

8 March 2018

**Final report by the Complaints Commissioner**  
**Complaint number FCA00396***The complaint*

1. On 27 September 2017 you asked me to investigate a complaint about the FCA. I have carefully reviewed the papers sent to me by you and by the regulator. My preliminary report was issued on 15 January 2018. Both you and the FCA commented on the preliminary report, and I have taken those comments into account in producing this final report.

*What the complaint is about*

2. You complained that the FCA had failed to supervise a regulated firm [the firm] effectively. You said that the FCA had failed to identify financial problems the firm was experiencing, and had not addressed misleading advertising produced by the firm when it launched an investment platform.

*What the regulator decided*

3. The FCA Complaints Team reviewed the FCA's supervision of the firm and informed you that there was a satisfactory supervision strategy in place, which could not be discussed in detail with you due to confidentiality restrictions. The complaint response concluded that there had been delays in implementing the supervision strategy due to operational challenges, but that this was an isolated incident that had now been rectified.

*Why you are unhappy with the regulator's decision*

4. Although you are grateful that the FCA looked into your complaint, you are concerned that the FCA is more anxious about its reputation than upholding regulatory standards. Despite acknowledging gaps in its supervision of the firm, you consider the FCA has failed to address the numerous issues raised. It remains your view that the firm has been using the FCA to maintain a licence to operate as an investment firm while failing to pay its staff and advertising for funds that have never sprung to life, defrauding investors. You have asked me to investigate.

*My analysis*

5. Paragraph 3.2 of the Complaints Scheme states that:

*Complaints can be made by anyone who is directly affected by the way in which the regulators have carried out their functions, or anyone acting directly on such a person's behalf, provided that the complaint meets the requirements of the Scheme. To be eligible to make a complaint under the Scheme, a person must be seeking a remedy (which for this purpose may include an apology) in respect of some inconvenience, distress or loss which the person has suffered as a result of being directly affected by the regulators' actions or inaction.*

6. Given this, I am surprised that the FCA Complaints Team did not seek formally to establish your connection with the firm or your status to raise a complaint before

accepting your request to treat your concerns as an official complaint. Instead it relied on internet searches and presumption. Furthermore, I am not persuaded that an official complaint was the most appropriate route to deal with the serious concerns you were raising about the firm and its activities. In my view, the FCA should have done more to explain this to you and to establish your connection to the firm before accepting this as a complaint.

7. Nevertheless, I am satisfied that relevant internal teams were informed of the information you had supplied. I also note that you were asked if you wished to approach the FCA's whistle-blowing team on an anonymous basis and were given further information about how to do this. This information was repeated in the complaint response, which informed you that there is a supervisory strategy in place for the firm.
8. Although the chronology is not completely clear, it seems that intelligence about the firm was being received from January 2017. However, it was not assessed until around 2 June 2017 when it was assigned to a caseworker in training. It is clearly of considerable concern that such a case could sit in a queue waiting to be assessed from 17 February to 2 June. The FCA's file shows that during this time project work was prioritised and some staff were off sick. The case was allocated to a new member of staff who seems to have been off work for several weeks in the relevant period. I am pleased to note that the FCA accepts that, "*while the team responsible for supervising [the firm] were experiencing a number of challenges (notably, absence of staff through illness, training gaps caused by time off and competing priorities) this should not have resulted in the delay that was experienced*". This was acknowledged in the complaint response to you, which concluded that there had been delays in implementing the firm's supervision strategy due to operational challenges, but that this was an isolated incident that had now been rectified.
9. Having reviewed the FCA's internal correspondence in detail, I was not satisfied that the resource issues identified had been adequately addressed. This is clearly vital, especially when responding to intelligence that alleges fraud, however small the firm. I therefore asked the FCA to explain what steps it has taken to address the identified delays and pressure on resources and to reassure me that there is no wider systemic problem.
10. I am pleased to say that I have received an extensive reply. I am satisfied that the FCA has looked into the circumstances that caused the delay, satisfied itself that, although flags were missed on three occasions, there is no wider systemic failing, and identified changes that it needs to make, including allocating more staff.
11. However, based on what I have seen, I have concluded that it was not reasonable for the Complaints Team to accept Supervision's assertion that the delays that occurred were an isolated incident. The evidence provided to me makes it clear that this was not the case: there were wider problems in the team. I am pleased to note that, in response to my preliminary report, the FCA accepts that the use of the word 'isolated' "*may not have been the most appropriate.*" Although the FCA goes on to say that there was no intention to mislead, I remain of the view that the effect was misleading; it implied this was a single incidence of delay. In my view the Complaints Team was too willing to accept the response received from Supervision without probing further. I am, however, pleased to note that the FCA agrees that it should have acted on the intelligence received and implemented its mitigation strategy earlier. It says that "*The implementation of the FCA's Mission*

*should help us improve our past practices and hopefully prevent situations like this happening again.”* It is very important that the FCA translates this hope into a robust and monitored strategy.

12. In June/July 2017 the Supervision team decided that the next appropriate step was to exercise its powers under section 165 of the Financial Services and Markets Act 2000 (FSMA) to obtain information from the firm. Although Supervision made informal enquiries of the firm in September 2017, and took advice from the FCA’s legal team (GCD), it was not until November 2017 that Supervision took steps to act on its s165 powers. Furthermore, it seems that the caseworker, when answering questions from the Complaints Team, did not know what was happening on the case, had not seen the intelligence reports on the firm and was not aware that the case was in mitigation, that is requiring action.
13. In response to my preliminary report the FCA has provided a timeline of Supervision activity in relation to the firm between September and December 2017. This shows a series of non-responsive or delaying emails from the firm, incorrectly claiming that it was no longer subject to FCA authorisation. The firm failed to meet the s165 request deadline and, as you are aware, entered into administration in December 2017. The FCA says that this marks the end of its supervisory responsibility for the firm as it is anticipated that the administrator will apply to cancel its permissions.
14. Although I accept that the Supervision Team may no longer have a role, I expressed my surprise to the FCA that your allegation that the firm was claiming FCA authorisation to investors is no longer of regulatory concern, particularly given that the firm was clearly saying the opposite to the FCA. The FCA responded that it has not said or indicated that this matter is no longer of regulatory concern. Although the firm cannot be supervised in a traditional sense, the FCA has confirmed to me that the fact a firm no longer exists does not exclude it being considered via other avenues outside of direct supervision. This is reassuring, although it remains of considerable concern to me that the FCA had intelligence about the firm from you and other sources for over six months without taking action. I note that in your response to my preliminary report you have told me that the firm and its CEO are being investigated in another jurisdiction and that the firm’s tax affairs are being considered by HMRC.
15. I was also concerned to read in the FCA’s file that there was apparently no risk assessment document or Service Level Agreement (SLA) in place for this case. I asked the FCA to explain to me how it assesses risk, why the intelligence received about the firm was regarded as ‘of low priority’ and to comment on the apparent lack of SLAs for this aspect of its work.
16. The FCA has told me that the firm is classified as a flexible firm, one of over 55,000 such firms that it regulates. This includes globally significant firms which have the capacity to cause significant harm to consumers as well as a much larger population of smaller firms all of whom can cause harm. The FCA tries to ensure that it maintains an appropriate balance of resources for supervision of both types of firm. Its supervisory approach for small firms continually evolves, learning from experience, reacting to developments and using new techniques (such as a greater use of data science) in order to make best use of the FCA’s finite resources. Each case file the FCA creates in relation to a flexible firm is subject to an SLA, which will vary depending on the level of risk assessed. This also governs how long a

specific case should take to compete. There are management protocols and information systems to monitor progress against the SLAs. There is also guidance available to all supervisors governing the supervision of risk events in relation to flexible firms

17. My understanding is that the firm was assessed as a low priority as it is a P3 firm with small capital, small turn-over and fewer than 50 employees. The FCA's approach to P3 firms can be found on the links below but these are the relevant highlights:

<https://www.fca.org.uk/publication/corporate/supervision-guide-flexible.pdf>  
<https://www.fca.org.uk/publication/other/factsheet.pdf>

- a. Pillar 3. Issues and products – the purpose of issues and products work, or thematic supervision, is to allow [the FCA] to address [its] key conduct priorities at the issue and product level. Issues and products work is driven by sector risk assessments of what is currently and prospectively driving poor outcomes for consumers and market participants, drawing on data analysis, market intelligence and input from the firm assessment process. [The FCA's] product intervention powers reinforce the effectiveness of the approach by allowing [it] to intervene early to mitigate and remedy emerging risks before they cause widespread detriment across a sector. The findings and remedial action will usually be extended to all firms that might be affected by the risk in question, not just those directly involved in the project.
  - b. Prudential Approach – [the FCA's] prudential supervision approach focuses on minimising the impact of failure on consumers and market participants, with pro-active supervision limited to a relatively small number of 'prudentially critical' firms. A prudential firm 2 classification (P1–P4) drives the intensity of prudential supervision...
  - c. **Firms will be categorised as P3 if they are prudentially non-significant and their failure, even if disorderly, is unlikely to have significant impact** (my emphasis). In these cases [the FCA] will be relying more on firms' own assessment of their financial resource requirements and focus on monitoring alerts that arise from inconsistencies and/or prudential failings. P3 firms may also be subject from time to time to a prudential assessment by [the FCA] as part of a peer group exercise, i.e. a cross-firm review of capital and liquidity standards.
18. In response to my preliminary report the FCA has said that paragraph a. above applies to all firms classified as a flexible firm rather than just P3 firms. The FCA has also commented on the words I have emphasised in bold in paragraph c. It says that, while this is a direct quote from an FCA Factsheet, it does not correctly capture the current approach towards P3 firm: since the publication of the FCA's Mission, its approach focuses on harm rather than impact. The FCA has also commented that it is important for the FCA that any failure of a firm is orderly.
19. Based on the above, it seems that the FCA's approach is to do larger, thematic reviews and sectoral work and not routinely examine the conduct or prudential issues at each small firm. This may also explain why little, if any, work was done in relation to the firm between January and July 2017. Nevertheless, I would still expect there to be regulatory action with SLAs in place when specific information

or concerns are received about a firm – this does not seem to have happened promptly or effectively in this case.

20. In response to my question about why decisions were apparently made without knowledge of the full picture, the FCA has told me that it accepts that this appears to have happened at an earlier stage in Supervision’s dealing with the firm. However, the FCA is satisfied that all the intelligence about the firm was available to Supervision through its IT systems and it therefore does not consider that what happened on this case points to a wider systemic problem. Although I accept this, I have some residual concerns that a similar situation could happen again. Setting a low priority on a case just because it is a ‘prudential matter’ does not seem to me to be satisfactory. In this case there were serious allegations that the firm’s senior management was defrauding investors.
21. In response to my preliminary report, the FCA has told me that it is not FCA policy to give Supervision cases a low priority just because they relate to a ‘prudential matter’ and that many different factors are taken into account before determining how to prioritise a case. The FCA has provided me with considerable detail of these and also told me about steps it is taking to improve its overall approach to supervision and prudential supervision. It goes on to say that a significant increase in resource would be required for the FCA to be able to routinely review all 55,000 firms under its supervision. I accept this and, I welcome the steps the FCA is taking. The shortcomings in the handling of this case emphasise the importance of these steps.

#### *My decision*

22. I do not consider the Complaints Scheme was the most appropriate vehicle for the FCA to address the information you provided. Having taken that route, the FCA should have made clearer to you its approach to confidentiality and the reasons why it would not be providing you with further information. You can find further information about this here: <https://www.fca.org.uk/freedom-information/information-we-can-share>
23. The Complaints Team was insufficiently probing of the Supervision Team. The effect of the complaint response, which said that the delays in implementing the FCA’s supervision strategy for the firm were “an isolated incident”, was misleading. Although the FCA informed you that an appropriate supervisory strategy is now in place for the firm, I had to request substantial further information from the FCA in order to form my own view about whether this was a reasonable response. In my view the FCA did not sufficiently investigate your allegation that the firm “*has been using the FCA to maintain a licence to operate as an investment firm while failing to pay its staff and advertising for funds that have never sprung to life, defrauding investors.*”
24. For the reasons given, I uphold your complaint.

#### *My recommendations*

25. In my preliminary report I recommended that the FCA consider whether, in the light of my analysis:
  - 1) It should continue to provide me with confidential updates about the supervision of the firm, particularly regarding the allegations of fraud;

- 2) It should consider whether to revise its supervisory approach to small firms, in the light of this matter.
26. With regard to recommendation 1) the FCA states that because the firm is now in administration it does not consider it is necessary to provide further updates about Supervision of the firm. Although I accept that there will no longer be Supervision, I remain concerned that the allegations of fraud and misrepresentation that you made have not been investigated and that there appears to be a lack of curiosity or sense of urgency about these matters from the regulator.
27. With regard to recommendation 2), I have noted the steps the FCA intends to take to improve its supervisory approach. I urge the FCA to publish information about the improvements it is making, and I will consider the effectiveness of these improvements in the context of the complaints which I receive.
28. Finally, I recommend that to the extent that the FCA's published information does not reflect its current policy approach (paragraph 18 above) the published information should be updated as soon as possible.

Antony Townsend

8 March 2018