Finalised Guidance

FCA's approach to compromises for regulated firms

FG22/4

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1 Introduction

1.1 Compromises are arrangements between a firm and its creditors and/or shareholders that can be used to reorganise a company or group structure, including restructuring debts. We are seeing an increase in the number of regulated firms[1] proposing compromises to deal with significant liabilities to consumers, in particular redress liabilities. We are therefore consulting on guidance which sets out (i) how we consider compromises and the factors we consider when assessing them; and (ii) our role when a firm proposes a compromise.

1.2 With this guidance we aim to help firms understand what information we need and how we approach compromises in line with our statutory objectives to secure an appropriate degree of protection for consumers and protect and enhance the integrity of UK financial markets, with a view to reducing the number of proposed compromises that we do not consider to be appropriate. We also remind firms of their regulatory obligations, in line with Principle 11, to notify us immediately and provide relevant information at an early stage if they are considering proposing a compromise. Where firms determine there is no better alternative outcome for consumers than to propose a compromise, the guidance will help firms to propose acceptable compromises that are compatible with our rules, including the Principles for Businesses, and statutory objectives. In particular, if firms do propose a compromise in respect of redress liabilities, they should ensure it is the best proposal that the firm can make, which includes the firm providing the maximum amount of

[1] Firms authorised under the Financial Services and Markets Act 2000 (FSMA) and firms authorised or registered under the Payment Services Regulations 2017 (PSRs) or Electronic Money Regulations 2011 (EMRs)

funding for the compromise so that consumers receive the greatest proportion of what is owed to them.

1.3 The proposed guidance focuses on three types of compromise: schemes of arrangement (Schemes), restructuring plans (RPs) and voluntary arrangements (VAs). Firms should review the proposed guidance before considering such compromises to ensure that any compromise proposed will not be unacceptable to us.

1.4 This guidance only relates to compromises in relation to liabilities and does not apply to Schemes or restructuring arrangements in other circumstances such as with-profits restructuring. Separate rules and guidance may apply to those types of restructurings and firms involved in such arrangements should consult their normal supervisory contact at the FCA and PRA as applicable.

2 About this guidance

What does this guidance cover?

2.1 The guidance is set out in Annex 1.

2.2 The guidance is structured as follows:

- **Chapter 1 - Introduction** explains the scope of the guidance and our role in assessing compromises.
- **Chapter 2 - Engagement with the FCA** reminds firms that they are required to notify us if they propose a compromise and engage with us at an early stage. This chapter also outlines the minimum information that we expect to be provided by a firm, as part of their initial notification or at an early stage thereafter.
- **Chapter 3 - FCA's assessment of compromises** explains our approach to assessing a compromise proposed by a firm and the factors we will consider when deciding what action(s) to take.
- **Chapter 4 - FCA's participation in court process** explains the factors we will consider when deciding whether to participate in the court process.
- **Chapter 5 - Use of supervisory tools/regulatory action** explains when and how we may use our powers in relation to the conduct of a firm proposing a compromise.

2.3 The summary of feedback received to our guidance consultation on our approach to compromises for regulated firms (GC22/1) is set out in Annex 2. This summary sets out our response to the feedback received and the changes made to the guidance as a result.

Who does this guidance apply to?

2.4 The guidance is primarily aimed at firms solely regulated by the FCA and firms that are dual regulated by the FCA and PRA from the perspective of conduct regulation. It is also relevant to advisers of regulated firms considering compromises (including insolvency practitioners and professional advisers), trade associations, consumers and consumer protection organisations.

2.5 The guidance will not apply retrospectively to any compromise where the firm has issued a practice statement letter (in respect of Schemes and RPs) or proposal (in respect of VAs) to its creditors before the date that the proposed guidance comes into effect. For compromises where the firm has issued a practice statement letter or proposal to creditors before the effective date of the proposed guidance, we will review these on a case-by-case basis, however the principles in the proposed guidance may be relevant.

Equality and diversity considerations

2.6 We have considered the equality and diversity issues that may arise from the guidance. We do not consider the guidance will adversely affect any of the groups with protected characteristics under the Equality Act 2010. We believe the guidance may positively affect some groups with protected characteristics. For example, age, race and disability are protected characteristics, and having a lower income, physical or mental health condition is a driver of potential vulnerability. So, as the guidance is aimed at ensuring a fair outcome for all consumers in a compromise, those with protected characteristics and that are likely to be potentially vulnerable may benefit from this guidance.

Annex 1 – Guidance on the FCA's approach to compromises for regulated firms

Chapter 1: Introduction

1. This document provides guidance to UK based firms regulated by us on our general approach to compromises. This guidance is aimed at firms authorised or registered by us. This includes firms that are dual regulated by the FCA and PRA from the perspective of conduct regulation.

2. Compromises allow a firm to reach a binding agreement with its creditors and/or shareholders which can be used to vary the rights of some or all creditors and/or shareholders, including restructuring debts in full and final settlement of their liabilities. This guidance focuses on three types of compromise: schemes of arrangement (Schemes), restructuring plans (RPs) and voluntary arrangements (VAs). VAs comprise company voluntary arrangements (CVAs), individual voluntary arrangements (IVAs) and partnership voluntary arrangements (PVAs) [2]. This guidance only relates to compromises in relation to liabilities and does not apply to the use of Schemes or restructuring arrangements in other circumstances such as with-profits restructuring.

3. Schemes and RPs are governed by the Companies Act 2006 (Part 26 and Part 26A respectively). They are court approved agreements guided by a vote of the creditors and/or shareholders. The court test for sanctioning schemes is 'fair and reasonable' and for RPs is 'just and equitable'. If sanctioned by the court, the terms of the Scheme or RP are binding on the firm and the creditors and/or shareholders subject to the arrangement, regardless of whether they voted for it. CVAs and IVAs are governed by the Insolvency Act 1986 (Parts I and VIII respectively) and PVAs are governed by the Insolvent Partnerships Order 1994 (Part II); the court is notified of the creditors decision and there is no court hearing unless the VA is challenged by a creditor or us.

4. This guidance clarifies our general approach to compromises, including the factors we will consider when deciding if and what actions we will take in line with our statutory objectives to secure an appropriate degree of protection for consumers and to protect and enhance the integrity of UK financial markets. The guidance will help regulated firms understand our expectations and ultimately help firms to avoid proposing compromises that are unacceptable to us because they threaten or adversely affect our statutory objectives.

5. This guidance will not apply retrospectively to any compromise where the firm has issued a practice statement letter (for Schemes and RPs) or a proposal (for VAs) to its creditors before the date this guidance comes into effect. For compromises where the firm has issued a practice statement letter or a VA

[2] CVAs are available to companies registered in England, Wales, Northern Ireland and Scotland. IVAs are available in England, Wales and Northern Ireland but not Scotland. In Scotland, protected trust deeds are available (which are similar to IVAs). PVAs are available in England and Wales but not Scotland or Northern Ireland.

proposal to creditors before the effective date of this guidance, we will review these on a case-by-case basis however the principles in the guidance may be relevant.

6. This guidance is not exhaustive and should be read alongside the FCA's Handbook and other applicable legislative requirements and guidance.

The FCA's role in compromises

7. All regulated firms must comply with our rules, the Threshold Conditions (or Conditions of Authorisation under the PSRs and EMRs for PIs and EMIs (Conditions of Authorisation)), and the Principles for Businesses. If firms do not comply, we have statutory powers to take regulatory action. In Chapter 5, we set out when and how we might use our supervisory tools and take regulatory action where a compromise is proposed.

8. In addition, we have a statutory power to challenge CVAs and PVAs under section 356 of FSMA and IVAs under section 357 of FSMA. The circumstances in which we use this power are set out in section 13.10 of the Enforcement Guide (EG). We do not have a statutory role under the Companies Act 2006 in respect of Schemes and RPs, but the court will generally be interested in our view as regulator of firms proposing these arrangements.

9. We have an interest in compromises proposed by regulated firms because of our statutory objectives, in particular protecting consumers and the integrity of markets. Compromises that unfairly benefit a firm and its other stakeholders at the expense of consumers are unacceptable to us.

10. As part of our supervision, we will consider compromises proposed by regulated firms and firms that are appointed representatives or agents to determine whether the terms of the proposed compromise are compatible with our statutory objectives, Principles for Business and rules, and whether the terms of the proposed compromise or the firm's conduct warrants us to take regulatory action. For firms that are appointed representatives or agents, their principal firm is responsible for compliance with relevant regulatory obligations and we also expect them to be responsible for crystallised or contingent exposures which were created by the appointed representative or agent. Our role in a compromise is not to negotiate or design the details of a firm's compromise. We assess a compromise on its individual characteristics and based on the facts of each proposal, taking into account all relevant circumstances, to consider whether our participation in the court process and/or regulatory action would be appropriate.

11. Where redress is due to consumers, we expect firms to have made provision for the redress in line with our guidance in FG20/1 (Our framework: assessing adequate financial resources). In general, we would be concerned if a regulated firm proposes a compromise where customers are offered less than their full redress and the firm continues trading, where such redress liabilities were caused by serious and/or deliberate misconduct by the firm. If firms do propose a compromise in respect of redress liabilities, they should ensure 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.

12. We will consider whether it is appropriate to make a public comment in relation to proposals that have a significant impact on consumers or markets, including whether we consider they are consistent with the approach set out in this guidance.

Chapter 2: Engagement with the FCA

13. When a firm is considering proposing a compromise, in line with Principle 11 and relevant rules in SUP, PSRs and EMRs[3], the firm should notify us immediately and provide relevant information at an early stage to enable our assessment of the compromise. We consider proceeding with preparation for a compromise, without notifying us to be a significant breach of Principle 11 and the notification requirement in SUP 15[4]. In such circumstances we will consider the appropriateness of conduct by the firm's senior management. Following the initial notification, firms should provide further information in a timely manner.

14. Firms should seek appropriate advice in order to ensure they fully understand the compromise process, statutory and regulatory requirements, and consider our expectations set out in this guidance before proposing a compromise. When proposing a compromise, a firm should ensure it will have appropriate resources to manage the compromise together with its business-as-usual activities, if relevant.

15. When considering proposing a compromise a firm should have regard to the information lists below and make every effort to gather the information as quickly as possible and provide it to us for our assessment.

Information for initial assessment of the proposed compromise

16. For us to make an initial assessment of whether we are likely to consider the proposed compromise, a firm should provide the following minimum information as part of its initial notification to us.

    a) An explanation as to how the liabilities subject to the compromise arose. This includes the relevant period(s) of time, directors and senior management in place at that time, and any steps taken to mitigate the liabilities.

    b) Type of liabilities to be compromised, their value including whether they relate to complaints made to the firm/the Ombudsman Service.

    c) Actions that the firm has taken or is taking to remedy the cause(s) that led to the liabilities, including any changes in business practices and/or management.

    d) Creditor cohorts or classes (and estimated number of creditors within each cohort or class) to which the compromise will apply, how they have been determined, as well as an explanation of why any creditor cohorts or classes have not been affected by the compromise and how they will be treated.

    e) Anticipated pence in the pound return to creditors or creditor cohorts or classes subject to the compromise with high level details as to how this has been estimated and clarification as to any other expected type of return to

[3] SUP 15.3.21R(4) (for FSMA authorised firms) and regulation 37 of PSRs and regulation 37 of EMRs (for PIs and EMIs) as we consider a compromise to be a "substantial change in circumstance" for the purposes of those regulations.

[4] SUP 15.7 sets out the requirements for the form and method of notification

creditors (eg balance write-downs) or details of other ways in which it is proposed to allocate any losses (eg proposals that creditors receive a stake in the equity of the business).

f) Intended trading activity (i) in advance of the compromise coming into effect, (ii) while the compromise is in effect, and (iii) after the compromise has come to an end, including business model, projections and material assumptions.

g) We may also need additional information depending on the specifics of the situation, including:

i. Structure of the proposed compromise, including the parties/persons whose liabilities are to be compromised, and whether a special purpose vehicle (SPV) is to be used. Where an SPV assumes the liabilities of a firm subject to this guidance, the guidance will similarly apply to the firm using the SPV.

ii. Methodology and assumptions for calculating the gross liabilities to be compromised and any key factors that may affect this valuation.

iii. Anticipated contribution to the compromise from the firm (or any other companies in its group such as parent company). This includes any initial sum and subsequent or contingent sum such as a profit share, and how the costs of administering the compromise will be met.

Further information for full assessment of compromise

17. In addition, to enable a full assessment of the proposed compromise, firms should provide the following information, where relevant, at an early stage and in any event as soon as it is available. These lists are not exhaustive.

a) Substance of the proposed compromise

i. If not provided as part of the initial information, structure of the proposed compromise, including the parties/persons whose liabilities are to be compromised, and whether a special purpose vehicle (SPV) is to be used. Where an SPV assumes the liabilities of a firm subject to this guidance, the guidance will similarly apply to the firm using the SPV.

ii. If not provided as part of initial information, methodology and assumptions for calculating the gross liabilities to be compromised and any key factors that may affect this valuation.

iii. Granular methodology and assumptions for the assumed pence in pound return to creditors including the assumed claims rate, uphold rate and average redress award.

iv. If not provided as part of initial information, anticipated contribution to the compromise from the firm (or any other companies in its group such as parent company). This includes any initial sum and subsequent or contingent sum such as a profit share, and clarification as to how the costs of administering the compromise will be met.

v. A breakdown of the anticipated costs associated with the implementation of the proposed compromise.

vi. Details of other options considered, including other compromise proposals, with reasons why these were not taken forward.

vii. The counterfactual should the compromise not come into effect. If insolvency is a likely outcome, details of the estimated outcome for creditors (secured and unsecured, including group or connected parties) and shareholders, including expert reports where relevant.

viii. Anticipated voting process (including how creditor cohorts / classes will be ascertained for voting purposes).

ix. Anticipated claims process (including the claims methodology, the calculation methodology, and any appeals or complaints procedure).

b) Practical effect of the proposed compromise on relevant creditors

i. Rights being extinguished (including ability to raise a complaint with the Financial Ombudsman Service (Ombudsman Service)).

ii. Explanation of the effect of the proposed compromise on any compensation which may be available from the Financial Services Compensation Scheme (FSCS), should the firm be declared in default. Where appropriate, firms should engage with the FSCS as early as possible to discuss the proposed terms of the compromise and to discuss implications for the FSCS.

iii. Whether there are any set-off rights and, if so, how set-off rights will be dealt with in the proposed compromise.

iv. Any limitation periods for eligible claims to be compromised bearing in mind the time-limits set out in DISP 2.8.2R on how long customers have to complain to the Ombudsman Service.

v. If applicable, how the proposed compromise will apply to creditors who are now customers of a third party as a result of a sale of business and whether those creditors' claims will be treated in the same way as other creditors.

vi. Practical effect of the proposed compromise on the economic value/beneficial interest belonging to directors, shareholders, secured creditors, or other group/connected entities (as relevant).

c) Financial information

i. Financial forecasts for the minimum of the next six months or the period over which the compromise is proposed to run, whichever is longer.

ii. Management accounts for the period since last formal accounts (audited/statutory accounts where relevant) to the date of notification, including the directors or partners' capital accounts showing their drawings, contributions and profit shares and details of any inter-company loans.

iii. Whether directors or partners were paid any bonuses or remuneration in addition to their salary over time, including, but not limited to, the period of liability or whether the firm intends to pay any bonuses or remuneration after the compromise.

iv. Whether any other payments were made to any persons connected to the firm or its directors over time including, but not limited to, the period of liability or whether the firm or its directors intend(s) to make any payments to any such connected persons after the compromise.

v. Details of any clawback provisions in contracts entered into by the firm, for example with directors, partners etc, which enable money already paid to a stakeholder to be returned to the firm.

vi. Any intercompany loan positions in the group, including any loans to or from directors or partners, and any plans to repay these loans.

vii. Holders of security over the firm's assets (including where the firm is subject to a cross-guarantee) and the conditions under which security holders have the right to enforce.

viii. If the proposed compromise involves a sale of assets or equity of the firm, details of the proposed sale process, timeframe, and whether the sale will be to connected persons.

d) Other relevant information

i. An anticipated timeline the firm is working to, including critical path activities, key dates/deadlines and contingency arrangements.

ii. Plan for communicating and engaging with customers and all draft communications to customers (before sending to customers).

iii. Whether the firm will be setting up a creditors committee and how the committee will be set up and operate.

iv. External parties that will be engaged by the firm to advance the proposed compromise, the role and services provided by each party, and their main points of contacts.

v. Any tax implications for creditors.

vi. Explanation of how any existing complaints received by the firm will be dealt with, including any that have been referred to the Ombudsman Service.

vii. For Schemes, an explanation of how the Scheme meets the court's test of fairness and reasonableness[5].

viii. For RPs, an explanation of how the RP meets the court's test of just and equitable[6].

ix. Any other relevant formal or explanatory documents, including any reports prepared by the firm's advisers on the proposed compromise

18. If insufficient information is provided by a firm to enable us to assess the compromise, we will expect the firm to work with its advisers to provide the

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[5] For an example of how the fair and reasonable test has been recently examined by the Court, please see the judgment in All Scheme Limited, Re [2021] EWHC 1401 (Ch)

[6] For an example of how the just and equitable test has been recently examined by the Court, please see the judgment in Virgin Active Holdings Ltd & Ors, Re [2021] EWHC 1246 (Ch)

relevant information to us. Where necessary we will consider using our statutory powers to obtain such information (eg our powers under section 165 of FSMA to compel firms to provide information).

19. If aspects of the proposed compromise need further analysis (eg the methodology of the proposed compromise or where the proposed compromise is not straightforward and could impact retail and small commercial customers), we may require the firm to appoint a skilled person to provide a report under section 166 of FSMA. This would be with a view to assessing the possible impact and harm on consumers. We would expect to take the skilled person's report into account when assessing the proposed compromise against our statutory objectives. In line with SUP 5, we would expect a skilled persons' report to sufficiently identify and assess risks with supporting information and evidence. Please see our website for further information on skilled person reviews.

Firms' engagement with the PRA

20. The PRA have an interest in compromises proposed by dual regulated firms, and we would expect to liaise with the PRA on any compromise proposed by a dual regulated firm. In addition to notifying us, dual regulated firms should also notify the PRA and we will work with the PRA to consider the proposal.

Firms' interaction with the Financial Ombudsman Service

21. The Ombudsman Service is an independent service for resolving disputes between consumers and firms, and with a minimum of formality on a fair and reasonable basis. The rules and guidance for firms relating to the Ombudsman Service are set out in the Dispute Resolution: Complaints (DISP) part of the Handbook.

22. Where firms propose to compromise redress liabilities, the liabilities may arise from awards by the Ombudsman Service. Firms must at all times comply with the complaint handling requirements in DISP (as applicable) and engage with the Ombudsman Service where appropriate. Where a complaint has been referred to the Ombudsman Service, the firm must cooperate fully with the Ombudsman Service (DISP 1.4.4R).Where a firm is proposing a scheme that will ultimately extinguish a person's right to bring a claim against the firm – eg a claim that falls within the scope of the scheme - using other avenues, ie by going to court, then the FCA will look carefully at the communications a firm proposes to send to potential redress customers and the time frame in which claims must be brought before existing rights to pursue a claim are extinguished to ensure that both of these are fair in all of the circumstances.

Firms' interaction with the Financial Services Compensation Scheme

23. The FSCS is the UK's compensation scheme when a protected regulated firm is unable, or likely to be unable, to pay claims against it. The FSCS scheme is operated and administered by Financial Services Compensation Scheme Ltd under rules made by each of the FCA and PRA, and which set of rules apply is dependent on the nature of the act or omission giving rise to the claim for

compensation. The PRA makes the rules governing the compensation scheme relating to claims for a deposit, dormant accounts, under a contract or insurance or in respect of Lloyd's managing agents. The PRA's rules are in the Depositor Protection and Policyholder Protection parts of its Rulebook. The FCA makes the rules where the claim in question is in connection with protected designated investment business, home finance mediation, non-investment insurance distribution, certain debt management business and, from 29 July 2022, funeral plan business. The FCA's rules are in the COMP section of the Handbook (see COMP 5.2 for further details).

24. Firms should consider how the proposed compromise might impact any future claims to the FSCS, should the firm be declared in default. Where appropriate, firms should engage with the FSCS as early as possible to discuss the proposed terms of the compromise and to discuss implications for the FSCS.

Chapter 3: FCA's assessment of compromises

25. We will assess a compromise proposed by a regulated firm on a case-by-case basis, against our statutory objectives, and consider whether the proposed compromise is compatible with our rules, including our Principles for Businesses. Key considerations include the treatment of customers and the outcomes they receive, customers' information needs and managing conflicts of interest. If the proposed compromise is not compatible with our statutory objectives, rules or Principles, we are likely to have significant concerns with it, which may lead to an objection in court. We may also use our regulatory powers in the circumstances described in Chapter 5 below.

26. In line with our consumer protection objective, the outcome a customer would receive compared to other stakeholders, and whether the firm (and, where applicable, its Group) has put forward the best proposal possible for customers will be a central consideration when reviewing a compromise. This is also consistent with the court's test for sanctioning a Scheme or RP, although our assessment of a Scheme or RP is distinct from, and because of our statutory objectives necessarily broader than, the court's assessment of the Scheme or RP.

27. In line with our market integrity objective, the firm's plans after the proposed compromise will be a key part of our considerations when reviewing a compromise. We would be concerned if a firm proposes a compromise which pays customers less than their full redress entitlement but continues to trade, where such redress liabilities have been caused by serious and/or deliberate misconduct by the firm, because this undermines the integrity of firms and reduces confidence in the market.

28. Following a compromise, we would expect a firm to meet Threshold Conditions and to be compliant with our rules, including the Principles for Businesses.

29. When assessing a compromise proposed by a firm, we will take into account all of the information provided by the firm and consider a number of factors including but not limited to:
    a) whether the proposed compromise provides the best outcome possible for customers taking into account:
        i. how customers rights are affected (eg rights of set-off)

ii. how compromise funds will be distributed and whether the proposed compromise provides a fair allocation of benefits and losses between all stakeholders of the firm

iii. whether a better deal was available to customers

iv. whether the firm proposes to undertake a fair process for creditors affected by the proposed compromise, eg:

- the transparency or comprehensiveness of the information that the firm proposes to provide to customers
- whether customers have access to guidance/advice on the compromise (including alternative options to the compromise)
- whether customers have had an opportunity to liaise with the firm on the proposed compromise

b) nature and scale of any misconduct that led to the liabilities subject to the proposed compromise

c) number of, and impact on, any customers with characteristics of vulnerability

d) whether the liabilities to be compromised involve redress, client assets or safeguarded funds

e) effect of the proposed compromise on eligible customers' FSCS compensation rights

f) how much is being put into the compromise fund by the firm (or wider group if applicable)

g) how the firm will deal with claims and appeals

h) what the firm intends to do following the compromise (eg continue to trade or wind-down)

30. Firms should be mindful of these factors when considering proposing a compromise. This will help to avoid proposing a compromise which we would be likely to object to in court.

31. We consider it unlikely that a compromise over client assets would be appropriate. For Schemes, this was confirmed in the judgment of Lehman Brothers [2009] EWCA Civ 1161, which established that a company cannot use a Scheme to alter or limit proprietary rights. For VAs, EG 13.10 states where a company, partnership or individual has control of consumer assets which might be affected by the VA, this will be a matter for the FCA to consider challenging a VA.

32. We consider it unlikely that a compromise over funds safeguarded under the PSRs and EMRs would be appropriate.

Letters of non-objection

33. Previously, some regulated firms have requested a 'letter of non-objection' from us for any compromise they intend to propose. There is no statutory requirement on us to provide such a letter. Generally, we do not consider that there are likely

to be circumstances where issuing a letter of non-objection will be appropriate for the type of compromises within scope of this guidance. Instead, we focus our resources on assessing the proposed compromise and taking any connected supervisory and/or enforcement action. In an appropriate case, where the facts or circumstances warrant doing so, we will communicate any concerns we have with the proposed compromise, and the FCA's position, to the relevant firm and, where appropriate, the court.

Chapter 4: FCA's participation in court process

34. Our overall position on participating in the court process is the same regardless of the type of compromise proposed. However, as set out in paragraph 8 of the guidance, under the existing legislative framework, we have statutory powers under FSMA to challenge VAs. We do not have a statutory role under the Companies Act 2006 in respect of Schemes and RPs.

VAs

35. Our position on participating in proceedings for VAs is set out in section 13.10 of the EG. Section 13.10 of the EG provides that we will consider challenging an arrangement approved by a majority of creditors by using our powers in sections 356 or 357 of FSMA in exceptional circumstances and after considering the matters set out in EG 13.10.2.

Schemes and RPs

36. As a firm's regulator, the court will usually be interested in our views based on our wider knowledge of the firm and its business. We will consider whether to participate in the court process as part of our assessment of the proposed Scheme or RP. In an appropriate case, where the facts or circumstances warrant doing so, we will communicate any concerns we have with the proposed compromise, and our position to the relevant firm and, where appropriate, the court.

37. In terms of our participation in the court process, where we object to the proposed compromise, we can make representations at either, or both, the hearing of an initial court application (to convene a meeting of creditors) and the hearing for application for court sanction. We would set out the reasons why we think the proposal should not be approved/sanctioned by the court and/or set out the concerns we have with the proposal. The court may then wish to consider our views as part of its assessment of whether to approve/sanction the Scheme or RP.

38. When deciding whether to participate in the court process, we will take into account a number of factors including but not limited to:

    a) whether the proposal fairly balances the interests of all stakeholders

    b) number and type of creditors subject to the compromise

    c) total amount of liabilities subject to the compromise

    d) average amount of liability being compromised

e) whether the compromise gives rise to matters of public interest (eg is of interest to the wider public and other stakeholders from a consumer protection perspective)

f) whether the firm has provided adequate information on the compromise in order for us to perform our assessment

39. The consideration of Schemes and RPs is not business as usual work for us given we do not have a specific statutory role under the Companies Act 2006 to intervene in such arrangements. So, for Schemes, and in some circumstances RPs (eg where this involves a significant restructuring of the firm or the group to which it belongs) we may charge a Special Project Fee[7] to cover our exceptional supervisory costs. Special project fees are calculated based on the number of hours individuals work on the specific restructuring transaction plus external costs of professional advisers we need to engage. We would not charge a Special Project Fee for VAs as these would be covered in our fees for business as usual work given our statutory powers to intervene in these arrangements.

Chapter 5: Use of supervisory tools/regulatory action

40. As part of our assessment of a proposed compromise, we will consider whether it is appropriate to take regulatory action against the firm and/or its senior management and we will not hesitate to use our regulatory tools if it is appropriate to do so. This is most likely to be relevant in the context of a compromise involving redress liabilities. For example, we may consider enforcement action on past conduct that caused the liabilities giving rise to the compromise.

41. In determining the appropriate regulatory action, we will take account of any potential misconduct leading to the compromise (determined by supervisory review and any previous, current or proposed enforcement action) and/or the past behaviour of senior management of the firm). We also consider whether the firm complies with Threshold Conditions or Conditions of Authorisation at the time of the proposed compromise and is likely to in the future.

42. If a firm proposes a compromise to reduce or limit redress that we consider arose, or it is likely that has arisen, from serious and/or deliberate misconduct and the firm then continues to trade, we may use our regulatory powers to prevent the firm pursuing the compromise. It may not be compatible with our regulatory objectives to permit a firm to compromise its regulatory liabilities and continue to undertake regulated activities in such circumstances. We have a range of powers provided by FSMA, PSRs and EMRs which enables us to take action against a firm to protect consumers and markets. This can include, for example, imposing requirements on the firm to take specific actions (such as appointing new management), varying the firm's regulatory permissions to restrict business or imposing additional prudential requirements if appropriate. There may be circumstances in which regulatory action follows the court's approval of a compromise, for example where we become aware of serious or deliberate misconduct at a late stage. Our consideration of whether to exercise our regulatory functions will be determined on a case-by-case basis and its merits taking account of our statutory objectives.

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[7] FEES 3, Annex 9 Special Project Fee for restructuring, see para. (2)R(b) and (c). For further information on the rationale for Special Project Fees please see our consultation paper on regulatory fees and levies: policy proposals for 2020/21 (CP19/30).

43. When assessing the fitness and propriety of current or prospective Senior Management Function holders or approved person (as relevant) candidates, either at the time the compromise is proposed or in future, we will also take account of the proposed compromise and the circumstances relating to it. The Senior Managers and Certification Regime does not apply to PIs and EMIs.

44. Our assessment is independent to that of the compromise approval process, and irrespective of whether a compromise is approved by creditors and/or shareholders and the court (where appropriate), we will continue to assess the firm and its senior management, and we may consider further regulatory action where our assessment considers it appropriate.

Phoenixing

45. Phoenixing is a common term often used to describe the practice of closing a firm and that firm re-appearing under a new guise to avoid liabilities arising from the old firm. Each time this happens, the insolvent company's assets, but not its liabilities are transferred to a new, similar 'phoenix' company. The insolvent company then ceases to trade and might enter into formal insolvency proceedings (liquidation, administration or administrative receivership) or be dissolved. In the UK under the requisite laws directors of a company that has failed are not prevented from forming a new company, unless they are personally bankrupt or disqualified from acting in the management of a limited company. Furthermore, firms are not prevented from proposing a compromise. However, there is a risk that a company owing significant sums, often in the form of consumer redress awarded by the Ombudsman Service, will be left unpaid. Directors, shareholders and senior staff who have engaged in financial misconduct may reappear, connected with a new firm of similar business or with the firm after the compromise takes effect. We consider this unacceptable practice. Where we find such individuals have deliberately avoided their responsibilities and not complied with previous redress awards made against their firms, we will question the fitness and propriety of these individuals and take necessary steps against them so that they do not cause further harm to consumers.

Chapter 6: Examples demonstrating the FCA's approach to compromises

The following examples are intended to illustrate how the FCA would consider compromises proposed by firms, in line with the guidance above. The FCA will assess proposed compromises on a case-by-case basis, taking into account the facts and matters specific to the compromise proposed to determine the appropriate regulatory action.

Firm A

Firm A is an insurance broker that provides card protection policies. Following identification of widespread mis-selling of the policies, Firm A proposes a Scheme to efficiently structure the redress claims process, allowing all customers to submit claims within the period of the Scheme and preventing the uncertainty of potential future claims arising. The Scheme provides a simple process for customers who were mis-sold to make a claim for redress. As claims are made, the firm will pay money into the Scheme to meet their outgoing redress payments. Firm A produces clear, fair and not misleading communications to policyholders by using language that is clearly understood (including translations for non-English speakers), using different mediums that meet accessibility needs for all policyholders, explaining the alternative options and providing contact details for policyholders to send any questions or concerns about the proposed Scheme. Once approved by creditors and sanctioned by the court, through the Scheme, policyholders will be able to claim compensation for mis-sold policies; successful claimants will be paid 100% of the redress owed to them. To make sure all policyholders come forward and future liabilities are made certain, Firm A would contact policyholders to make their claim three times using two different methods and provide a reasonable time period for making the claim.

We would consider this to be a fair compromise as policyholders will be able to claim 100% of the redress owed to them and no policyholders were unfairly treated or excluded from the process.

Firm B

Firm B is a financial adviser specialising in providing advice on pensions. Firm B has received a significant number of complaints from customers due to poor advice. Some customers have referred their complaint to the Ombudsman Service which has resulted in redress awards against the firm. The value of Firm B's liabilities to redress creditors is over £200m in aggregate. Several complaints are still to be considered by the Ombudsman Service. A large proportion of the redress creditors are customers with characteristics of vulnerability. With mounting redress liabilities, the firm is in financial distress and proposes a Scheme to settle its liabilities to redress creditors to allow it to stay solvent. If the Scheme is sanctioned, redress creditors will receive 25 pence in the pound; secured creditors, shareholders and other unsecured creditors will be unaffected. Firm B's shareholders will also retain their full ownership stake despite not contributing any funds to be made available to meet the redress claims.

Firm B is intending to continue to trade despite being unable to meet its liabilities to customers created by the firm's misconduct. We do not consider this to be the best possible compromise that the firm can make as customers are not receiving the greatest proportion of what is owed to them. If it is unable to pay the full redress due to its customers, the firm should consider all options available to it, including a wind down scheme if appropriate. Whichever option the firm proceeds with, it should pay as much money as it can into the Scheme to ensure its customers get the best possible outcome. Furthermore, the firm is continuing to trade but economic returns are not being divided fairly between all stakeholders as only redress creditors will be affected in terms of the liabilities owed to them. Therefore, redress creditors would not receive a fair outcome in respect of the liabilities owed to them. We would take these factors into account along with the scale and nature of any misconduct which led to the redress liabilities when deciding whether to use our regulatory powers and/or whether to object to the Scheme in court.

Firm C

Firm C is a consumer credit firm. Firm C has received a significant number of mis-selling complaints from customers due to its unaffordable lending practices. Some customers have referred their complaint to the Ombudsman Service which has resulted in redress awards against the firm. The value of Firm C's liabilities to redress creditors is over £100m in aggregate. Several complaints are still to be considered by the Ombudsman Service. A large proportion of the redress creditors are customers with characteristics of vulnerability. Firm C proposes a Scheme to settle its liabilities to redress creditors. If the Scheme is sanctioned, redress creditors will receive 50 pence in the pound. The only likely alternative to the Scheme is insolvency. Firm C has ceased its lending activities and the firm will wind down following the implementation of the Scheme, meaning that it will no longer continue in business. Due to the wind down, it is likely that other creditors will incur losses and shareholders will lose the value of their investment in the firm. Therefore, other creditors and shareholders of the firm will also be affected by Firm C's proposals.

We have significant concerns about the Scheme being proposed and used by Firm C to limit the amount of redress paid to customers. However, we are conscious that the only likely alternative to the Scheme is the insolvency of Firm C and that the Scheme is proposed as part of a wind down whereby all stakeholders of the firm will be affected. We would take these factors into account along with the scale and nature of any misconduct which led to the redress liabilities when deciding whether to use our regulatory powers and/or whether to object to the Scheme in court.

Annex 2
Summary of feedback received

Consultation title	**GC22/1: Guidance on the FCA's approach to compromises for regulated firms**
Date of consultation	25 January 2022 – 1 March 2022
Summary of feedback received	We received 11 responses to GC22/1, including from regulated firms, advisers of regulated firms (including insolvency practitioners and professional advisers), trade associations, regulated bodies and consumer protection organisations. This document provides a summary of the feedback we received and our responses. Respondents largely welcomed the proposed guidance, with several noting their agreement that it was necessary in terms of clarifying our approach to compromises for regulated firms. Some respondents made suggestions and comments in certain areas of the proposed guidance. Descriptions of the feedback are included below and have shaped the final guidance. We would like to thank all respondents for their feedback.
Response to feedback received	Below we summarise and respond to significant areas of feedback we received on the proposed guidance. The feedback is presented under each of the questions posed in GC22/1. ***Q1: Do you agree with our expectations on firms' engagement with the FCA in Chapter 2? If not, why not? Are there any other considerations that would be useful to consider?*** Most respondents agreed with our expectations, with one noting that the list of information that we expect firms to provide as part of their notification gives greater clarity to their advisers.

We received minor comments in the following areas:

Timeframe for engagement with the FCA

Several respondents requested further clarity on the timeframe for notifying us. Some suggested that the appropriate timeframe should be as soon as a firm is considering a compromise and able to provide sufficient information about the compromise for us to make an initial assessment of it. Others noted that the list of initial information may take time to prepare or may not be available until later in the process.

Our response - Where a firm is considering proposing a compromise, it is important that it acts quickly to prepare the relevant information and provide it to us early in the process to enable our assessment of the proposed compromise. The guidance sets out the information that we need as part of the initial notification and further information we need at an early stage. We have amended the guidance to clarify that firms should make every effort to gather information as quickly as possible and provide it to us for our assessment. We have not included a specific timeframe as compromises are considered on a case-by-case basis and, therefore, the appropriate timeframe will vary.

Information for assessment of a compromise

Two respondents suggested extending the period for management accounts and financial forecasts to enable us to have a more meaningful assessment of a compromise. Another suggested that we should investigate payments made, or proposed to be made, to other stakeholders and require clawback provisions where such payments have been made to the detriment of consumers. Two were concerned that the information that we expect firms to provide as part of their notification duplicates disclosures required under the legislative framework governing compromises. One respondent requested clarity on the circumstances in which a Skilled Person Report pursuant to section 166 of FSMA may be necessary.

Our response - We have amended the guidance to extend the period for management accounts to cover the period since the last formal accounts and financial forecasts to align with the period of the proposed compromise. Under the current legislation governing compromises, we do not have the power to effect clawback provisions to require a firm's stakeholders to return money already paid to them. However, we have amended the guidance to request details of firms' contractual clawback provisions to assist with our assessment of a proposed compromise. We have also amended the guidance to include a link to the information on our website on skilled person reviews. We are not removing or reducing the list of information that we expect firms to provide as part of their notification as there are no existing requirements under the Companies Act 2006 already requiring such information to be provided to the FCA.

Engagement with the FSCS and Ombudsman Service

One respondent noted that the FSCS should be regarded as a last resort in paying the liabilities of a firm. One respondent requested clarity on DISP and the role of the Ombudsman Service in a compromise and questioned whether it is possible for a compromise to extinguish a right to raise a complaint.

Our response - While we agree that payment of full redress to consumers is a priority and that the FSCS should be considered a last resort, we have not amended the guidance to explicitly refer to this as the relevant rules governing compensation claims are cited in the guidance. It is possible for a compromise to extinguish a right to raise a complaint as the terms of a compromise may state that a customer will give up their legal right to bring a claim via the Ombudsman Service or via the Courts in return for making a claim/complaint under the compromise. The extent to which a customer's rights are extinguished will vary on a case-by-case basis. We have amended the guidance to clarify that, where a firm is proposing a scheme that will ultimately extinguish a person's right to bring a claim against the firm – eg a claim that falls within the scope of the scheme - using other avenues (ie by going to court), then the FCA will look carefully at the communications a firm proposes to send to potential redress customers and the time frame in which claims must be brought before existing rights to pursue a claim are extinguished to ensure that both of these are fair in all of the circumstances.

Q2: Do you agree with our approach to assessing a compromise in Chapter 3 and the factors we will consider? If not, why not? Are there any other considerations that would be useful to consider?

Most respondents agreed with our approach, including the factors that we would consider and that our assessment needed to be conducted on a case-by-case basis.

We received suggestions and comments in the following areas:

Treatment of consumers

Many respondents were concerned that the guidance was seeking to treat consumers as a special category of creditors, with one noting that this was not reflected in the current legislative framework. One respondent highlighted that the FCA's proposed new Consumer Duty would disapply Principles 6 (treating customers fairly) and 7 (customers' information needs) and, therefore, the guidance should be considered in this context to ensure there are no conflicts. They also suggested requiring firms to appoint a consumer advocate to opine on the design and fairness of proposed compromises.

Our response - We disagree that the guidance is seeking to treat consumers as a special category of creditors. Rather, the guidance is seeking to remind firms of their legal and regulatory obligations to customers. We believe our guidance is consistent with the objective of the proposed new Consumer Duty in terms of requiring firms to deliver good outcomes for retail customers. We have amended the guidance to avoid any conflicts with the proposed new Consumer Duty. Firms should consider all of the rules (and Principles) that are applicable to them when considering a compromise to ensure that any compromise proposed will not be unacceptable to us. While we agree that it is helpful for firms to consider appointing a consumer advocate on the design and fairness of a proposed compromise, we are not expecting all firms to appoint one given this may not be proportionate or feasible in every case.

Letters of non-objection

Two respondents requested that we reconsider our position on letters of non-objection. One suggested that such letters would save time and costs, while the other noted that in the past such letters had played an important role in enabling the court to deal with cases on a proportionate basis, expeditiously and fairly.

Our response - We have not amended our position on letters of non-objection for the reasons outlined in the guidance. As stated in the guidance, we focus our resources on assessing the proposed compromise and any connected supervisory and/or enforcement action. We have clarified that, in an appropriate case, where the facts or circumstances warrant doing so, we will communicate any concerns we have with the proposed compromise, and the FCA's position, to the relevant firm and, where appropriate, the court.

Q3: Do you agree with the factors we will consider in deciding when to participate in court proceedings in Chapter 4? If not, why not? Are there any other considerations that would be useful to consider?

Most respondents agreed with the factors we will consider in deciding when to participate in court proceedings. We received minor comments in the following areas:

Participation in the court process

One respondent queried why our guidance was drawing a distinction between CVAs, Schemes and RPs, stating that it implied that the FCA adopted a more lenient approach to VAs. Another noted that the factor of whether a compromise fairly balances the interests of all creditors should be extended to all stakeholders of the firm. One respondent disagreed with our assessment of a compromise being distinct from the court process and that our participation in any formal compromise procedure already allows for any regulatory issues to be brought to the court's attention.

Our response - We disagree that we are taking a more lenient approach to VAs; our overall position is the same for all types of compromises but the legislative framework for our participation in the court process is different for VAs compared to Schemes and RPs. We have amended the guidance to clarify this. We have also extended the factor of whether a compromise fairly balances all interested parties to include stakeholders. Our assessment of a compromise is necessarily distinct from that of the court because we have different objectives; as stated above, the guidance aims to help firms understand our expectations and the basis for our participation in the different court processes.

Special Project Fees

Several respondents requested clarity on the rationale for charging special project fees for costs incurred in assessing Schemes and RPs. Two respondents suggested an early indication of quantum of such fees would assist firms.

Our response - The rationale for Special Project Fees is set out in our consultation paper on regulatory fees and levies: policy proposals for 2020/21 (CP19/30). We have amended the guidance to explain that the rationale for charging special project fees is that Schemes are not considered to be business as usual work for us given we do not have a specific statutory role to intervene in such arrangements. We have also amended the guidance to clarify how Special Project Fees are calculated. We disagree with including an indicative quantum for a special project fee as this will be determined on a case-by-case basis, and Special Project Fees may not always be applicable.

Q4: Do you have any comments on our use of supervisory tools/regulatory action in respect of compromises in Chapter 5? Are there any other considerations that would be useful to consider?

Many respondents agreed with our approach to the use of supervisory tools and regulatory action. One stressed that where we intervene to stop a firm proposing a compromise, we should consider the impact on the end consumer. Another suggested that the exercise of our regulatory functions should be carried out independently of the evaluation of the compromise process. One respondent was concerned about the possibility that once a compromise has been sanctioned by the court, it should not be undermined or unwound through regulatory action.

Our Response - Consumer protection is one of our statutory objectives and achieving fair outcomes for customers is central to our approach to, and assessment of, proposed compromises. The impact on the end consumer will therefore be a key consideration in our consideration of whether we use supervisory tools and regulatory action. The assessment of a compromise and our consideration of any appropriate regulatory action in respect of misconduct leading to the compromise are interlinked as the same information may be relevant to both. However, our consideration of whether to exercise our regulatory functions will be determined on a case-by-case basis and its merits taking account of our statutory objectives. The purpose of the guidance is to clarify how we approach assessing compromises and the factors firms should consider. We have amended the guidance to clarify this.

Q5: Do you agree with our proposal that we will consider using our regulatory powers where firms propose compromises in relation to redress liabilities and we are likely to find, or have found, the liabilities were caused by serious or deliberate misconduct by the firm? If not, why not?

The majority of respondents agreed with our proposal. Two noted that the firm’s management should be held accountable for serious or deliberate misconduct and, where individuals deliberately avoided their responsibilities, we should question the fitness and

	propriety of those individuals. Another queried what types of conduct might be considered serious or deliberate misconduct. Two noted that customers may be more adversely affected if a compromise does not proceed, and a firm instead goes into administration. **Our Response** - As noted in our guidance, when assessing the fitness and proprietary of a firm's senior management at the time of a compromise being proposed or future, we will take into account the proposed compromise and the circumstances that led to it. We have not amended the guidance to include examples of the types of conduct that might be considered serious and/or deliberate misconduct as this will vary on a case-by-case basis based on the facts and matters of the specific case. We are not amending the guidance to exclude the possibility or use of regulatory powers following court approval of a compromise as there may be circumstances in which regulatory action is appropriate where, for example, we subsequently become aware of misconduct, and we do not want to risk fettering our discretion to act when needed. The fact that a compromise may have been sanctioned by a court would be a relevant factor we would have to take into account when deciding what, if any, further regulatory action was appropriate.
Changes made to the guidance as a result of feedback received	In line with the responses above, we made a number of changes to the drafting of the finalised guidance to give greater clarity and to address issues raised in feedback in certain areas.

Annex 3 – Abbreviations used in this paper

COMP	Compensation Sourcebook
CVA	Company voluntary arrangement
DISP	Disputes Resolution Complaints Sourcebook
EG	Enforcement Guide
EMI	Electronic Money Institution
EMR	Electronic Money Regulations 2011
FCA	Financial Conduct Authority
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
IVA	Individual voluntary arrangement
PI	Payment Institution
PRA	Prudential Regulation Authority
PVA	Partnership voluntary arrangement
PSR	Payment Services Regulations 2017
RP	Restructuring Plan
SPV	Special purpose vehicle
SUP	Supervision Manual
VA	Voluntary arrangement