Teneo
The Global CEO Advisory Firm

Where Next for the Consumer Scheme?

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Introduction

The recent Amigo ruling, where Mr Justice Miles declined to sanction the proposed Scheme of Arrangement despite scheme creditors (including consumer redress creditors) voting overwhelmingly in favour, has cast doubt on the viability of schemes as a tool to restructure struggling lenders. But does that mean the end of the road for consumer schemes, or does the ruling provide much needed guidance on a tool that has seldom been used in the consumer credit space?

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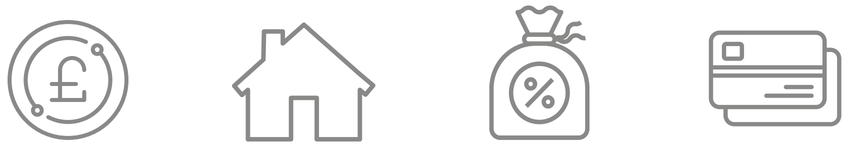
The consumer credit market has seen a fundamental shift in the treatment of affordability

The consumer credit market has grown substantially since 2012, with a number of new products brought to the market in the wake of the 2008 financial crisis.

In April 2014 the Financial Conduct Authority ("FCA") assumed regulatory responsibility for the sector, and immediately identified it as having the potential to harm consumers. Additional regulation designed to protect the consumer followed (including price caps introduced with effect from 2015), with a particular focus on:



High-cost credit **Rent-to-own** **Overdrafts** **Credit Cards**

As the market grew, affordability assessments became an area of increased focus for the regulator, and two landmark determinations by the Financial Ombudsman Service ("FOS") in 2018 confirmed that the FOS could consider complaints in relation to loans that were more than six years old, provided that the complaint was made within three years from the date that the complainant became aware (or ought reasonably to have become aware) that they had cause for complaint.

In addition, the Kerrigan v. Elevate judgement in 2020 concluded that an "unfair relationship" can be created between lender and borrower where the lender has breached the FCA's Consumer Credit Sourcebook in respect of creditworthiness and affordability checks. The judgement also highlighted that this is particularly the case where the lender has failed to take into account that repeat lending might cause financial difficulty for the borrower, and that where a series of loans are made, the unfair relationship will continue even when earlier loans are paid off.

Redress claims have significantly challenged the sub-prime lenders

Against this background, and following the expiry of the payment protection insurance ("PPI") complaint deadline, claims management companies ("CMCs") have turned their attention to certain consumer credit firms, which CMCs appear to perceive as "low hanging fruit".

This is creating challenges for firms in the firing line, even before considering redress liability, as CMCs have the capacity to process a significant volume of claims, causing:

1. A material drain on lender resources; and
2. Significant FOS fees for lenders (£750 per referral to the FOS), notwithstanding the validity of a claim.

In most cases, where CMCs find conduct breaches the lender can be left under a cloud of potential redress claims and in a precarious financial position. Any skilled person review and remediation, which has been the "go to" strategy to date, will only add to the firm's costs at a time when cash can be at a premium.

Viable restructuring options have historically been limited

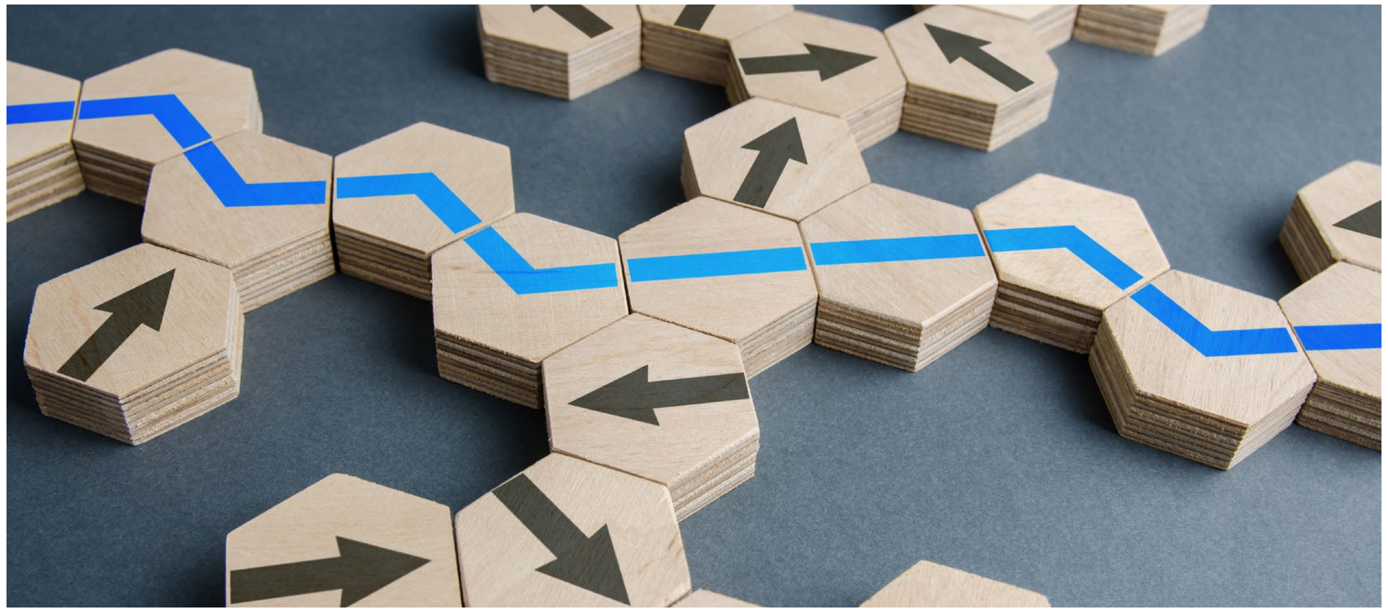
Historical efforts from lenders to restructure their balance sheets (whether due to mounting redress liabilities or for other reasons) have been minimal, as lenders have had limited liquidity to explore solvent options, and perceived that the FCA considered the use of compromise tools (e.g. Schemes and Company Voluntary Arrangements ("CVAs")) to be incompatible with its rules, principles and objectives.

As a result, a number of consumer credit firms have been left with little option but to file for insolvency when faced with financial difficulty, eroding value and resulting (in most cases) in little or no returns to consumers with redress claims.

However, in 2019 Instant Cash Loans ("ICL") became the first consumer credit lender to implement a redress scheme, successfully compromising redress claims. Relevantly, the ICL scheme provided that:

1. The business would cease trading; and
2. The shareholder would make a contribution of up to £18m, which would only be provided if the scheme was approved.

After this precedent setting case, there was a surprising lull in the use of schemes, until Amigo and Provident launched their schemes in January and March 2021 respectively.



Amigo and Provident have attempted to use Scheme of Arrangements to prevent insolvency

Amigo

The Amigo scheme, launched in January 2021, broadly provided that Amigo would:

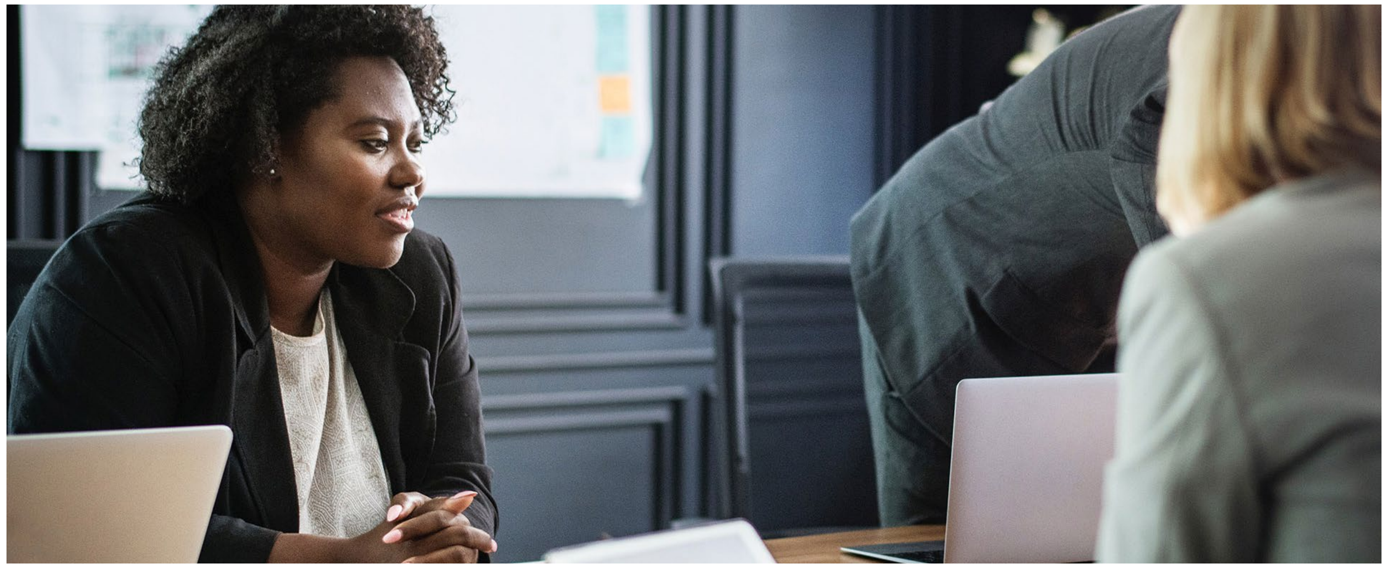
- Make £15m available for scheme creditors (consumer redress creditors and the FOS), which it estimated would equate to a return of c. 10%.
- Make a further "balance adjustment contribution", which would depend on the amount of set off between consumer claims and the loan book.
- Continue to trade and make a profit contribution of 15% over 4 years (tested year by year), but existing shareholders would retain 100% ownership.

Amigo claimed that, if the scheme was not approved, the relevant alternative was insolvency, and that in such a scenario, given the significant level of secured debt, scheme creditors would receive nil.

Although the FCA consistently stated that it did not support the scheme, it did not formally oppose the scheme until shortly prior to the sanction hearing.

At sanction, the FCA attended and opposed the scheme on a number of grounds, but principally that:

- The FCA did not agree with firm that the relevant alternative (i.e. what was likely to happen if the scheme was not sanctioned) was insolvency, as the firm provided no evidence supporting this conclusion and had significant (> £100m) cash at bank. The FCA argued that, if the scheme was rejected, prudent directors acting in accordance with their duties would try and negotiate a new restructuring, and as such the scheme is not better than the relevant alternative (as the relevant alternative is a better restructuring proposal, not insolvency).
- The scheme was fundamentally unfair, as shareholders were retaining 100% ownership and making only a minimal profit contribution (the quantum of which had not been adequately justified in evidence), with scheme creditors (who rank ahead of shareholders) suffering a c. 90% haircut. This was particularly relevant given that the scheme creditors had not been involved in negotiating the terms of the scheme.



In such circumstances, the FCA argued that the scheme creditor vote (which was overwhelmingly in favour of the scheme) should be overridden as creditors had voted under a false impression and had not understood that: (1) insolvency was not necessarily the relevant alternative; and (2) while they were being asked to concede c. 90% of their economic rights, junior ranking shareholders were to be allowed to retain 100% ownership.

Ultimately, Mr Justice Norris, who was critical of the level of disclosure in relation to certain scheme terms, declined to sanction the Amigo scheme:

"I am not satisfied that the court should sanction the Scheme… I have accepted the submissions of the FCA that the Redress Creditors lacked the necessary information or experience to enable them properly to appreciate the alternative options reasonably available to them; or to understand the basis on which they were being asked by Amigo to sacrifice the great bulk of their redress claims, while the Amigo shareholders were to be allowed to retain their stake.

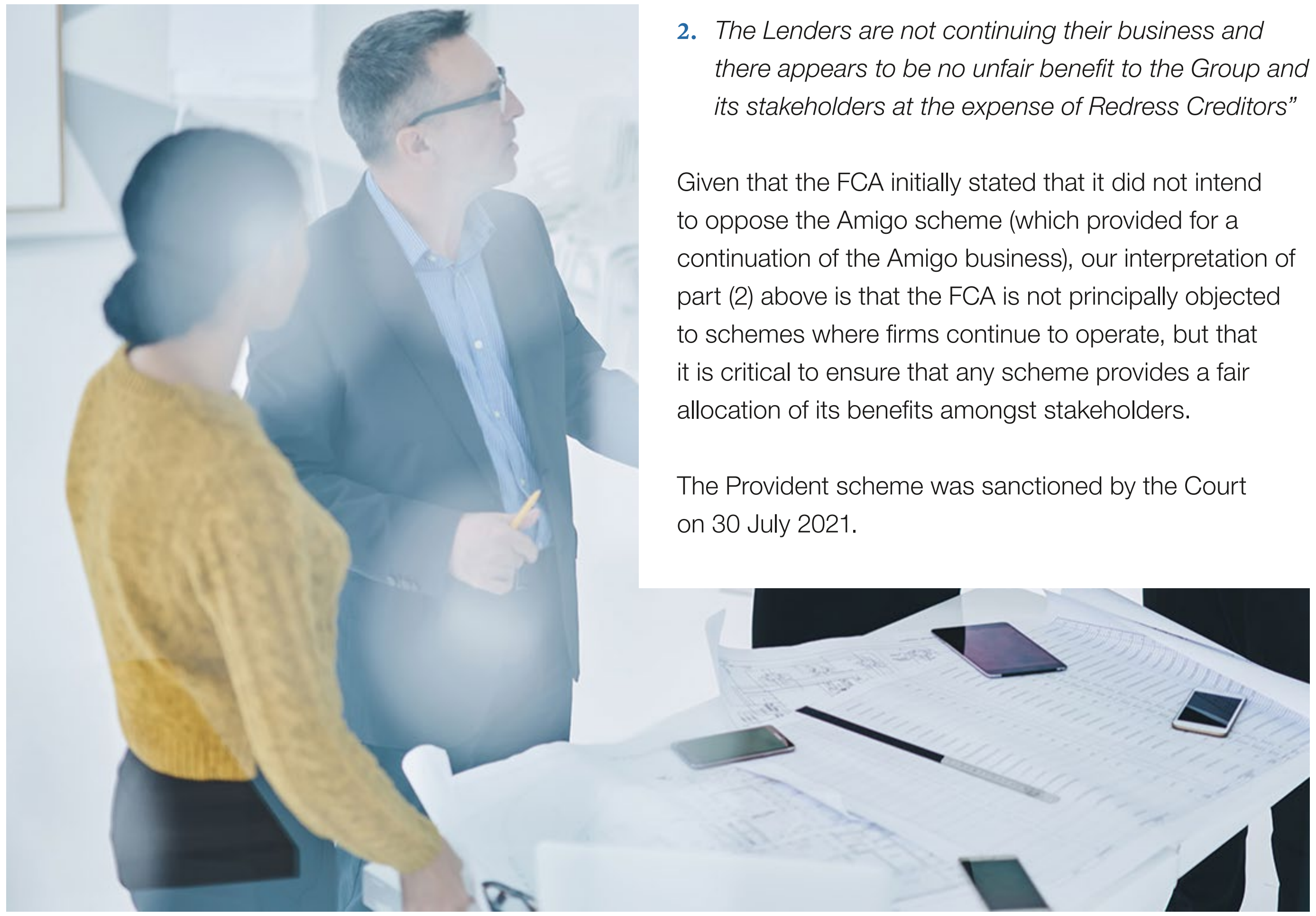
I have also accepted the FCA's submission that the court's refusal to sanction the Scheme will probably not lead to the imminent insolvency of the Group; there is no evidence of any immediate (or even medium-term) liquidity crunch, and the directors will doubtless wish, if possible, to preserve the value of the enterprise for its various stakeholders. The FCA expects the directors to continue to explore and promote a restructuring which fairly allocates the benefits and losses among the various stakeholders. I agree with that, and would urge the directors to continue their efforts to promote a suitable restructuring."

It is rare for the Court to decline to sanction a scheme and to "call the firm's bluff" in relation to a relevant alternative of insolvency. To date, Amigo has yet to formally launch a new restructuring proposal (although it has indicated that it will likely propose some form of enhanced scheme), and the success of Amigo's next step may impact the approach to future schemes lacking a burning platform.

Provident

The Provident scheme, which was launched in March 2021, broadly provided that:

- The Group would make £50m available for scheme creditors (consumer redress claims and the FOS in relation to the home collect credit division) and provide a further £15m of funding for scheme costs, neither of which would be available if the scheme is not approved; and critically
- The home collect credit division would be wound down, and the Provident Group would exit the home collect credit market.



Provident claimed that, if the scheme was not approved, the relevant alternative was insolvency of the home credit division and that, in such a scenario, scheme creditors would receive nil.

As with Amigo, the FCA stated that it did not support the scheme, as it was inconsistent with the FCA's rules, principles and objectives. However, unlike Amigo, the FCA confirmed that it did not intend to oppose the sanction of the Provident scheme based on two key factors:

1. *"The Lenders face an imminent insolvency in which many Redress Creditors would receive less than under the Scheme*
2. *The Lenders are not continuing their business and there appears to be no unfair benefit to the Group and its stakeholders at the expense of Redress Creditors"*

Given that the FCA initially stated that it did not intend to oppose the Amigo scheme (which provided for a continuation of the Amigo business), our interpretation of part (2) above is that the FCA is not principally objected to schemes where firms continue to operate, but that it is critical to ensure that any scheme provides a fair allocation of its benefits amongst stakeholders.

The Provident scheme was sanctioned by the Court on 30 July 2021.

Lessons learned

The door is not closed to consumer credit firms using schemes to restructure their balance sheets, and the FCA has announced it will consult on its approach to schemes later in Autumn 2021. However, the FCAs representations at the Amigo sanction hearing, together with its published correspondence in relation to the Provident scheme, already provide some guidance as to how lenders should approach schemes in the future:

1. Engage early with the FCA: while the FCA will not negotiate on behalf on consumers, and is unlikely to set a target for the firm to try and meet in order to obtain its support (or non-opposition), early engagement with the FCA can help shape the terms of a scheme to minimise the risk of the FCA opposing the scheme.
2. Engage with scheme creditors: "take it or leave it" schemes, where there has been no negotiation with scheme creditors, will naturally require a greater level of disclosure and justification regarding the stakeholder economics, and attract greater scrutiny from the FCA and the Court. While there are clearly practical challenges to engaging with consumer creditors, early engagement can mitigate the risk of challenge at a later date.
3. Share the benefit: notwithstanding engagement with the FCA and consumer creditors, the firm should consider how it intends to fairly allocate the burden and benefit of the scheme. This will be particularly relevant where the firm intends to continue trading with shareholders retaining an interest:

   a. While there is no absolute priority rule in the UK (i.e. there is no rule that prevents shareholders retaining an interest when creditors are being compromised), firms should consider how appropriate it is for existing shareholders to retain (100%) ownership is in the circumstances (e.g. where no new money is provided), and the extent to which equity upside should be reallocated to scheme creditors.

   b. The terms of the scheme should not be founded in considering "how much can we squeeze creditors" or "how much can we reallocate from shareholders". Instead, the terms should be derived through honest negotiations between the parties.
4. Carefully assess the relevant alternative: with all schemes and restructuring plans, identifying and evaluating the relevant alternative is critical to success at sanction, and the firm will need to demonstrate that the scheme offers a better return than the alternative. Amigo and Provident have drawn into focus the FCA's expectations that, if insolvency is not imminent, the FCA will consider whether there is scope for a new, enhanced scheme, that could provide a better return, and so firms should ensure that they have exhausted all options before launching.
5. Be transparent and straightforward: it goes without saying that the language of scheme documents needs to be simple and accessible for consumer creditors with limited financial sophistication. However, while the Amigo judgement accepted that there was no requirement for firms to pay the costs of advisers, Mr Justice Norris indicated that it was critical for firms to explain why the terms of proposal were as they were (e.g. why shareholders are retaining ownership, or the level of shareholder contribution), particularly if engagement with a particular scheme creditor group has been limited. Absent transparent and straightforward explanations to enable scheme creditors to make a *"reasonable judgment on whether or not the Scheme was in their interests… the court is most unlikely to be able to place any reliance on, or give effect to, the affirmative vote at the Creditors' Meeting".*

We are highly experienced in supporting consumer credit restructurings…

Project Roger
Consumer Credit
Solvency Assessment

- Engaged by the FCA to perform loan book provisioning review of a UK HCSTC lender, alongside cash flow and balance sheet solvency assessment of the lender and associated businesses.
- We concluded the lender was insolvent and were retained to advise the FCA in relation to its strategy and communications.
- The Firm ultimately decided that it was insolvent and took pre-emptive action to file for administration.

PerfectHome
Rent to Own
Contingency Planning

- Advised PerfectHome on options including M&A and wind down / collect out of its debtor book. Regularly reviewed the company's solvency and ability to trade in light of cash constraints.
- M&A process identified significant interest in the business, however no offers were received for the Company's shares. A sale was ultimately implemented via a pre-pack administration, preserving jobs and providing continuity for consumers / borrowers.

Project Cricket
Consumer Credit
Scheme of Arrangement

- Engaged company-side to provide advice regarding a proposed Scheme of Arrangement in relation to a market leading provider of personal loans to sub-prime borrowers in the UK.
- Our work focussed on assessing the prospects of the scheme being approved (including the position of the FCA), the relevant alternative, and the implications on the Group if the scheme was not approved.

Project Rota
Retail Investment Scheme/Lender
Solvency Assessment

- The Group received loans from retail investors which is used to lend to sub-prime borrowers.
- We were engaged by the regulator to review the solvency of the group.
- Our work included a desktop review of the underlying business model, balance sheet and assets and considered whether there were any risks to the group not being able to repay the retail investment absent further lending.

…and have been instrumental in shaping the current Scheme/Restructuring Plan market

Virgin Active
Leisure & Travel
Restructuring Plan

- Designed and implemented a holistic restructuring solution, using a Part 26A Restructuring Plan to bind secured and unsecured creditors through a single process.
- Led negotiations with shareholders, lenders and the licensor, and developed the proposal to landlords.
- Successfully defending challenges to the relevant alternative, with Court concluding our relevant alternative was correct.

Pizza Express
Casual Dining
Restructuring Plan

- Engaged by the Company to produce a comparator to provide an indication of likely returns to creditors. Concluded that the Plan had to better both: (1) an accelerated sale of the Group, which was supported by a third party valuation and a Group led M&A process; and (2) a Group wide liquidation.
- In both cases the value broke in the secured debt, and ensured that the Plans provided a return so that creditors were no worse off than either potential relevant alternative.

Virgin Atlantic
Travel & Aviation
Restructuring Plan

- Engaged by the RCF lenders and reporting to additional lender groups. We undertook a red flag review of the business plan and advised the senior lenders in negotiations with the company on a restructuring proposal, which was delivered through the first Restructuring Plan agreed in the UK.
- This was supported by additional shareholder funding and third party new money, as well as consensual concessions from the financial creditors.

Codere
Gaming
Scheme of Arrangement

- Advised a global gaming provider operating across multiple jurisdictions in Europe and America, to produce an EPM which considered multiple scenarios.
- Included in these scenarios were a base liquidation and an accelerated M&A alternative to support a potential Scheme of Arrangement.

Teneo's Financial Services Restructuring Team

Teneo's Financial Services Restructuring Team includes market leading experts and provides pragmatic solutions to firms and their stakeholders in periods of stress.

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Selected recent credentials*

The Abraaj Group Private Equity fund Provisional Liquidators $13.6bn assets	Raphaels Bank UK-based independent bank Solvent Wind Down £243m assets	PerfectHome Consumer credit – Rent to Own Accelerated M&A £30m loans
phoenix Commodities Trader Liquidators $1.2bn creditor claims	**Project Guillemot** UK-based challenger bank Solvent Wind Down Plan support £445m assets	Banco Popular Spanish Systemic Bank Valuation under the EU's BRRD €147.8bn assets
ESBD Private wealth bank Manager and Liquidator $2bn AUM	Harrington Brooks Debt management Accelerated M&A 38,000 clients	**Project Opal** Insurance Contingency Planning and options review £190m debt
Project Roger Consumer credit – HCSTC / mini-bonds Solvency review >50,000 customers	Providence Bonds PLC Funds and Mini-bonds Administration and asset recovery 1,000 retail bondholders	Standard Chartered European Bank Wind Down & Liquidation £2.4bn AUM

* Including when Teneo Restructuring was Deloitte UK's Restructuring Services team

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