The tightrope of compliance: regulated entity compromises

Paul Fleming, **Emma Sadler** and **Steven Francis** outline the issues around the FCA's approach to debt compromises and provide practical insights for IPs.

The overriding objectives of the Financial Conduct Authority are to protect consumers and to maintain the integrity of the financial markets in the UK. The FCA recognises that a disorderly wind-down of a firm will risk undermining those objectives and there are obligations placed on regulated firms and controls available to the FCA to help prevent this from happening. It is a condition of obtaining regulated status that a firm has a robust wind-down plan in place. The FCA has produced detailed guidance in relation to its expectations on wind-down plans,[1] which covers the credibility of such a plan and its capability of implementation, with particular focus on liquidity and cash flow modelling, intra-group dependencies and wind-down trigger calibration.

However, even for those firms which have a suitable wind-down plan in place, the risk of the occurrence of an unforeseen event is ever-present, as has been seen over recent years with the impact of Financial Ombudsman Service decisions on a firm's requirement to undertake a past business review. Where regulated firms face financial (di)stress, the management must walk the tightrope of compliance with very many regulatory obligations (which will apply to the firm and in many cases to individual managers) while also being mindful of their duties to minimise loss to all creditors.

A telling example, is that FCA rules require firms to treat their customers fairly (TCF). The rule is deliberately open-text, placing the onus on a firm to establish how it informs day-to-day decisions on matters that affect customers. There are even doubts about whether TCF goes far enough, and the FCA is planning on introducing a new consumer duty to enable it to further enforce customer protections where firms seem unwilling or unable to proceed as the FCA wishes.[2] There is no FCA rule requiring firms to treat general creditors fairly but, under statutory and common law rules, firms are expected to protect all creditors' positions in times of financial distress.

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The restructuring framework in the UK is heralded as providing one of the most flexible systems promoting business and entrepreneurial activity but there is a tension with regulatory rules with which firms and their controlling personnel must comply. The FCA's approach to compromise of creditor claims is one such example of where this is evident.

Restructuring tools

UK company and insolvency law has within its armour a number of useful restructuring tools such as:

- Company voluntary arrangements
- Schemes of arrangement
- Restructuring plans (introduced by the Corporate Insolvency and Governance Act 2020)

CVAs are perhaps not quite so attractive for compromises of claims in relation to complex regulated firms due to the inability of a CVA to compromise secured or preferential creditor claims, necessarily resulting in the perception that the unsecured consumer is subject to more detrimental treatment than other institutional creditors.

A scheme of arrangement has been the tool of choice in the two most commonly reported attempts to effect compromises of creditor claims, being *Re Provident SPV Ltd* [2021] EWHC 2217 (Ch) and *Re ALL Scheme Ltd* [2022] EWHC 549 (Ch) and [2021] EWHC 1401(Ch) (hereafter

Amigo Loans. There is no requirement for the firm to be insolvent to implement a scheme of arrangement and it can result in the compromise of both creditor and member claims. However, where financial distress is evident, the helpful addition of the 'cross-class cram down' that comes with a restructuring plan enables the votes of those creditors who are economically unaffected by the plan to be discounted and the benefit of this should not be underestimated.

A scheme of arrangement was approved in the *Provident Finance* case. The FCA was represented at the convening hearing and then subsequently raised objections to the scheme in a letter placed before the judge. However, the FCA, ultimately, did not formally oppose the scheme on the basis that it considered there was a real and imminent prospect of insolvency if the scheme was not approved and it was intended that the entity would be wound down, thereby ensuring any 'upside' from the scheme would be for the benefit of the scheme creditors rather than the shareholders/ other stakeholders.

Conversely, the FCA did formally oppose the first *Amigo Loans* scheme on the basis there was no intention to wind down the business following the scheme (with the existing shareholders retaining their, potentially, profitable share in the business going forward). The court did not sanction the first scheme, which resulted in a second scheme (or schemes, in the alternative) being proposed. The existence of the second sanction application arguably justified the FCA's objections. The second schemes were unique in their approach. Firstly, there was a proposed compromise of the redress claims with a continuation of the business thereafter, provided certain conditions are met (one of which being the FCA's consent to Amigo restarting lending) (new business scheme). In the alternative, the second scheme would have involved the wind down of the business in a more cost-effective manner than an insolvency. The FCA did not oppose this application and the court has recently sanctioned the new business scheme following overwhelming support from Amigo's creditors.

Consultation on proposed guidance

In January 2022 the FCA launched a consultation on its proposed guidance for its approach to compromises of regulated firms.[3] This consultation closed on 1 March 2022. It is keen to ensure the restructuring tools available to regulated firms are utilised in such a way that does not undermine the FCA's objectives. The guidance focuses on those firms that are subject to redress claims that seek to compromise those liabilities but continue to trade. The FCA guidance codifies the approach it has taken in recent cases, making clear that it expects to be furnished with all relevant information to enable it to consider if it will raise an objection to the scheme or

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plan in either the convening or sanction hearing or (for a CVA) by bringing a challenge to court. The FCA states that it will object to the proposed compromise unless '*…it is the best proposal that the firm can make, which includes the firm providing the maximum amount of funding for the compromise so that consumers receive the greatest proportion of what is owed to them*'.

The FCA's proposed guidance on its approach is unsurprising given its overriding objective. However, it brings into sharp focus the tension that could exist with other statutory and common law duties for directors to minimise loss to all creditors. In all likelihood, the success of a compromise in this sector will depend on an evaluation of whether the only alternative to the compromise is insolvency.

This brings with it concerns in relation to the future of the sub-prime lending market. The apparent increase in FOS complaints in relation to such lenders is likely to lead to an increase in the implementation of redress schemes. This threatens the ability for some lenders to continue to trade, with the resulting effect that many lenders will vacate the market. With the rising number of people with poor credit ratings and the risk of them necessarily turning to illegal lending, there is a tension between maintaining integrity in the market by imposing additional regulatory obligations on lenders and encouraging sub-prime lenders to remain active.

Formulating a compromise

The ability for a firm to seek a compromise of its liabilities from such redress schemes is therefore vital to help maintain a spread of lender-offerings across the market. However, with the increasing focus of the FCA on ensuring these schemes are really producing the best result for consumers, is the regulatory burden too high?

The proposed guidance issued by the FCA provides helpful clarity on how to formulate such a scheme proposal. The guidance contains an extensive list of the minimum information the FCA would require a firm to provide to it. In practice we have seen increased sophistication in negotiations between firms and their advisers, and the FCA, and early and full engagement is essential.

Insolvency

Arguably, the FCA's hand is much weakened once IPs are appointed over a firm. While IPs must be mindful of the regulatory requirements and will work with the FCA to ensure the impact on consumers is as minimal as possible, they have their own statutory and regulatory code to comply with and ultimately they are in control of the business.

It is the tension between the protection of consumers and maintenance of integrity in the market (whether real or perceived) and insolvency that appears to have fuelled the approach the FCA is now taking. It is focusing on ensuring firms have a wind-down plan that is thought-through and capable of implementation and, with the proposed new guidance, it is ensuring regulated firms are clear as to what the FCA will expect if they seek to compromise consumer claims. The benefits that the UK company and insolvency regime provide are useful tools for entities in distress, but where this is applied to a regulated entity, the ability to avail themselves of these tools remains tempered by the need to walk the tightrope between regulatory and other statutory or common law compliance.

With the backdrop of the recent High Court sanctioning of meetings for the novel Amigo schemes, it is anticipated that, once the FCA guidance is issued (following closure of its consultation on 1 March 2022) practitioners will have increased clarity as to the stance of the FCA and hence the use of the available restructuring tools. □

[1] https://www.fca.org.uk/publication/thematic-reviews/tr22-1.pdf

[2] The aim is for final rules on the consumer duty to be confirmed by end July 2022 https://www.fca.org.uk/news/press-releases/fca-introduce-new-consumer-duty-drive-fundamental-shift-industry-mindset

[3] https://www.fca.org.uk/publication/guidance-consultation/gc22-1.pdf

PAUL FLEMING is a partner (restructuring) at Addleshaw Goddard LLP.

EMMA SADLER is a legal director (restructuring) at Addleshaw Goddard LLP.

STEVEN FRANCIS is a partner (financial regulation) at Addleshaw Goddard LLP.