Complaints Commissioner

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Final report by the Complaints Commissioner

Complaint number FCA00684

The complaint

1. On 10 December 2019 you asked me to review the decision of the FCA in response to a complaint which had been made by another law firm (law firm A) on behalf of a number of your clients, who had lost money in a Ponzi scheme. Your law firm has now taken on the complaint.

What the complaint is about

2. The FCA described law firm A's complaint as follows:

> *Part One*
>
> *[Law firm A] claims that in March 2008 the Authority was made aware of a mortgage fraud allegation against Mr [A], who was a Controlled Function holder at [firm X], which was an Appointed Representative ("**AR**") of [firm Y], an authorised firm. However, despite having been informed of this allegation, the Authority failed to investigate it or otherwise act on it.*
>
> *Part Two*
>
> *[Law firm A] alleges that in July 2012, when processing the application made on behalf of Mr [A] for an authorisation to carry out the CF30 Controlled Function ("**CF**"), the Authority was aware that Mr [A] had provided information on the application form which was untrue, yet the Authority failed to act on this knowledge.*
>
> *Part Three*
>
> *[Law firm A] alleges that in October 2012 the Authority received credible information on an illegal deposit taking scheme which was being operated by [firm X] of which Mr [A] was the director. However, the Authority at that time took the decision not to take any action. This allowed the scheme to operate until 2014, when the Authority took enforcement action that led to the closing down of the scheme.*
>
> There was originally a Part Four to your complaint, but you have withdrawn it because of the result of legal proceedings, and I therefore do not consider it in this report.

What the regulator decided

3. The FCA's decisions on each part of your clients' complaints were as follows:

    a. Part One was not upheld. The FCA said that the Financial Services Authority (FSA) – the regulator at the time – dealt promptly with the information about alleged mortgage fraud, and acted in accordance with the policies in place at the time (2008);

    b. Part Two was not upheld. The FCA said that the FSA dealt appropriately with the information which it received in 2012 in relation to Mr A's application;

    c. Part Three was partly upheld. The FCA investigation showed that the information about the alleged illegal deposit taking scheme was not followed up as it should have been, apparently due to an administrative error.

4. Law firm A responded to the FCA's decision by asking the FCA to reconsider on the following basis:

    a. In respect of Part One, the FSA's risk threshold was 'far too high and the triage process far too lax', and the risk had not been mitigated;

    b. In respect of Part Two, the FSA knew that the 'honesty, integrity and reputation' of Mr A was in question, and should not have deferred consideration of those issues simply because Mr A's application had been withdrawn;

    c. In respect of Part Three, law firm A invited the FCA to pay compensation for the admitted failure, or explain why not.

5. The FCA responded by confirming its decision, saying in particular that:

    a. In respect of Part One, complaints about the regulator's general policies were excluded from the Scheme;

    b. The FCA should not be held responsible for your clients' losses, and setting out the limitations of the Complaints Scheme in relation to ex gratia compensation.

Why you are unhappy with the regulator's decision

6. In your letter of 10 December to me, you say that the FCA should have upheld the complaint in its entirety, issued an apology, and awarded 'full compensation'. In essence, your case is that the FSA failed to respond adequately to clear information, received in 2008 and 2012, raising serious concerns about Mr A and the activities of firm X.

Preliminary points

7. In this complaint, there is not much in dispute in terms of facts. The issues are whether the FSA/FCA's actions or inactions were reasonable; and, if they were not reasonable, what remedy, if any, should be applied.

8. That being so, I should emphasise four points. The first is that it is not my role to substitute my regulatory judgement for that of the regulator. The FCA (and the FSA before it) is a 'risk-based regulator', which means that it has to assess how it should apply its limited resources according to the risks of which it becomes aware. The fact that a possible breach of its regulations is brought to its attention does not mean that it is *required* to take action. My task is to consider whether the decisions taken by the FSA and FCA were within the range of reasonable decisions that could have been taken, bearing in mind the regulator's policies at the time (and, as has already been explained to your clients, this Complaints Scheme does not deal with complaints about the regulator's policies).

9. Second, the Complaints Scheme includes a provision for *ex gratia* payments, but payments under the Scheme are not of the kind or quantum which might be awarded by a court; nor is this Scheme the forum for considering complex issues of causation. The FCA has immunity from being sued for damages (save where bad faith or breach of human rights is established), and this Scheme cannot be used to undermine that immunity.

10. Third, I should make it clear that this report is concerned *solely with the actions or inactions of the regulator in response to the information which was available to it: I have made no assumptions or findings about the culpability of individuals.*

My analysis

The regulatory structures

11. To understand this case, it is necessary to understand the regulatory structures within which the FSA/FCA, firm Y (which is regulated directly by the FCA), firm X (which was an appointed representative of firm Y, and supervised by firm Y), and Mr A (the Director of firm X, and authorised as an individual by the FCA) operated.

12. Mr A worked for a different firm of financial advisers before establishing firm X. Firm X was originally directly authorised by the FSA, but then became an appointed representative of firm Y (the 'principal firm'). This meant that firm X undertook its regulated financial services under the auspices of firm Y, which made arrangements to monitor firm X's compliance both with the regulator's requirements and its compliance with the terms of the agreement between firms X and Y. As for all appointed representatives, firm Y was required to notify the FSA of firm X's appointment.

The three problems

13. The first problem arose in 2008, when building society Z notified the FSA that it had removed a number of mortgage brokers – including Mr A – from its panel. The reason for this was that the society had identified a number of mortgage applications made in 2005, including one from Mr A, which it suspected had been made on a fraudulent basis – the issue being that the applicants had applied for residential mortgages, but were using the mortgages for buy-to-let.

14. You have stressed in your response to my preliminary report that these were serious and detailed allegations, made against a number of individuals, and reported by a major building society, and I agree with you.

15. The FSA decided that this matter did not meet the risk criteria which would justify regulatory intervention.

16. The second problem arose in July 2012. Although Mr A worked for an appointed representative rather than a directly regulated firm, he required certain FSA permissions for what are known as 'controlled functions'. He held a CF1 permission as the firm's director, but had allowed his CF30 (customer function)

permission to lapse the previous year, because he had not needed it. However, a change in the organisation meant that he needed the CF30 permission again, and firm Y applied on his behalf. The FSA decided that, because of the information about alleged mortgage fraud received in 2008 (which Mr A allegedly should have but did not disclose on the application), it should treat the application as 'non-routine': it went back to firm Y to ask whether Mr A had ever been removed from a mortgage lending panel. Mr A's application was withdrawn. An intelligence report on this matter was drawn up in the FSA, but the supervision department determined that no further action was required.

17. The third problem also arose in 2012. Intelligence was received that another member of firm X had been taking deposits from clients and paying interest – something that the firm was not permitted to do – and that one client had had difficulty in getting his money back. A report was drawn up which was intended to refer the matter to supervision for further investigation, but the report went astray, and nothing was done.

Were the FSA/FCA's decisions reasonable?

18. I shall deal with each of the problems in turn.

19. In relation to the first problem, the question is whether the FSA should have done more in response to the information about alleged mortgage fraud. The argument which law firm A put to the FCA on behalf of your clients was:

> *I am unaware of any basis on which the FSA could have considered the risk posed by Mr [A] (which you plainly admit) had been "mitigated"…I was astonished to read that a report of conduct such as you had could be regarded as an acceptable risk….When deciding to close the file, the relevant staff at the FSA must have assumed that the report might be true. No reasonable regulator could accept a credible risk that a financial adviser might be a mortgage fraudster without looking into it.*

20. In your letter to me, you have effectively repeated these points. You have also drawn attention to the FCA's decision to rely upon the confidentiality provisions in section 348 of the Financial Services and Markets Act 2000 as a reason for not supplying further details of why the decision was made to take no action. You challenge the use of s348, which you say is designed to protect the confidence

of others, not that of the FCA. You also say that, in your view, the decision not to pursue the information further was clearly contrary to the FCA's published policies on supervision and enforcement (although you acknowledge that those policies are dated 2019).

21. I have looked carefully at the confidential records of the FSA's decision to take no further action. The FCA was correct in saying that the FSA considered the information about the alleged mortgage fraud promptly. The records show that the information was clearly understood, and that the policies then in place were applied.

22. The FCA says it is unable to provide the full reasons behind the Authority's decision that the risk had been mitigated, saying that 'this is due to confidentiality restrictions under section 348 Financial Services and Markets Act (FSMA) 2000 and our policy on sharing information'. I have queried the FCA's position on this, and it has explained that, while the general criteria by which decisions were and are made are not covered by s348, explaining how they were applied to a particular case is likely to involve breaching s348 because it may disclose confidential information received by the FCA.

23. This view of s348 is problematic, because it makes it hard to understand why the regulator has made decisions, and can lead to an erosion in public confidence. In your response to my preliminary report, you argued that you ought to be able to see any unpublished policies applying at the time in order to be able to respond. I have considerable sympathy with your point of view, but the fact is that for regulatory reasons the FCA considers that detailed policies of this kind should not be published. I invite the FCA to consider whether it might be more open about the historic policies of the FSA, but that is as far as I can go.

24. However, I have tried to be as helpful as I can within those constraints. Put simply, and without disclosing any confidential details about this case (although I have had access to those confidential details), the position is that the FSA's policy was that a report about suspected mortgage fraud did not necessarily justify further inquiries, and that policy was applied. It seems to me that that is sufficient to analyse the position under this Scheme.

25. I recognise that you – and many others – might be surprised to learn that the FSA considered that reports suggesting mortgage fraud should not necessarily be followed up. I was surprised when I learned this. The fact that a major building society felt it necessary to remove advisers from its panels because of concerns about their integrity might be seen as a good reason for the regulator to make significant further inquiries.

26. Against that, the FCA has pointed out that, even if the FSA had decided to take the matter further, it is likely that it would have waited for firm Y's investigation into the matter, which concluded that there was insufficient evidence against Mr A. Furthermore, I note that in the judgment in the case against firm Y, the judge concluded that the steps taken by firm Y in response to the information about the alleged mortgage fraud were defensible, so it might be argued that the FSA was entitled to place some reliance upon firm Y's supervision of firm X.

27. There is one further aspect to this part of your complaint. The FCA told you that the FSA recorded the matter as 'risk mitigated', a point which you challenged. I asked the FCA about this, since it seemed to me that the risk had not, in any real sense, been mitigated at all. The FCA has looked at this point further, and it tells me that the description of the closure as 'risk mitigated' was not in fact contemporaneous, but was applied when data was migrated from an old FSA system to a new FCA system in 2014. The FCA thinks it likely that the original description was 'risk-based closure'.

28. There is clearly a legitimate debate about whether the FSA's policy was defensible; and it is unsatisfactory when the policy is not published. However, complaints about the regulator's policies are explicitly excluded from this Complaints Scheme. It appears that the FSA applied its policies in this case, however misguided those policies may have been. For that reason, **I do not uphold part one of the complaint**.

29. Turning to the second problem (Mr A's application to reinstate his CF30 permissions), again the facts (see paragraph 16 above) are not in dispute. I do not think that the FSA's handling of the application itself can be faulted: it identified the record of the 2008 concern, and made further inquiries of firm Y. Following those inquiries, the application was withdrawn. The FSA wrote a report

stating that a further assessment of Mr A's integrity would need to be made if there were a further application. The FCA's conclusion was that 'the Authority [i.e. FSA] appropriately and proportionately acted on the knowledge available to it at the time'.

30. In your letter to me, you say that the FCA has failed to address a point made by law firm A in its follow-up to the FCA's initial decision letter. Law Firm A wrote:

> *…the case officer* [considering the CF30 application] *knew about the report of* [building society Z] *in 2008….The case officer also knew, contrary to the statement in your letter, that there was additional intelligence in respect of Mr* [A]*, because she knew that he had lied in relation to the CF30 application, saying that he had not been removed from a mortgage panel….If Mr* [A's] *honesty, integrity and reputation needed to be fully assessed, this should not have waited until he made a further application.*

31. It seems to me that it is this, and not the question of whether or not the application itself was properly handled, which is the heart of part two of the complaint. I agree with you that the FCA has failed to address it. Indeed, the FCA's decision – that 'the intelligence had already been deemed as being outside of risk appetite back in 2008', and 'It appears that no additional adverse intelligence was received by the Authority' ignores the clear fact that the person assessing the application made significant follow-up inquiries in the light of the allegedly false statement on the application form. Either the person assessing the application considered that the 2008 decision was wrong, or they considered that the matter needed further inquiries in the light of new evidence.

32. The further inquiries which the authorisations team made of building society Z and firm Y looked into the following matters:

    a. There was evidence that building society Z had informed Mr A that he had been removed from the panel;

    b. When firm Y, following up the FSA's inquiries, had asked Mr A whether or not he had ever been removed from a mortgage panel, he had 'categorically denied it'.

33. I conclude that, at the point when the FSA closed the application file (because the application had been withdrawn), and completed a report recording these

matters, the FSA had considerable material which might have justified some further action, not least because Mr A continued to be approved by the FSA for CF1 functions (as a director).

34. It appears that the FSA supervision team decided to take no further action on the grounds that nothing had significantly changed since 2008. In my view, that was a judgement which was not defensible.

35. In response to my analysis in paragraphs 29-34 above, the FCA has told me that it accepts that this part of the complaint should have been upheld. It has said, however, that it is possible that, even if the matter had been followed up, the FSA might have concluded that, in the light of the 2008 internal inquiry by firm Y, no further action was justified. That is, of course, possible, although the FSA might have decided that the matters described in paragraph 32 were sufficiently serious to justify further action. It is not possible to be certain of this.

36. **I uphold part two of the complaint.**

The third problem

37. The FCA's letter to law firm A gave a fairly full explanation of what happened late in 2012 when the FSA received information about unauthorised deposit taking by firm X, and admitted that action should have been taken but was not due to administrative error. I have studied the confidential papers, which support that conclusion. **That element of the complaint was upheld** (although the FCA did not accept that there had been any deliberate concealment of the fact that no action had been taken)**, and I agree with the FCA's decision.**

Decision

38. I have upheld parts two and three of the complaint (the FCA had already upheld part three). The issue which arises is what, if any, remedy should be available.

39. The FSA did not intervene on three occasions: the first was a consequence of its policies, and I cannot consider that further; but the second and third were in one case a deliberate decision not to investigate further (problem 2), and in the other an administrative error (problem 3)

40. There is no question that the two errors were significant ones. I **recommend** that the FCA apologises for the FSA's failures in respect of parts two and three of the complaint. The FCA has agreed to write to your clients with apologies.

41. The question is whether to go further. Your clients are seeking compensation (and not only from the FCA). In paragraph 9, I explained the limitations of the arrangements for *ex gratia* compensation under this Scheme. In my preliminary report, I made the following points:

    a. The principal cause of your clients' losses appears to be the actions of firm X;

    b. There can be no certainty about what, if any, difference it would have made to your clients' position if the FSA had acted differently in 2012;

    c. This case raises complex questions of causation, and relative liabilities of firm X, firm Y, and the FSA, of a kind which could only be resolved in legal proceedings;

    d. Parliament has given the FCA immunity from actions for damages (save in limited circumstances). The scale of this case, and the kind of compensation which might be claimed, means that an award of compensation under this Scheme would effectively undermine the intention of Parliament's grant of immunity.

    e. I understand that the Financial Services Compensation Scheme (FSCS), which is the statutory scheme to reimburse customers who have lost money in firms which have failed, is now accepting claims for compensation from investors who lost money in the scheme. There is advice on the FSCS website about this.

42. In response to my preliminary report, you have asked me to reconsider my position on compensation, and you have made the following principal points:

    a. This Complaints Scheme makes provision for *ex gratia* payments;

    b. The fact that Parliament has granted the FCA (and previously the FSA) immunity from being sued for damages on most grounds does not prevent this Scheme from making *ex gratia* payments, nor do such payments undermine that immunity;

c. In other cases where FCA errors have led to loss, I have recommended such payments.

43. There is an unfortunate lack of clarity in the provision for *ex gratia* payments in the Complaints Scheme, a matter which I have repeatedly raised with the regulators. On the one hand, it is beyond doubt that payments are permitted under the Scheme. On the other, it clearly cannot be right that the Scheme should be operated in such a way as to permit payments which to all intents and purposes are payments for damages, even if they are dressed up in different clothing – that would clearly undermine Parliament's intention to provide the regulator with some protection.

44. It is for that reason that the regulators, my predecessors, and I have operated. the Scheme on the basis that large-scale damages-type payments are not awarded.

45. There is a further, practical issue. Awards for damages are made with all the scrutiny and safeguards of a judicial process, set up to consider complex questions such as causation. This Scheme, which is a complaints resolution scheme, is not set up in that way.

46. You have drawn my attention to other cases where I have recommended *ex gratia* payments. Inevitably, each case turns on particular circumstances, but there is a distinction between unarguable administrative errors where the outcome is clear, and circumstances (as in this case) where either there was an arguable error of judgement and the consequences of that must be a matter of speculation or an administrative error where again the consequences must be a matter of speculation.

47. For all these reasons, it seems to me that **it would not be appropriate to make an *ex gratia* payment under this Complaints Scheme**. I recognise that this will be disappointing to your clients.

Antony Townsend
Complaints Commissioner
27 May 2020