Complaints Commissioner

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Final report by the Complaints Commissioner

Complaint number 202400106

The Complaint

1. You made a payment directly to your customer account with payments Firm X in relation to a transaction instruction in late 2023. Shortly afterward, within a couple of days, the Firm entered into special administration, and you unfortunately lost access to your funds.

2. You made a complaint to the FCA on 1 March 2024 about its role in connection with the Firm. You raised a number of complaint points, of which you referred only one to me. You alleged that the FCA had not regulated the Firm appropriately and you requested compensation as remedy under the Complaints Scheme ("the Scheme"). That is the complaint which is the focus of my review.

3. The FCA sent you its Decision Letter regarding your complaint on 30 April 2024. It did not uphold your complaint that it had not properly regulated the Firm. It said that it had supervised the Firm in line with its approach to supervision for payment portfolio Firms. The FCA explained that for legal reasons, it could not provide any details about how the FCA has supervised Firms nor disclose whether the FCA had taken any action against the Firm.

4. You then referred this complaint to my office on 6 May 2024. You allege that the FCA failed in its regulatory oversight of the Firm, that it is hiding behind a cloak of confidentiality, and has not properly explained why it does not uphold your complaint. You believe that, if the joint administrators of the Firm cannot identify and return your money, the FCA should reimburse you for your loss.

Background

5. The Firm is authorised by the FCA to provide payment services under the Payment Services Regulations 2017 (the PSRs). In 2023, the Directors of the Firm concluded that it was insolvent and applied to the Court for a special administration order. The Firm subsequently entered special administration.

Preliminary Points

6. Due to confidentiality reasons, I am unable to go into as much detail as I would like with respect to my findings below, and therefore have not disclosed the full particulars of the case. I appreciate that this is particularly frustrating in this case given that so much of the information relating to the information available to the FCA cannot be disclosed for legal reasons (as set out below). I have, however, written separately to the FCA to substantiate and provide more detail on my findings below. Section 348 (s.348) of the Financial Services & Markets Act 2000 (FSMA) classes some information the FCA holds about Firms as confidential and restricts how that information is dealt with. Equally, any information that is not restricted by s.348 FSMA may be restricted due to the FCA's policy on sharing information about regulated Firms and individuals who also have legal protections. There is a good explanation of the statutory and FCA policy restrictions on information sharing here https://www.fca.org.uk/freedom-information/information-we-can-share

7. I want to acknowledge that at the time of the events giving rise to this complaint, the relevant team within the FCA had a heavy workload and were focused on a large number of firms which they believed posed a higher risk to consumers than the Firm (see paragraph 9) and that the Firm consistently withheld information. I also acknowledge that the FCA has undertaken a comprehensive lessons learned exercise, which mitigates the risks of this happening again (see paragraph 18 onwards below).

My decision and recommendations

8. I uphold the complaint that the FCA's regulation of the Firm was not appropriate or effective. My key findings of the FCA's supervisory failings are summarised below insofar as I am able to disclose them.

9. The root causes of the FCA's failure to regulate Firm X appropriately were significant gaps and weaknesses in the FCA's implementation of its practices with respect to overseeing the Firm and a failure to act appropriately in relation to a number of wider red flags. A number of deficiencies in the FCA's supervision of the Firm are outlined below.

10. The FCA's strategy for monitoring the portfolio of firms in which the Firm was placed focused (although not exclusively) on a specific set of criteria. These were considered on an ongoing basis. The Firm scored as low risk based on these criteria. The FCA has explained that, at the time, it was dealing with a high number of Firms many of which presented greater risk than the Firm based on these criteria. I accept that this was the case. Accordingly, this is where it channelled its resources as part of its risk-based approach. It explained that it has increased its resources within the payments portfolio in recent years to deal with this heavy workload and these risks. It has also increased its use of supervisory tools focused on cases where "the potential for ongoing harm is greatest''. I acknowledge the context in which the FCA was operating, however, in my view, in this case, there were other factors at play which were both significant and serious and which should have triggered robust scrutiny and action on the part of the FCA. It does not appear to me that the FCA handled emerging risks presented by the Firm adequately, relying too heavily on its standard approach. The FCA did take actions with respect the Firm X but, in my view, these were ineffective, not timely, and insufficient.

11. The FCA had reasonable grounds to review matters in relation to Firm X's business activities including its safeguarding of client funds and its systems and controls but did not do so appropriately.

12. I accept that the Firm consistently withheld information from the FCA, however, despite this, there were a number of red flags which were known to the FCA. As I mention above, I am not able to go into detail about what they were. The FCA repeatedly failed to give sufficient weight to these. The FCA failed to appreciate the significance of an ever-growing number of red flags including concerns about anti money laundering controls and the firm's approach to safeguarding funds, which were indicative of serious problems, and to act on them effectively. This meant the FCA never obtained or understood a true picture of the

circumstances under which the Firm was operating until it entered administration, despite the long passage of time, when it ought to have gained this understanding.

13. The FCA did not consider whether the Firm's breaches and other red flags taken as a whole might be symptomatic of serious problems.

14. The FCA's measures to deal with the worsening problems at Firm X were insufficiently robust.

15. There was material delay on the part of the FCA progressing the case. The FCA has accepted that there was material delay on their part in progressing the case. This was not helped by issues concerning staff turnover and handover and general pressure on resources during a time of heavy workload.

16. The FCA did not sufficiently test or adequately follow up the information provided by the Firm.

17. Whilst I agree with the FCA that it cannot prevent Firms from failing nor guarantee that consumers will not lose money, in this case the FCA's delays in dealing with the Firm were unreasonable and its actions insufficient such that they amount to supervisory failings for the reasons I give above. For instance, had the FCA appreciated the significance of possible irregularities by the Firm earlier, which it ought to have done, then the FCA should, in my view, have intervened (or taken other regulatory action) earlier. This may have resulted in fewer clients being onboarded after this intervention and therefore potentially less clients would have suffered detriment than eventually did, and there might have been less dissipation of client funds than occurred overall.

18. The FCA has said that, having fully taken stock of the insights derived from its lessons learnt exercise, including in the context of my provisional findings, it accepts the outcome and my decision to uphold the complaint. It acknowledges that it could have better assessed the risk and explains certain measures it is putting in place to inform ongoing internal work in this area. It accepts that it should have acted on a number of red flags earlier and that there were delays in its dealing with the Firm. The FCA does not, however, accept my finding that it considered each piece of information in isolation. It explains that when assessing new intelligence it consistently and explicitly considers if it makes a

material difference to the existing case strategy - adjusting its plans where it was deemed appropriate.

19. In response to my preliminary report, the FCA has provided me with the outcome of its lessons learned exercise which it conducted in June 2024 with respect to the handling of this case. The document represents a comprehensive and thorough review of this case by the FCA. It sets out a well- considered strategy for future internal procedural improvements which, once implemented, should significantly strengthen the FCA's approach to supervision, in this sector. I welcome the fact that the FCA has undertaken this review and has candidly acknowledged the shortcomings in this case, while also setting out a clear blueprint for reform.

20. It is a key component of the Scheme that, where there is found to be a failure, this is identified, accepted, and where appropriate acted on. I commend the FCA for proactively undertaking the lessons learned exercise. It seems to me that this is a very thorough exercise that identifies a number of important improvements. I expect that, once implemented, they will reduce the likelihood of these events re-occurring. They are likely to apply more broadly than the precise circumstances of this case and I encourage the FCA to think broadly about their potential application.

21. The improvement plan includes enhanced procedures for staff training, case handovers, intelligence follow-up, interdepartmental collaboration and prioritisation in the face of complex or competing information.

22. I **recommend** the FCA update me within three months on whether it has implemented the changes it proposes to its internal systems and controls in order to avoid future recurrence of such deficiencies in future. The FCA has accepted this recommendation.

Remedy

23. I consider that the FCA's failures may be relevant to arguments that the FCA "caused" some of your losses. For the avoidance of doubt, I have not determined what losses, if any, you have incurred, nor whether you would be eligible for compensation from the Financial Services Compensation Scheme

(FSCS). The findings set out below are based on the assumption that you are able to provide evidence of actual financial loss.

24. My initial investigation did not comment on the likelihood that, at any particular point in time, different action by the FCA would have resulted in Firm X being prevented from receiving further client funds with the result that clients' exposure would have been less than it in fact was (including due to dissipation of client funds). In my view such considerations were best left to the FCA to determine in the first instance, including whether compensation is payable in respect of particular transactions by clients in the light of the totality of the facts relevant to any particular claim. The FCA had not had an opportunity to consider these issues and so I recommended it did so in response to my preliminary report.

25. The FCA has since considered the matter and concluded that it will not offer you a financial remedy on the following grounds:

    a. The FCA was not the direct cause of your loss; the underlying cause of the loss was the financial circumstances of the firm, which led to it entering administration. Your funds were accepted by the Firm one day after an undertaking was signed by the Firm (which restricted it accepting new funds) and the Firm had been instructed by the FCA to return funds received following the signing of the undertaking. The loss at issue was incurred in spite of the FCA having taken action to restrict the Firm's activities. Therefore, the cause of your loss is not a question of whether restrictions were or were not in place to prevent further consumer harm, but a result of the actions of the Firm.

26. Under the Complaints Scheme, which governs the actions of both the Regulators and me as Commissioner, there is a fundamental divergence in approach. This arises principally because the Regulators and the Commissioner are each required to apply different factors when making their respective decisions under the Scheme, and neither is required to have regard to the considerations adopted by the other. My statutory function as Commissioner pursuant to relevant legislation, is to recommend compensation where I consider it "appropriate." The most recent Scheme sets out a number of criteria

which the FCA apply when considering whether to accept a recommendation on my part to make (or consider making) a compensatory payment. By way of example, they will not normally make a payment in respect of individual loss unless the FCA were the sole or primary cause of the loss. These criteria do not apply to me. This creates a mismatch in approach, expectations and outcomes which I have raised before[1].

27. In this case, the FCA relies on three arguments: (a) that your funds were received after a voluntary undertaking (VU) had been signed prohibiting new funds, and that the Firm failed to comply with the FCA's instructions to return those funds; (b) that the underlying cause of the loss was the Firm's misconduct in failing to safeguard client funds; and (c) that the FCA had taken action to restrict the Firm's activities, and thus the loss occurred despite regulatory intervention. I turn to these below.

28. The FCA argues that, because the Firm breached the terms of a VU and failed to return the funds, the resulting loss to you is attributable to the Firm alone. However, this argument overlooks a critical point: the FCA allowed the Firm to remain operational despite serious, pre-existing concerns, and failed to intervene earlier when the same red flags were apparent. This is likely to have resulted in at least some people incurring loss that they might not otherwise have done. Moreover, the FCA's own supervisory timeline shows delay and inadequate escalation of risks prior to the VU.

29. While the FCA did eventually impose restrictions, this was too little, too late.

30. Although the Firm's misconduct was certainly the immediate cause of your loss, the Firm's non-compliance with the FCA's restrictions does not extinguish the FCA's previous failures. While the Firm committed the act that crystallised the loss, it was the FCA's prolonged failure to mitigate escalating risks that enabled continuing harm. It is this chain of inaction, not just the final act, that must be assessed.

31. Whilst it can not be certain what the outcome of any of the FCA's earlier actions might have been, it must be noted that the Complaints Scheme is not a judicial process. It exists to provide redress for regulatory failings based on principles of

[1] Page 18, https://frccommissioner.org.uk/wp-content/uploads/2023-2024-Issued-29-July-2024-2.pdf

fairness, not based on the legal principles establishing liability. Paragraph 6.13 of the Scheme specifies a "common-sense analysis", not a forensic or evidential standard akin to, for example, the law of tort. The question is not whether harm would definitely have been avoided, but whether FCA action should have prevented or reduced it. In this case, I believe this is the case. In common sense terms, the FCA allowed a Firm in relation to which there were serious issues to remain operational long enough to do more harm. I consider that is a significant regulatory failing.

32. Importantly, the FCA has acknowledged delays in this case and agreed that it missed opportunities to act on red flags. Where a regulator has failed to respond to known risks, and consumers suffer harm as a result, it is reasonable to infer a strong causal link unless clearly displaced by other factors. The FCA has not made out the latter case.

33. The FCA materially contributed to the scale, timing, and possibility of the harm. Had the FCA acted earlier, it is likely that the Firm would not have been in a position to accept your deposit. The Firm was only able to accept your funds because the FCA had delayed more robust action. The Firm's breach occurred within the context of and due to the FCA's delay, not independently.

34. In view of the above, I **recommend** that the FCA make a contributory compensatory payment to you on an ex-gratia basis in recognition of its part in the outcome. This would not amount to an admission of legal liability, nor would it undermine the statutory immunity afforded to the FCA. Rather, it would give proper effect to the Scheme's aims: to provide redress for clear regulatory failings where appropriate and in circumstances where fairness demands it.

35. Lastly, the FCA's reliance on the "sole or primary cause" test should be tempered by the Scheme's own language. Paragraph 6.13 of the November 2023 Complaints Scheme states that "if it is not clear that we are the sole or primary cause, this is <u>likely</u> to mean that a compensatory payment... is not appropriate"—indicating that the FCA retains discretion. It seems reasonable that the FCA may adopt a policy but must not apply it so rigidly as to fetter discretion unlawfully.

36. As mentioned, I recommend that the FCA make a contributory compensatory payment. If the FCA declines this recommendation, I **invite** it to publish a clear and transparent explanation of the criteria it applies when deciding whether to make a compensatory payment for regulatory failure in cases where it is not the sole or primary cause of a complainant's financial loss

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