FCA Validation Orders and Consumer Detriment

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Consumer detriment is a relevant factor to be taken into account by the Financial Conduct Authority (FCA) before making a determination under s.28A of the Financial Services and Markets Act 2000 (FSMA) that an otherwise unenforceable agreement was valid, and when the FCA failed to consider such detriment, it had acted unlawfully in fettering its discretion and had come to a decision that it could not have reasonably arrived at. So held Judge Timothy Herrington in the Upper Tribunal (Tax and Chancery Chambers) in Plaxedes Chickombe and 44 others v Financial Conduct Authority [2018] UKUT 258 (TCC) (1 August 2018).

The applicants' references to the Tribunal resulted from a Validation Order made by the FCA on 5 February 2018 whereby the authority had determined that it was *just and equitable* to enforce 1,444 regulated credit agreements ("the Regulated Agreements") that had been made between the applicants and Clydesdale Financial Services Limited, trading as Barclays Partner Finance ("BPF"), a company wholly owned by Barclays Bank PLC. The Regulated Agreements financed the acquisition by the applicants of timeshare accommodation from a group of companies known as "Azure". At the time of the references a total amount in the region of £47 million was outstanding under the Regulated Agreements.

The Validation Order came to be made as follows. BPF became aware that the Regulated Agreements had in fact been brokered by an unauthorised broker within Azure ("the Broker"), in breach of the general prohibition in s.19 FSMA against persons carrying out regulated activities in the UK without FCA authorisation or an applicable exemption. Although BPF itself was an authorised person, the Regulated Agreement were made in consequence of something said or done by the unauthorised Broker, acting in breach of the general prohibition. This circumstance rendered the Regulated Agreement unenforceable against the borrowers pursuant to s.27(1A) FSMA. On 26 May 2017 BPF applied to the FCA for validation of the Regulated Agreements under s.28A FSMA. That section (in contradistinction to s.28 FSMA which confers a discretionary power to validate unenforceable agreements on the court) applies to "credit-related" regulatory activities and makes validation of an otherwise unenforceable loan agreement a regulatory rather than a judicial decision. Significantly, s.28A(3) provides that the FCA may by written notice to the applicant allow the agreement to be enforced if the authority is satisfied that

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"it is just and equitable in the circumstances of the case". The FCA considered that it was *just and equitable* to validate the Regulated Agreements, amongst other things, because it considered that there was no consumer detriment caused by the fact that the Broker did not have regulatory permission at the time the agreements were made, and that the borrowers were unlikely to have been treated differently if the Broker had been authorised.

The applicants exercised their rights pursuant to s.28B(3) FSMA and made the references alleging that they had suffered detriment arising from the conduct of the Broker in connection with the entry into the Regulated Agreements. The complaints centred on the Broker's failure to explain the terms of the Regulated Agreements (including their duration and financial impact on the borrowers), its failure to give the applicants sufficient time to consider the terms of the proposed agreements, its misrepresentations and its aggressive and oppressive conduct and pressure calculated to ensure that the applicants signed the Regulated Agreements.

The FCA had not known about these allegations when it made the Validation Order. Once it did become aware of them, the authority conceded that its decision to make the Validation Order was flawed, and it asked the Tribunal to remit the matter to it with a direction to reconsider its determination. The FCA submitted at the hearing that it considered that evidence of consumer detriment was a relevant factor to be taken into account in deciding whether *it was just and equitable* to make a validation order, and since such evidence had not been taken into account at the time when the existing Validation Order was made, the authority conceded that the decision was not one that in all the circumstances was within the range of reasonable decisions open to it.

That should have been the end of the references. However, BPF who appeared as an Interested Party, whilst ultimately agreeing that the matter should be remitted to the FCA, asserted that (i) consumer detriment was only a relevant factor to the extent that it was caused by the fact that the Broker was not authorised at the material times and that, accordingly, in deciding whether to grant a validation order the authority should only have regard to the question of whether consumers suffered a detriment as a result of the Broker's unauthorised status and that (ii) the existing Validation Order should continue to have effect in the meantime. In relation to (ii) the FCA supported the applicants' position that upon the matter being remitted to it, the existing Validation Order would cease to have effect.

BPF's two objections ((i) and (ii) above) necessitated the hearing before the Tribunal. Objection (ii) concerning the validity or otherwise of the Validation Order was resolved by BPF undertaking to the FCA that it would not enforce its rights under the Regulated Agreements until the authority had remade its determination.

In relation to objection (i) BPF submitted that since the way in which the Broker had carried out its credit broking activities, including the way in which it dealt with customers, was the same when it was carrying on activities for Azure as when it (later) became an appointed representative of BPF, the customers under the unregulated regime had exactly the same customer experience before and after the Broker became an appointed representative. This demonstrated, according to BPF, that there had been no consumer detriment caused by the fact that the Broker had not been authorised at the material times. In any event, BPF asserted, the allegations of consumer detriment were allegations of mis-selling, and Barclays had a robust complaints procedure in place which would consider any mis-selling complaints that might be made by customers, who could escalate the matter by referring their complaint to the Financial Ombudsman (FOS). BPF also relied on the reasons formulated by the FCA for making the Validation Order, which BPF asserted, showed that the authority itself had limited its consideration of consumer detriment to whether consumers had been prejudiced as a result of the Broker being unauthorised. BPF therefore invited the Tribunal to direct that the extent to which consumer detriment should be taken into account by the FCA in its renewed s.28A determination should be limited to considering any detriment caused by the fact that, at the material times, the Broker was unauthorised.

The judge made no findings at the hearing as to whether the applicants had fallen victim to mis-selling, and he accepted BPF's evidence (which was not challenged) that the Broker conducted its credit broking activities (including how it treated customers) in the same way when carrying on those activities for Azure and as an appointed representative for BPF. But he rejected BPF's invitation to direct its proposed limitation to the scope of the FCA's consideration of consumer detriment. Instead the judge ruled that the FCA's own limitation of considering consumer detriment only in relation to whether consumers had been prejudiced by the fact that the Broker was unauthorised when making the existing Validation Order was too narrow and that in taking that approach the authority had unlawfully fettered its discretion. He pointed out further that a determination in accordance with s.28A FSMA (whether it was *just and equitable* to enforce an otherwise unenforceable agreement) required the authority to consider *"all relevant factors and*

conduct a multifactorial assessment by reference to all the circumstances and balancing the various factors which it identifies as being relevant to the matter". With that in mind, the judge explained, it was understandable that s.28A did not seek to limit the scope of the authority's enquiry and did not prescribe a list of factors that had to be taken into account in the process. Although the inclusion in s.28A(6) of the question of knowledge by the relevant firm of the third party's regulatory status was a strong factor to be weighed in the balance, it was for the authority to decide what weight to give to various other factors. Accordingly, any consumer detriment caused as a result of the Broker being unauthorised would have to be weighed in the balance alongside evidence of consumer detriment more generally, and it was for the FCA to decide what respective weight it would give to those various factors.

In the result the judge determined the references in favour of the applicants and remitted the matter to the FCA for reconsideration of its determination in making the Validation Order. He expressly directed that the authority should take consumer detriment into account, without placing any further limitation on the scope of what it should consider.

Comment

The judge's reasoning and his decision are plainly correct. This was a very unusual case. The authority had conceded the references, and the applicants and the FCA had reached complete agreement on the necessity of remittance and consideration of the consumer detriment allegations as part of the balancing exercise under s.28A FSMA.

At the hearing, counsel for the claimants and counsel for the FCA summarised the Handbook breaches that would be made out if the consumer detriment allegations advanced by the applicants were proved, including breaches of Principle 6 (Statement of Principles for Business) which requires a firm to have due regard to the interests of its customers and treat them fairly. Guidance on the content of Principle 6 given in CONC 2.2.2G explains that targeting customers with regulated credit agreements that are unsuitable for them and subjecting them to high pressure selling, aggressive or oppressive behaviour or unfair coercion all amount to conduct contravening the principle. The conduct described by the applicants had precisely that character.

The FCA submitted that the evidence provided by the applicants/ borrowers in relation to consumer detriment was a probative indication of the kind of conduct and outcomes that FSMA and its regulatory regime sought to prevent. As such the FCA considered evidence

of consumer detriment a relevant matter for the purposes of its power to validate under s.28A and that further enquiry was required to assess the full extent of the detriment to borrowers under the Regulated Agreements.

It is disappointing, but not altogether surprising, that BPF sought to tie the FCA's hands in carrying out a fresh s.28A determination by seeking to exclude from its consideration the treatment of customers by its unauthorised broker. BPF's argument was not made any more palatable by its attempt to persuade the Tribunal that its customers, after all, had a remedy for mis-selling by making a complaint to Barclays or FOS, and implicitly suggesting that they should be relegated to those routes. Undoubtedly it would suit Barclays better to deal separately with each claim through its own complaints process, while remaining entitled to collect the £47million residual debt under the Regulated Agreements. It is hoped that the FCA will carry out a full and proper enquiry into the detriment to borrowers under the Regulated Agreements (including the consumer detriment allegations that were advanced by the applicants), and, if the alleged conduct is proved to the authority's satisfaction, revoke the existing Validation Order and decline to make a fresh one. That would leave Barclays unable to enforce the Regulated Agreements, and the example set by such a result would surely concentrate future lenders' minds to ensure that the regulatory status of their brokers was scrutinised and that their brokers' treatment of the lenders' prospective customers was properly supervised.

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