six months or 12 months? Why were you not aware of the risks of the lack of consistency? It could have taken two days or more. You are not seeing an angry reviewer; you are seeing a disappointed reviewer. Naturally, one is called on to carry out a very important review of this kind, and the chief executive officer says he will not co-operate.

I do not want to take up the time of the Committee more than I need to, but on this business about sophisticated and non-sophisticated, and the dividing line, there is a certain emotional appeal about using the words "non-sophisticated" and "sophisticated". Why should sophisticated people not take care of their own contracts? Why should they be looking to a regulator to help them out of a fix that they got themselves into, whereas we have these vulnerable people who do not know much about what is going on? You can see it has a certain appeal, but it would never appeal

to me. That is not because I am some hard-faced individual, but, when you look at what happened, the first cut for dividing between sophisticated and non-sophisticated customers was based on the Companies Act 2006. If you were deemed to be non-eligible, you had two of the following: a turnover of £6.5 million, assets of £3.26 million or 50 employees. If you had two or more of those, you were out and you stayed out.

Was there any evidence that, if you had two or more of those, you had any knowledge of IRHPs, you had any experience of IRHPs or you should have known about IRHPs? No. It was an arbitrary dividing line based upon the Companies Act definition. It had nothing whatsoever to do with derivatives. Just going back to Dame Angela's question at the beginning on how easy or difficult it is to arrive at these decisions, that is what they did. That is why I say if you make a U-turn—and it was a U-turn—of that importance, you have to justify it. You have to go out and talk to people, consult with them, and try to get a degree of consent, because a lot of regulation is based on consent. If you do not have consent and due process, and you make arbitrary decisions and build on those, what you do is what happened to the FCA. They got to reputational risk and an existential risk that they might not even exist anymore because they lost the consent of those they were regulating, and they lost the consent of those to whom they were ultimately responsible, which is Parliament.

These are serious matters. When you make U-turns of that kind, what followed was a necessary consequence. In my view, they never recovered that position, in terms of credibility.

Q34 **Alison Thewliss:** I suppose the missing piece of the jigsaw—that decision and that U-turn—is Martin Wheatley, is it not? Have any of the other members of staff you had spoken to been able to explain any of those decisions?

John Swift: I cannot attribute that to Mr Wheatley. As I said at the outset, I do not know why that U-turn was taken. All I know is what is in my report. There was a meeting on 26 June, at the FSA, and on 27 June the decision had been taken. That decision was then communicated to the banks, to say, "Eligibility has now moved substantially. We have bought into these representations and the scheme will no longer involve any form of past business review of any sale or any aspect of your conduct to those people who have two or more of £6.5 million turnover, £3.26 million in assets or 50 employees, irrespective of what you have done." That is why I have called that a regulatory free pass, and I do not resile from the use of that expression.

Q35 **Alison Thewliss:** The FCA had agreed with your recommendation to include post-termination co-operation obligations in the employment contracts of all senior FCA personnel. Could you tell me what difference you think that would make, if any, in this case?

John Swift: I have made the recommendation because I hope it would

have an effect. If you put a term in somebody's contract to say, "This is what you do," I would like to think that most people would comply with the terms of their contract and do it. I cannot predict how many people would say, "No. It is a term in my contract. I am not going to along with it. Enforce it if you want." I would hope that most people in positions of responsibility within the public sector—and the private sector, too, but certainly if you are a regulator and that is a term of your contract, and there is a review into what you and your colleagues did that has a serious public interest impact—would go along with that.

Q36 **Alison Thewliss:** You did ask nicely, then presumably slightly less nicely, as you were making these requests to meet with Mr Wheatley. I am just curious. Once somebody has walked out the door, does that then end up in the courts—to enforce something like that?

John Swift: That is a matter for whatever is in the contracts. Mr Capps wants to add something.

***David Capps*:** Ultimately that might be the outcome, but if somebody had a contractual obligation, even post-termination, one would expect them to recognise they are contractually bound by it. Ultimately it could end up in court, but hopefully they would adhere to that obligation in any event.

Q37 **Alison Thewliss:** Turning now to issues about the redress scheme, you talked earlier about how it took much longer to action than the FCA had intended. You said in the review that delay was an inevitable consequence of the scale and complexity of the scheme rather than inaction by the FCA during the period. You had said earlier as well that you thought they were just being unrealistic in those deadlines that they had boxed themselves into. Can you tell me a bit more about that and why they ended up in that particular mess?

John Swift: They just got it wrong. I am speculating; perhaps I should not speculate. I do not understand how any regulator, knowing that 20,000 contracts have to be reviewed—in terms of what happened before the contract, a counterfactual as to what would have happened had the banks not been in breach, the possibility of considering different kinds of remedies, and a review by the skilled persons of each and every provisional decision taken by the bank—would think all this could be done in six months. There are 20,000 contracts. But that is what they said.

It is not for me to say whether they believed that. I assume they believed that at the time, but all I would say is that was wholly unrealistic. As is clear from my report, not only could they not start in January 2013; they could not even start until May 2013 because of all the other bits and pieces that had to be resolved. I cannot take it any further than that.

Alison Thewliss: If Mr Capps or Mr Grubeck wants to come in on anything, they are welcome to do so.

John Swift: Mr Capps wants to make an extra point, which is that one of the matters to which I referred in my report is the FCA coming very late to the recognition that appropriate redress could involve more than simply the tear-up of the contract and the repayment of the moneys, plus 8%. It could and should extend to consequential losses. That was not well handled by the FCA. I do not need to go into it because the reasons are all set out in my report. At the time when the scheme began to operate, the FCA had accepted that consequential loss claims were available, should be assessed by reference to the law of tort, and could be applied by the banks and the skilled persons. That in itself led to inevitable further delay, as Mr Capps quite rightly reminded me, in the scheme. But they knew that back in January 2013.

Q38 **Alison Thewliss:** In terms of their decision to have this timescale and everything else, what were the consequences of that? Did it give them less time to consult with stakeholders? What else might have been the consequence of that tight timescale they gave themselves?

John Swift: The timetable would never work; it could never work. I do not see, in our evidence, that anybody who was involved, the banks or the skilled persons, ever thought it would.

Alison Thewliss: Nobody thought to tell them that

John Swift: That is a question I cannot possibly answer.

Q39 **Alison Thewliss:** Within the screeds of evidence that you had looked at, had there been anybody saying this is unrealistic?

John Swift: The answer to the question is that the FCA had to let it run, not least because of the critical importance of the skilled persons. The skilled persons did have that power of veto. They had to be satisfied that what the banks were proposing was within the scheme. In my report, I have referred to cases where the skilled persons did reveal why their inclusion was so critical. It is inevitable that a bank, aside from the aspect of bias, might tend to be persuaded that its conduct was within the rules. I am going back to a point that I made before.

Q40 **Alison Thewliss:** To what extent did the exclusion of sophisticated customers mean that the scheme took longer to implement, as it took time to work out who was sophisticated and who was not? Did that add delay as well?

John Swift: No. As I said before at a previous question, once the sophisticated customers were out, they were out.

Q41 **Alison Thewliss:** Did that take long to establish?

John Swift: No, it did not. The evidence from the skilled persons is that, essentially, it was a quantitative test for these 10,000 contracts. Even though the quantitative test was extremely complex, if you look at it as a spreadsheet, and I even referred to it as an ancestry chart, trying to work your way through it, it was capable of being managed. By that time,

the subjective test, which had also been included in the scheme as a means of excluding customers with knowledge and experience of the complexity, as insisted on by the banks, was of minor relevance. Only 291 cases were ever decided under the subjective test because the extension of the quantitative test had effectively removed the need for the subjective test.

Q42 **Alison Thewliss:** That is useful. You said within the report, "The IRHP case is a classic example of where a regulatory failure to identify the risks and put out a few fires at the outset left the FSA with a conflagration". What more could it have done to identify the risks at an earlier stage, and what actions could it have taken earlier in the process?

John Swift: It should have listened to the whistleblowers. It should have had in place sufficient warning signs, and not just whistleblowers. Heavens above, a regulator should have the resources. We are talking about 2001 to 2008. There was the collapse of the banks in 2008. There has been a mass of literature around that time that derivatives were causing the collapse. It could not have been new to a regulator at the time that, once the banks started selling derivatives to customers falling within that protected class, there might be a problem because a derivative of that kind is a bet. It is a contract. You may come out of it on the right side or the wrong side, but my word, if you come out on the wrong side, you are in a serious problem.

In fairness to the FCA, it did carry out its own supervisory exercise and it did recognise failures. Yes, I did use the expression "putting out a few fires rather than a conflagration". I believe it could, and should, have been done. It is a somewhat emotive expression, but when the conflagration was there, when Members of Parliament and the press were pointing to what was happening throughout the country, there was then the rush to find a solution. As the FCA knew, when you rush to a solution, you sometimes live to regret what you did. That is what I said before. I am not mincing my words. The FCA came very close to a serious loss of regulatory credibility. In my view, I can trace it back to that rushed decision that they took.

Q43 **Alison Thewliss:** The FCA response stated that IRHPs were sold to SMEs alongside loans that mostly were not regulated, which made it harder for them to spot the problem. Do you buy that?

John Swift: No.

Alison Thewliss: They should have been aware of it.

John Swift: Yes. Sometimes a no and a yes is preferrable.

Alison Thewliss: That is absolutely fine. Thank you very much.

Q44 **Siobhain McDonagh:** My questions will look at the root causes and the repercussions of your review's finding that the FCA fell below the appropriate standard of transparency. You found that, in all

circumstances, the FSA/FCA did not strike the appropriate balance between the two public interest principles of transparency and the protection of confidential information. What were the repercussions of this for the customer?

John Swift: They were very serious. From the outset, there was an asymmetry of information as between those who fell within the protected class, by which I mean all private customers and retail clients and not simply those who were eligible within the scheme, and the banks. That asymmetry of information came to its worst position at the time when the scheme began to be implemented. The customers had been drip-fed information about what was in the scheme, but they had to pick it up from press releases and other documents. They never saw the principles in the scheme by reference to which they might get redress. To my mind, that is an extraordinary set of affairs.

Going back, when the U-turn was taken, the FCA should have paused and said, "We are minded to take a decision, as a result of which we will not exercise any of our regulatory jurisdiction in respect of customers who"—and you have heard it from me before—"have two or more of £6.5 million, £3.26 million or 50 employees. Is it not about time that somebody knew about this? Why are we doing it? Should we do it?" There was no consultation before the scheme, no transparency of the scheme, no stopping and pausing when the dividing lines were being changed. Why was HMT the only stakeholder that was engaged in that process?

If you do that as a regulator, you increasingly lose credibility because you lose consent for what you are doing, and the FCA fell, to my mind, well on the wrong side of that balance. Transparency is critically important for a regulator. Without telling people what you are doing and why you are doing it, you do not get respect for what you are doing. Doing the right things in the right way should be the motto on every regulator's desk. Due process is critical.

It is fair to say that, in accepting the bulk of my recommendations, the FCA admits that it was wrong to have included the confidentiality clause in the agreement with the banks and it would never do so again. To the extent that it did include that confidentiality clause, which is a matter within its own judgment, it was then forced to argue before the Information Commissioner that it was bound by statute not to disclose the scheme; otherwise it would be a criminal offence.

It allowed itself to enter into an agreement with the banks that imposed a confidentiality obligation on it, and then it said it would be a criminal offence to disclose that. Not surprisingly, we have taken issue with the FCA as to whether it looked hard enough at section 349 of the statute, which provides for several gateways. In its response to the recommendations, one senses a degree of acceptance by the FCA that the method might be somewhat more complicated than a straightforward refusal to disclose the information.

Q45 **Siobhain McDonagh:** How successful were campaign groups like Bully-Banks in helping customers? What hampered their effectiveness?

John Swift: Bully-Banks was very effective in the early stages. It provided a forum for many customers throughout the country who had no forum and nowhere to put their arguments. It was Bully-Banks that collected the evidence. They went beyond what the fourth estate was doing. Constituents were coming through the MPs. They were collecting the body of evidence as a pressure group, and they were foremost in making these representations to the FSA, but that is as far as it went. We obviously talked to them; we talked to Bully-Banks. Bully-Banks worked night and day trying to get the FSA to understand just how serious these matters were. I commend them for what they did.

Q46 **Siobhain McDonagh:** Do you believe that the root cause of the lack of consultation and transparency was the FSA's belief that the scheme was confidential, and it would be a criminal offence to publish it without the banks' consent?

John Swift: Yes, I do. I have just answered that question.

Q47 **Siobhain McDonagh:** Though the FCA accepted your recommendation about transparency, its response to your report stated that the voluntary scheme may not necessarily fall under the gateways set out in FSMA that allow it to disclose without the firm's consent. How do you respond to that analysis?

John Swift: Whoever put that answer forward has used the expression "may well". Anybody who uses the expression "may well" invites the response, "Well, it may well not be". As I have said, the FSA has gradually moved its position from being, "We will all go to jail if we publish this" to "There may be difficulties in the use of section 349." Our view is that they should have pushed harder. I do not think you necessarily need a change to the statute, but this is the position of a regulator whose sole function is to promote the public interest. That is what regulators are there for. If they cannot tell the public at large what they have agreed is their preferred scheme for dealing with a massive breach of their own regulatory requirements, I would detect a lack of force and energy rather than a problem with the statute itself.

Q48 **Siobhain McDonagh:** Section 348 of the Financial Services and Markets Act currently protects the disclosure of confidential information. Do you believe that the changes to section 348 of the Financial Services and Markets Act are warranted to ensure that the protection of disclosure of confidential information does not lead to a lack of public transparency?

John Swift: As I have said, I think I may have covered this in my previous answer, but, to the extent that it enables the FCA to embark on publication with a greater degree of confidence that it would not be subject to prosecution, that would be a very good idea.

Q49 **Kevin Hollinrake:** Can I thank you for your work and your evidence

today? In discussions with the Chair, I would like to declare my interest, an interest you might be already aware of, in that the APPG on fair business banking has given evidence to your inquiry. We are intending to take forward a judicial review of some of the FCA's work in this area, which, again, you will be aware of. I am very keen not to be accused of anything that might further the interest of that claim, of course, which, again, you would be aware of. I am sticking to material that has been prepared for us by the Clerks. There are lots of things I would like to ask you on, but I shall not.

I want to look at hidden credit lines. Have you found evidence that banks took out hidden credit lines for customers that they did not know about to cover them for potentially huge losses on the IRHPs?

John Swift: Mr Hollinrake, can I make some prefatory comments about this credit line business?

Kevin Hollinrake: Please do.

John Swift: In the terms of reference, at ToR 3, the FCA asked me to look at what it calls technical issues, one of which was called break cost and one of which was called contingent liability. At pages 340 to 341 of my report, I addressed the issue of contingent liability, and I would like the Committee, not now, to read what I said in those pages. I used the words "contingent liability" to have the same meaning as the utilisation of credit limit. In that part of my report, I referred to representations that had been made to me that the credit limit was hidden from customers, should have been disclosed to customers and was not.

In my report, I say, in effect, whatever the legal position is about whether the CLU or the credit line should have been disclosed under the regulatory requirements, which is the only way that it could have been disclosed because the regulatory requirements are the principles, the conduct rules, it would not have made any material difference. Why not? The sales standard, and in particular sales standard 2, placed such a high, onerous obligation on the banks as to lead, in most cases, to a finding that the banks were in breach.

If the banks had not disclosed to a customer what was called the break cost, and the break cost was then identified as requiring particularisation of quantities, they were in breach. What would an additional obligation to disclose the hidden credit line have done? I would say the probability is nothing. I cannot go into certainties, but the probability is that it would have added nothing. That break cost disclosure was so critical that you may recall that, in one part of my report, and I will not name the bank, breach was found in 97% of the contracts and the cause was the breach of the sales standard.

My conclusion is that that would not have been relevant disclosure to breach. The question is whether it would have been relevant to redress. This gets into a more difficult area and, again, it is one that I address in my report, on pages 341 and 342, for the transcript and if the Committee

wished to refer to it, because I know that this issue has given rise to considerable criticism, not just of the FCA but, dare I say it, of this report.

Once the FCA had committed itself to including consequential loss within redress, and once the principles had been accepted as tortious, the issue as to whether a customer could recover would depend on causation. Were the losses caused by the breach? The breach here was the mis-selling of the IRHP. If there had been no IRHP, what losses would the customer have incurred? We asked one of our skilled persons, Osborne Clarke, to what extent they had looked into it—again, this is in my report—and they said they did. If there was an opportunity cost that had been lost as a direct result, if there had been some demanding of extra security by the bank as a result, those would have been taken into account in consequential loss.

I also concluded in my report that it was not clear from all the skilled persons' reports whether all the skilled persons had adopted that approach. In the report, I also referred to the fact that the FCA did not clarify what it was expecting the banks of the skilled persons to do in respect of that critical aspect of the redress. Customers who were eligible for their cases to be reviewed by the banks and the skilled persons did not lose out in terms of breach by reason of the lack of a specific obligation to disclose a hidden credit line. I would say that, once consequential loss was included as an important aspect of redress, they did not lose out on that either.

The suggestion is being made, not within these walls, but outside, that, as a result of that, regardless of regulatory failure, there has been a significant loss to SMEs that are eligible. I reject that. I have said what I have said in my report. I have considered those representations, and I do not resile from them in any way whatsoever.

Q50 **Kevin Hollinrake:** That is very clear. Thank you. Are you content then that it did not affect things because there would have been a breach anyway? There was a mis-selling, anyway, so therefore they had access to the compensation scheme. Is that basically what you are saying?

John Swift: Yes.

Q51 **Kevin Hollinrake:** The compensation scheme was based upon banks having to decide what was in the mind of the customer when they decided to choose or sign up to a certain product, including an IRHP, and make compensation on that basis. If the customer did not know, for example, that a £5 million loan would then create another £500,000 or £1 million further hidden credit line, the customer might well have done something completely different. Is that not the case?

John Swift: The hypothesis excludes everything in the sales standards. The position I take is that, if there had been no disclosure as to the break cost, and we are talking about 90% of mis-sale here, those customers

would have said, "I am not touching that with a bargepole". That is the conclusion I have arrived at. It is possible, hypothetically, that you could create a theoretical situation in which everything else had been compliant, but that had not been disclosed. I can see that, on that theoretical case, those consequences might follow, to which I would add this: there is a separate argument, and it seems to be largely the position of the courts, that such an obligation to disclose was never put on the banks. Also, if it had been part of the regulatory requirements, which is my point, why was it never picked up by the skilled persons? That is exactly what the skilled persons were there to do. If this had been a breach of the regulatory requirements, it does not matter whether it was in the sales standards or not. It would have been picked up as an obligation, and never was.

Q52 **Kevin Hollinrake:** Aside from whether you think these people would have got compensation anyway, there is clearly a requirement, in COBS 14.3.2, that the bank disclose all significant risks to a business. Are you not uncomfortable that they did not? There is this hidden credit line. Whatever you said might have been the case in terms of the assessment and the payments of consequential loss, the banks did not disclose a significant amount of credit, which affected all kinds of things, including their ability to borrow or to re-bank. It breached loan to value obligations. Are you comfortable that that was something that banks did not disclose and should not have had to disclose?

John Swift: As I have concluded in my report, I referred to legal barriers. My understanding was that there was no obligation on the banks, either of common law or under the COBS, even under that one to which you referred, to disclose that quantification of their own risks. Nor was there an obligation to disclose the MTM value of that IRHP as it developed over time.

The case falls if there is no obligation under the regulatory requirements to disclose that information. What I am saying, and I cannot go further than that, is that, even if there had been that obligation to disclose, in the vast majority of cases, it would have made not a ha'p'orth of difference on whether the customer was eligible for redress.

Kevin Hollinrake: On that particular point, 14.3.2, subsection 2(d) says that any margin requirements or similar obligations must be disclosed.

John Swift: Exactly.

Q53 **Kevin Hollinrake:** A margin requirement has a monetary value to it. Therefore, why was it not disclosed? There is a requirement, under the conduct of business sourcebook, to disclose, and they did not.

John Swift: Why was it not disclosed in my report? I am now going to ask Mr Capps to answer that.

Kevin Hollinrake: That was not my question.

John Swift: I would ask Mr Capps to answer that question.

***David Capps*:** You refer to margin requirements in subsection (d). The common understanding of margin requirements is the requirement to make margin payments; usually they are initial margin and, in addition to that, they are variation margin. That is usually in the derivatives world, perhaps by way of cash. The expression we have seen used is not margin requirements, but rather the expression "margin credit" has been raised by certain commentators. That margin credit appears to us to just be another way of saying hidden credit line, contingent liability or CLU.

We do not actually think that this expression "margin requirements" is really engaged. In subsection (c), if you want the detail, there is reference to a requirement to disclose contingent liabilities. We take the view that the contingent liability of the customer, under the IRHP, is the potential break cost from day one, right the way through until expiry of the swap.

Kevin Hollinrake: Thank you for your evidence.

Harriett Baldwin: Dame Angela, I just wanted to make this point through you. If Kevin Hollinrake does have questions that are beyond the scope of what is in front of him, he should feel very comfortable asking them. Do you not agree?

Chair: Kevin is well aware. He has made his declarations and he decided to conduct himself in the way that he did.

Harriett Baldwin: Or he felt able to.

Q54 **Chair:** Do not worry. We had a discussion about this before the Committee began.

Mr Swift, I would like to thank you very much for giving evidence to us. It seems to me that there is a balance that the FCA/FSA, the regulator, has to gather between enforcement powers and these voluntary agreements to put redress right after something bad has happened. Do you think, from what you have seen, that the FSA/FCA has got this balance right or that, somehow, it is too reluctant to take enforcement action?

John Swift: There are two aspects to the question. In the context of my review, I have talked about information asymmetry. There was a serious information asymmetry both ways, not just between the banks and the customers, and that is my point on transparency, but between the banks and the FCA, in terms of whether the conduct justified enforcement in addition to customer redress. The FCA, in its response to my recommendations, has accepted that redress and enforcement are not mutually exclusive, and that it will be considering that in any future exercise of its regulatory powers, which I welcome.

Q55 **Chair:** I also just wanted to check your thoughts on whether perhaps there need to be changes to make it easier for regulators to enforce, rather than this view that, somehow, it will be easier to have what has

turned out to be a very complex and difficult redress scheme, which has essentially left the so-called sophisticated customers without any protection from enforcement at all.

John Swift: Yes.

Q56 **Chair:** I suppose I am asking you whether Parliament should be looking at the way the law is balanced between enforcement and redress in this manner in the future. You are an eminent QC and you may have a view on that.

John Swift: I have not given a lot of thought to that issue and whether it falls within the function of Parliament. I suppose I would put the matter back to you and say that one of the reasons why this Committee is here is to ensure that the regulator in this case applies the statutory duties in a manner that promotes the interests of consumers generally and provides adequate justification for its decisions.

I will wait and see. I have done my bit. I am not there to review what actions the FCA is now taking. It has said that it is considering my recommendations, accepting them and folding them into a programme that it has. I am always a bit hesitant about knowing what happens when your recommendations get folded into something else, but we have this commitment from the FCA that this is what it is doing. It is looking at what Dame Elizabeth and Mr Parker said. What comes out of this review, I hope, is not so much the need for Parliament to change, but the need for regulators to change and recognise that, without internal change, no amount of reviews by you or by me is going to provide the real solution for customers.

Q57 **Chair:** Finally, do you worry that we have seen an example here of regulatory capture by the banks; that the customer voice, especially those who have been mis-sold in what is a long line of mis-selling scandals that have emanated from the banks, is too quiet and soft, with not enough powers; and that the regulator perhaps is being captured by those it is regulating?

John Swift: I have not used the expression "regulatory capture". In a previous existence, I was of course a regulator myself and had regulatory capture in front of me every time I carried out a particular function. Regulatory capture is plainly a denial of the function of an independent regulator. They were getting pretty close, in those discussions with the Treasury, but when the Treasury calls you to a meeting, bearing in mind the position of the Treasury, under FSMA—but as I said before, to my mind, they held their independence.

The problem was that they made, in my view, serious errors of judgment, driven by a lack of information and the need to arrive at solutions that were not the right solutions to have been made and not done in the right manner. Having said that, and I must say this, this is not all bad news. The fact is that £2.2 billion, which was the cost and the risk to 40,000 customers, moved from them to the banks. That would not have

happened had it not been for the FCA's supervision and taking the banks on. For that, credit is due.

Chair: Perhaps credit is due for that, but we should all be thinking about how we can avoid these mis-selling scandals happening in the first place. Thank you very much for your evidence today, Mr Swift. That concludes the Treasury Committee's evidence session on this particular report. Thank you very much for coming.